

Other Canadian Provinces Implement Derivatives Scope and Trade Reporting Rules

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On January 22, 2016, the securities regulatory authorities in Alberta, British Columbia, Saskatchewan, New Brunswick, Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island, and Yukon (the "Participating Jurisdictions") **adopted Multilateral Instrument 91-101 Derivatives: Product Determination and the related Companion Policy (the "Scope Rule") and Multilateral Instrument 96-101 Trade Repositories and Derivatives Data Reporting and the related Companion Policy (the "TR Rule") (together, the "Instrument").**

The implementation of the Instrument comes after the Participating Jurisdictions published proposed rules (the "Proposed Instruments") in January 2015 for comment.

The Scope Rule is expected to come into force on May 1, 2016, except for transaction reporting, which will begin on July 29, 2016. However, in cases where the reporting counterparty is not a reporting clearing agency or a derivatives dealer, no report is required until November 1, 2016. The TR Rule comes into force in each of the Participating Jurisdictions, subject to any necessary Ministerial approval or required amendments, on May 1, 2016. Similar rules are already effective in Manitoba, Ontario and Québec (the "Existing Rules").

The Scope Rule

The purpose of the Scope Rule is to define those instruments that are the type of derivatives that are subject to the TR Rule. Initially, the Scope Rule is only relevant for this purpose and for the proposed national instrument regarding customer clearing that was recently released. All other legislation, rules, notices or other policies applicable to derivatives continue to apply. However, it is expected that the Scope Rule will apply, with some amendments, to future rules that address other aspects of derivatives regulation.

The Scope Rule designates certain instruments as derivatives primarily by defining **those that are excluded from being a derivative. Excluded instruments include:**

- those regulated by gaming control legislation;
- insurance, income or annuity contracts;

- currency exchange contracts, provided that the contract settles, and is intended by the parties to be settled, by delivery of the contracted currency within two business days and does not permit roll-over;
- commodity forward contracts where physical delivery is intended and the contract generally does not provide for cash settlement;
- evidence of deposits issued by certain Canadian financial institutions; and
- those traded on certain stock exchanges (specifically excluding swap execution facilities from this exemption).

The Scope Rule sets out for each jurisdiction deeming rules with respect to whether certain types of contracts or instruments are derivatives or securities. Where the contract or instrument is a derivative, the TR Rule applies. In addition, there are certain circumstances where an instrument falling into both definitions is not considered a derivative, including if the instrument is issued by an issuer, control person or insider of the issuer to compensate or incent the performance of a director, employee or service provider of the issuer (or its affiliate) or as a financing instrument to raise capital for the issuer.

The Companion Policy to the Scope Rule clarifies that contracts entered into for consumer, business or non-profit purposes that do not involve investment, speculation or hedging, such as employment contracts, guarantees, contracts for business purchase and sale transactions and commercial sale arrangements, are not derivatives for purposes of the TR Rule.

The TR Rule

The TR Rule covers two matters: (a) the requirements to become and operate as a recognized trade repository in the Participating Jurisdictions and (b) the establishment of derivatives data reporting requirements.

For entities that wish to establish and operate a trade repository in one or more of the Participating Jurisdictions, the TR Rule establishes the application process and addresses ongoing requirements relating to the general operations of a repository, including: governance; the board of directors; management roles and responsibilities; the chief compliance officer; fees; providing access to services; the acceptance of reporting; general communications; due process; data records, data security and confidentiality; risk management; and outsourcing.

The other part of the TR Rule addresses the reporting requirements with respect to derivatives transactions. Under the TR Rule, detailed derivatives data for each derivatives transaction involving a local counterparty is required to be reported to a recognized trade repository. Details on the data to be reported are included in Appendix A to the TR Rule.

The TR Rule provides for the following three exemptions from trade reporting:

- commodity trades (other than cash or currency) where none of the parties to the trade are a clearing agency, a derivatives dealer or an affiliate of clearing agency or a derivatives dealer and where the aggregate month-end gross notional exposure of each counterparty under its commodity derivatives trades is less than \$250 million in each of the preceding 12 calendar months;

- derivatives trades between the government of a local jurisdiction and a crown corporation or agency the accounts of which are consolidated with those of that government; and
- derivatives trades between a non-resident derivatives dealer and a non-local counterparty.

The TR Rule includes rules to determine which counterparty will have the obligation to report. The intention of the TR Rule is to facilitate data reporting by a single counterparty. Generally, the reporting counterparty is the clearing agency for trades that are cleared through a recognized or exempted clearing agency, or a clearing agency not yet recognized or exempted that has provided a written undertaking to the applicable securities regulator to act as the reporting counterparty. If the transaction is not cleared, the following rules determine which counterparty must report:

- in a transaction between a derivatives dealer and a non-dealer, the reporting **counterparty is the derivatives dealer**;
- in a transaction between two derivatives dealers or two counterparties neither of which is a derivatives dealer, the counterparty determined to be the reporting counterparty under a written agreement between the parties; and
- in any other case, each local counterparty other than an individual.

If a written agreement is entered into as referred to above, each local counterparty must keep a record of the agreement for seven years after the expiration or termination date of the transaction.

Under the TR Rule, the data that must be reported is categorized into creation data, life-cycle event data and valuation data. The report with respect to the initial creation of a reportable trade is required to be made in real time unless it is not practicable to do so. In that case, it must be done, no later than the end of the next business day. Life-cycle event data with respect to an existing trade must be reported by the end of the business day on which the life-cycle event occurs. The timing for the reporting of valuation data depends upon the status of the reporting counterparty; derivatives dealers and reporting clearing agencies are required to report daily, whereas other reporting counterparties only report quarterly.

The trade repository has obligations to make certain trade data available to the securities regulators, the counterparties and the public.

Comparison between the Instrument and Ontario's Existing Rules

Generally, it is intended that the Instrument be consistent with the Existing Rules. However, some differences to be aware of are set forth in the chart below. It is anticipated that further amendments will be made to the TR Rule to align it with amendments that are currently proposed in Ontario.

	Existing Rules in Ontario	The Instrument
Local Counterparty	A derivatives dealer must be registered as a derivatives dealer to be a local counterparty.	Simply engaging in the business of trading in derivatives causes the dealer to be a local counterparty.

Substituted Compliance	Reporting obligation can be satisfied if the transaction is reported to a designated trade repository pursuant to the laws of a foreign jurisdiction listed in Appendix B of the Existing Rules (the United States and the European Union).	Substituted compliance by reporting in compliance with the U.S., European or other foreign requirements is not currently permitted. However, it is anticipated that the substituted compliance will be implemented.
Reporting Counterparty	For a derivative that is not cleared and is between two derivatives dealers or two end-users, the parties can determine the reporting counterparty pursuant to the ISDA methodology.	For a derivative that is not cleared and is between two derivatives dealers or two end-users, the parties can designate one party as the reporting counterparty under a written agreement.
Exemption	Not available in Ontario.	The TR Rule exempts trades of commodity (other than currency) if the aggregate month-end gross notional amount under all outstanding derivatives of the non-currency commodity asset class of the local counterparty and certain affiliated entities, excluding derivatives with an affiliated entity, did not, in any calendar month in the preceding 12 calendar months, exceed \$250 million.

Contact Us

If you have any questions about the Instrument, please contact the authors of this alert or [any other member of the BLG Derivatives Group](#). BLG is ranked as the Number One Law firm in Canada for Derivatives by Derivatives Weekly and was named Canada Law Firm of the Year at Global Capital's 2014 and 2015 Americas Derivatives Awards. BLG's Derivatives Group is a multi-disciplinary team of lawyers that cuts across several of our practice groups. The team is experienced in negotiating derivatives documentation with sell-side and buy-side market participants around the world. Our clients include financial institutions, investment dealers, futures commission merchants, market intermediaries, securitization conduits and a wide variety of derivative end-users, such as mutual funds, hedge funds, pension funds, other investment vehicles, commodity producers, real estate firms, insurance companies, risk management firms and other corporate end-users. Our advice covers derivative structuring and document negotiation, regulatory compliance, tri-party collateral control practices and close-out issues. We also advise on compliance and registration requirements relating to derivatives in Canada.

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