



RBC Capital Markets

OTC Derivatives:

Second Update on Canadian Reforms

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Contents

Introduction	3
Canadian Regulatory Landscape	4
Definition of Derivatives for the Purpose of Canadian Reforms	6
Trade Repositories and Reporting Requirements	7
Clients' Reporting Responsibilities	8
Central Counterparty Clearing	9
Scope of Eventual Canadian Clearing Mandates	10
Segregation and Portability Requirements	12
Clearing Agency Requirements	12
Exchange and Platform Trading	13
Margin Requirements on Non-Centrally Cleared OTC Derivatives	13
Other Areas of Forthcoming Canadian Requirements	15
Conclusion	16
Appendix	
Comparison of OTC Derivative Platform Registration and Trading Requirements (Proposals) across Jurisdictions	17
Other RBC Reports in this Series	20
References	21
Glossary	22

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Introduction

As they emerged from their 2009 summit, leaders of the G20 countries had just agreed to sweeping reforms of global over-the-counter (OTC) derivatives markets. Six years later, these reforms, consisting of transaction reporting to trade repositories, as well as central clearing and platform trading of certain standardised products, continue to shape the evolution of derivatives markets across global jurisdictions.

Though the G20 reform agenda was a direct response to a historic global financial crisis, one which has largely passed, its implementation will extend for several more years. Internationally-active clients are likely familiar with the ongoing roll-out of *Dodd-Frank Act* requirements in the US and with similar European reforms that stretch until at least early-2017. A late addition to the reform agenda, margin requirements on non-centrally cleared derivatives promise to be amongst the most impactful regulatory changes to date, with implementation beginning at end-2015 and stretching until 2019.

What of Canada? For all but the most diligent watchers of regulatory movements, the direction and pace of Canadian reforms is more difficult to discern. To help answer this question and alleviate uncertainty for its clients, RBC has prepared the below high-level summary, which captures active areas of Canadian rulemaking and outlines our expectations for regulatory timelines going forward.

As new rules are imposed on Canadian markets, RBC also takes this opportunity to thank its valued clients for their patience. RBC will continue to keep clients informed of emerging requirements and will attempt to minimize the impact of reforms to its trading relationships, where possible.

Canadian Regulatory Landscape

For purposes of interpreting Canadian derivatives reforms, it is first beneficial to have a view of the federal and provincial authorities taking part in the rulemaking process; we depict portions of the Canadian regulatory landscape in the figure below.

Figure 1: Overview of Canadian Regulatory Landscape for OTC Derivatives



- Prudential regulator and supervisor for Federally Regulated Financial Institutions (FRFIs).
- Produces Guidelines in lieu of rules text.
- Conducts principles-based enforcement and supervision.



- Financial system oversight, including:
 - payment, clearing and settlement systems
 - financial stability risk assessment.



- The CSA is a voluntary umbrella organization to improve, coordinate and harmonize regulation amongst provincial regulators.
- Each provincial securities regulator / commission retains jurisdiction to regulate securities markets in their home province.

Cooperative Capital Markets Regulatory System

- In September 2013, an agreement was signed by the governments of Canada, Ontario and British Columbia for a cooperative regulatory system.
- The governments of New Brunswick, Nova Scotia, Saskatchewan and PEI have since joined.
- Draft uniform provincial capital markets legislation and matching federal legislation have been issued for comment.

Canadian OTC Derivatives Working Group (OTCD WG)

Working group tasked with providing advice and coordinating efforts to meet Canada's G20 commitments, related to OTC derivatives, in a manner consistent with the continuing stability and vibrancy of the Canadian financial system.

As described above, the Office of the Superintendent of Financial Institutions (OSFI) has responsibility for regulating many of Canada's largest financial institutions, including all banks, as well as certain pension plans, insurance companies and other entities. In November 2014, OSFI released its Guideline *B-7: Derivatives Sound Practices*, thereby reflecting global reforms through its updated expectations for Canadian FRFIs' OTC derivatives activities. Important portions of this guidance are highlighted below.

Figure 2: Summary of OSFI Guidance with Respect to FRFIs' OTC Derivatives Activities

Reform area	Excerpts from guidance
Trade reporting	<ul style="list-style-type: none"> • FRFIs must report derivatives transactions to a recognized trade repository, following the derivatives data reporting requirements that have been adopted in the province in which the head office and/or principal place of business of the FRFI is located. (Further details provided in sections below.)
Legal Entity Identifier (LEI)	<ul style="list-style-type: none"> • OSFI expects that FRFIs will continue to actively participate in the development and implementation of the LEI initiative to facilitate trade reporting. • They should not only obtain their own LEIs, but encourage their clients and counterparties to derivatives transactions to obtain an LEI.
Central clearing	<ul style="list-style-type: none"> • FRFIs are expected to centrally clear, where practicable, new standardised derivatives where clearing services are available on a qualifying central counterparty.
Platform trading	<ul style="list-style-type: none"> • FRFIs should support efforts to increase the movement of OTC derivatives trading to organized platforms as the standardisation of derivatives increases and jurisdictions develop guidance regarding the use of electronic trading platforms.
Margin	<ul style="list-style-type: none"> • FRFIs can choose to exchange variation margin to collateralise changes in mark-to-market exposure of a derivative.

It is important to note that, in several of the above areas, OSFI may update its regulatory guidance to reflect changing provincial and foreign OTC derivative requirements.

Outside of the federal scope of regulation, other Canadian and foreign derivatives market participants may fall under provincial authorities' jurisdiction. Provincial securities authorities follow a rules-based approach to regulation and enforcement; at times, the resultant series of consultation papers, proposed rules and final text can make it difficult to track the current state of reforms. Layered upon this, provincial OTC derivatives rulemaking continues to emerge through a series of province-specific rules, Multilateral Instruments (rules texts issued jointly by two or more provinces) and National Instruments (applicable across Provinces) – furthering complexity. Despite this approach, extensive cooperation through the CSA has allowed for only minor deviations in end-requirements across provinces.

In order to cut through the complexity described above, we depict the current status of provincial authorities' rulemaking efforts in the table that follows, as well as our current expectations for future releases. Readers should note that, currently, portions of trade reporting requirements have been implemented in the provinces of Ontario, Quebec and Manitoba only.

Figure 3: Current State of Canadian Provincial OTC Derivatives Rulemaking

Rule making area	CSA consultation paper	Model rules		Final rules	First portions implemented
Trade Repositories	June 2011	Dec 2012	June 2013	Nov 2013	Oct 2014
Surveillance and Enforcement	Nov 2011				
Segregation and Portability	Feb 2012	Jan 2014	Early 2015	Late 2015	Early 2016
End-User Exemption	Apr 2012	N/A – Folded into Registration and Clearing Rules			
CCP Clearing	June 2012	Dec 2013	Feb 2015	Late 2015	Mid/Late 2016
Registration	Apr 2013	Mid 2015			
Exchange and Platform Trading	Jan 2015				
Capital and Collateral	N/A	Mid 2015	Mid 2015	Late 2015	Dec 2015

Released
 Anticipated date
 Timing unknown

Having reviewed OSFI guidance, the majority of this report provides additional detail on current provincial proposals or final rules in each of the rulemaking areas described above.

Definition of Derivatives for the Purpose of Canadian Reforms

In line with its principles-based approach to regulation, OSFI broadly defines derivatives within its guidance to Canadian FRFIs:

“Derivatives are financial contracts whose values depend on, or are derived from, the value of one or more underlying reference assets. The value can be determined by fluctuations of the underlying asset, which may include stocks, bonds, commodities, currencies, interest rates and market indices. Derivatives include a wide assortment of financial contracts, including forwards, futures, swaps and options.

An over-the-counter (OTC) derivative is a bi-lateral contract, negotiated between two parties, that does not go through an exchange.”

The OSFI definition above can be contrasted against provincial authorities’ rules, where emphasis is placed on specific exclusions from OTC derivatives regulation. For example, below we outline products explicitly excluded from the Ontario Securities Commission’s

(OSC's) Product Determination rule. These exclusions have been synchronized, or are proposed to be synchronized, across most provinces for the purposes of trade reporting and are likely to extend to other areas of derivatives reform.

Figure 4: Examples of Exclusions from OTC Derivatives Reforms in many Canadian Provinces

Spot foreign exchange contracts	<ul style="list-style-type: none"> • Short term contract for the purchase or sale of a currency that is settled within two business days – the industry standard settlement period for spot. • A spot trade can continue to qualify for exemption if it settles over a longer period but was entered into contemporaneously with a related securities trade, since the settlement period for securities can be three or more days. • Intent is to settle the contract by delivery of the referenced currency (e.g. non-deliverable forwards do not qualify). • Counterparties can net offsetting obligations from multiple contracts that require delivery of a currency without invalidating the exclusion. • The contract must not permit a rollover (e.g. by not having a fixed settlement date or by allowing for the settlement date to be extended).
Physical commodities	<ul style="list-style-type: none"> • Transactions in goods where there is intent to settle the contract by delivery in a physical form or by delivery of an instrument evidencing ownership of the commodity. • Eligible commodities include agricultural products, metals, oil and natural gas, but also certain intangible commodities such as carbon credits and emission allowances.
Exchange-traded derivatives	<ul style="list-style-type: none"> • If traded on prescribed exchanges (e.g. listed futures or options). • Contracts traded on swap execution facilities (US), multilateral trading facilities or organized trading facilities (EU) would not qualify.
Gaming and insurance	<ul style="list-style-type: none"> • These types of contracts are typically covered by other legislation.
Other contracts	<ul style="list-style-type: none"> • E.g. a loan or mortgage with an interest rate cap or embedded interest rate option. • E.g. a commercial contract with pricing indexed to an interest rate.

Trade Repositories and Reporting Requirements

Starting on October 31st 2014, new OTC derivatives transactions involving Canadian FRFIs (e.g. Canadian banks and dealers) or foreign derivatives dealers transacting in the provinces of Ontario, Quebec and Manitoba became subject to trade reporting requirements.

Further extending the reach of trade reporting requirements, on January 21st 2015, staff of the Alberta Securities Commission, the British Columbia Securities Commission, the Financial and Consumer Affairs Authority of Saskatchewan, the New Brunswick Financial and Consumer Services Commission and the Nova Scotia Securities Commission issued, for comment, *Proposed Multilateral Instrument 91-101 Derivatives Product Determination*

and *Proposed Multilateral Instrument 96-101 Trade Repositories and Derivatives Data Reporting*, which should introduce largely consistent requirements to these remaining Canadian provinces.

Once fully implemented, the majority of OTC derivatives involving a “local counterparty” – a person or company (or affiliate of such entities) other than an individual, that is organized in or that has its head office or principal place of business in an applicable Canadian province – will be reportable transactions.

Clients’ Reporting Responsibilities

For many of RBC’s clients, the shift to a trade reporting regime has occurred relatively seamlessly given that, in a first instance, reporting responsibilities fall on a derivatives dealer counterparty – in this case RBC. RBC does the majority of its reporting to the DTCC Global Trade Repository, the largest repository for OTC derivatives.

However, in order for RBC to report a transaction correctly, all clients – regardless of their home jurisdiction - must have:

- obtained a Legal Entity Identifier (LEI) and communicated this information to RBC¹ ; and,
- completed and returned a Canadian Trade Reporting Representation Letter – indicating their principal place of business and agreeing to a reporting hierarchy by which RBC reports.

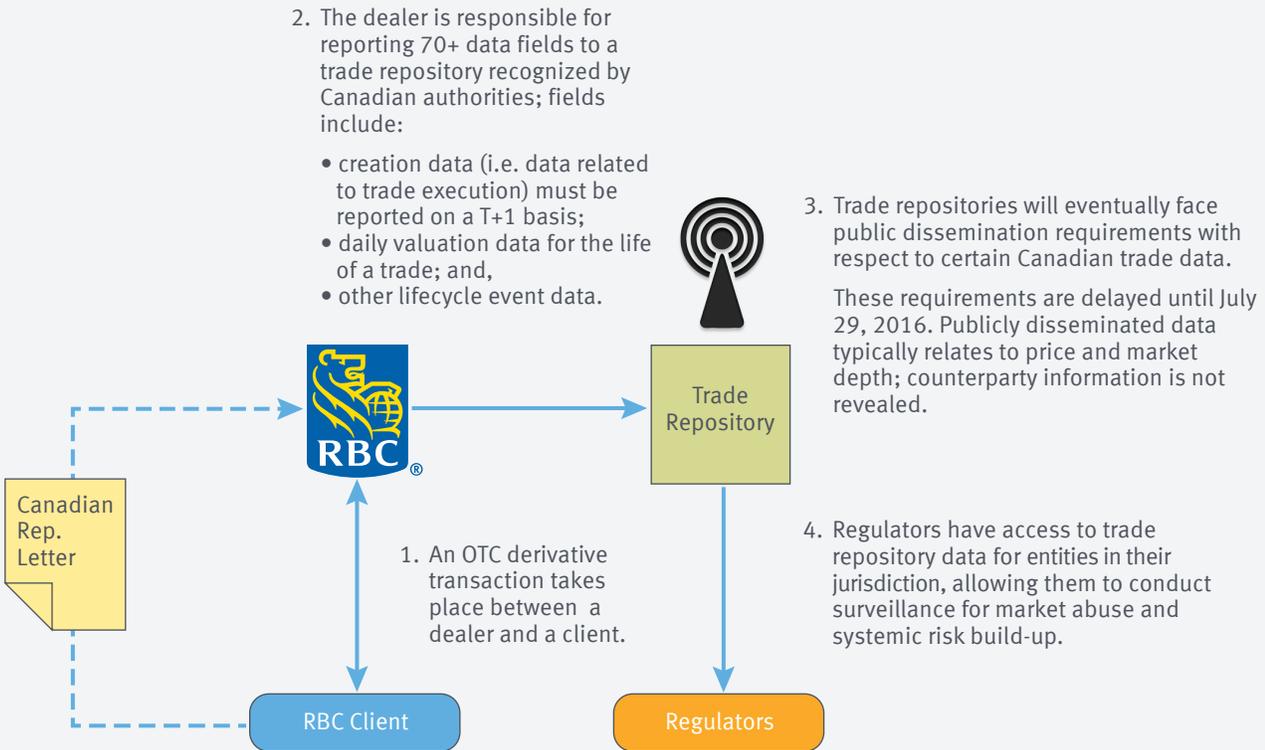
Although interim forbearance continues to be applied by global regulators, at some point, authorities are likely to enforce rigorous standards in trade reporting completeness and clients who have not met the above requirements may face interruptions to their trading activity.

We also caution that, in certain cases, transactions not involving a derivatives dealer counterparty – including a non-dealer’s inter-affiliate transactions - will be required to be reported starting on June 30th 2015. Please see our complete *Trade Reporting Update* for more information and speak to your legal counsel should you believe these requirements may apply to your organization.

1 A list of LEI providers can be found at <http://www.lei.org/>. Many RBC clients obtain the Global Markets Entity Identifier (GMEI) as their LEI. More information on the GMEI LEI, including how to sign up for one, is available by visiting <https://www.gmeiutility.org/>. RBC also has fact sheets relating to the LEI and other helpful information, so please speak to your relationship manager.

Figure 5: Info Graphic Example of the Canadian Trade Reporting Process

Note: Clients must have completed and returned a Canadian Trade Reporting Representation Letter and obtained an LEI, in order for a dealer to accurately report their trade.



Central Counterparty Clearing

The commitment to clear standardised OTC derivatives transactions through central counterparties (CCPs) is a cornerstone of the G20 reform agenda.

Through central clearing, a CCP places itself between counterparties to a financial transaction, thereby providing a high degree of assurance regarding contract performance. CCPs apply rigorous risk management standards to cleared transactions, settling daily mark-to-market changes in contract value through variation margin, holding initial margin from participants to self-insure defaults and insulating themselves against residual losses through a structured “loss-waterfall” of financial resources.

Recognising the benefits of CCP clearing, provincial authorities published *CSA Notice 91-303 Proposed Model Provincial Rule on Mandatory Central Clearing of Derivatives*, on December 19th 2013. These proposed rules outlined participant scope and timing considerations for eventual clearing mandates in Canada but did not indicate which specific products would be included.

As follow-on to these proposals, CSA members published *Proposed National Instrument 94-101 Mandatory Central Counterparty Clearing of Derivatives* on February 12th 2015. When compared to their earlier draft, the content of this second proposal was materially similar; a key evolution being its presentation as a National Instrument applicable across Canadian provinces. This latest clearing proposal also updates requirements for clearing exemptions, enlarges the scope of government entities excluded from the rules and allows us to update our estimated timeline for eventual clearing mandates, which we do below.

Scope of Eventual Canadian Clearing Mandates

Any new transaction in a mandatory clearable derivative that involves a “local counterparty” would be required to be submitted to a regulated CCP, unless subject to an exemption or exclusion. Similar to Trade Reporting requirements, a “local counterparty” would include a person or company (or affiliate of such an entity) that is organized in or that has its head office or principal place of business in an applicable Canadian province.

Exemptions from mandatory central clearing are proposed for non-financial end-users of derivatives as well as for intragroup transactions. It is important to note that Canadian proposals do not currently outline an exemption for financial entities below a threshold level of assets, as exists in US regulations². However, provincial rules also contemplate the ability to grant discretionary exemptions, as required.

Figure 6: Proposed Exemptions from Canadian Mandatory Clearing Requirements

Non-financial end-users	<ul style="list-style-type: none"> • At least one side of the transaction is an end-user entering into the transaction for the purpose of hedging or mitigating commercial risk. • The local counterparty must maintain records demonstrating that conditions for the exemption have been met. • Can extend to transactions entered into by an affiliated entity, if acting on behalf of a non-financial end-user for purposes of hedging or mitigating commercial risk. The affiliated entity cannot be subject to registration under Canadian securities law.
Intragroup transactions	<ul style="list-style-type: none"> • Transaction involves two entities that are prudentially supervised on a consolidated basis or affiliated entities that prepare financial statements on a consolidated basis. • Entities agree to the exemption; a written agreement sets out the terms of the transaction and it is subject to centralized risk evaluation, measurement and controls. • The required form (described in rules) is sent to the applicable regulator within 30 days of relying on the exemption.
Government entities (non-application)	<ul style="list-style-type: none"> • Government of Canada, of a jurisdiction of Canada or of a foreign jurisdiction; includes entities wholly owned and guaranteed by these governments. • Government-guaranteed crown corporations. • Bank of Canada, foreign central banks and the Bank for International Settlements.

² The CSA clearing proposal currently defines financial entities to include, amongst other entities, banks, credit unions, cooperative credit associations, pension funds and investment funds.

As discussed above, provincial rules limit their description of product scope to the proposed process to be followed when constructing a mandate. Notably, once a final clearing rule is in place, CCPs operating in Canada would be required to provide regulators with a list of products that they clear. From this superset of products, regulators would then assess whether products are suitable for a Canadian clearing mandate based on factors such as product standardisation, risk profile, liquidity, as well as through study of applicable trade repository data and comparable international standards.

The length of the CSA’s review process for determining products suitable for mandatory clearing, as well as the length of associated public comment periods, are key unknown variables that influence the timing of clearing mandates for Canada.

A new innovation also appears in the CSA’s February proposal – the anticipation that a clearing mandate would be phased-in across four categories of participants, as described below.

Figure 7: Process for Determining Mandatory Clearing Obligations in Canada



Segregation and Portability Requirements

Collateral segregation is an important consideration for market participants who either cannot or choose not to gain direct access to CCPs and who instead elect to clear transactions indirectly through a clearing member. The choice of clearing member is an important one; indirect clearers' transactions continue to be subject to a CCP's margin requirements, leading to large transfers of funds between broker and client.

CSA members first outlined their thinking on client segregation in January 2014, continuing to endorse a *Complete Legal Segregation* model for client asset protection in OTC derivatives markets. This model, similar to the Legal Segregation with Operational Commingling (LSOC) model in the US, has features whereby a CCP and clearing member must:

- collect margin from clients on a gross basis (i.e. long and short positions cannot be offset across clients);
- segregate client assets from their own property, but can commingle client collateral of the same clearing member in a single account;
- not use a client's collateral to offset the default of a clearing member or a clearing member's other clients; and,
- at least once a day, record the value of collateral required, held or posted to the CCP, which is attributable to clients overall and to each client's positions.

Since the above-noted release, CSA members have provided no further thinking in the areas of client collateral portability in OTC derivatives markets. However, as part of a broader consultation regarding their regulatory framework for Canadian clearing agencies (described below), CSA members did pose an open question regarding the appropriate level of collateral segregation for cash and exchange-traded markets in Canada. It is therefore possible that further regulation could emerge in these markets, in addition to OTC market reforms.

Clearing Agency Requirements

CSA members proposed their regulatory framework for clearing agencies (including CCPs) in *National Instrument 24-102* at the end of November 2014. Any CCP operating in the Canadian market, including foreign CCPs serving Canadian-based entities, will require recognition or an exemption from recognition by applicable provincial authorities. Exemptions from recognition would be available to foreign CCPs if deemed subject to similar regulation in their home market.

For the most part, the CSA's clearing agency requirements are a direct transpose of the *Principles for Financial Market Infrastructures*, an internationally-agreed text produced by the Committee on Payment and Market Infrastructures (CPMI) (formerly CPSS) and the International Organization of Securities Commissions (IOSCO). In certain areas, the CSA have nonetheless drafted joint supplementary guidance with respect to certain principles, in cooperation with the Bank of Canada.³

³ Regardless of the consultative nature of Canadian CCP requirements, certain clearing agencies based in Canada – although none clearing OTC derivatives - have been deemed as Qualifying Central Counterparties (QCCPs) through interim guidance provided by the Bank of Canada. As many readers may appreciate, recognition as a QCCP is an important determinant in achieving the reduced bank regulatory capital charges associated with cleared derivatives exposures under Basel III. See Bank of Canada Notice, "Qualifying Central Counterparties", Monday 28 July, 2014. Available at <http://www.bankofcanada.ca/2014/07/qualifying-central-counterparties/>

Exchange and Platform Trading

CSA Consultation Paper 92:401: Derivatives Trading Facilities, released on January 29th 2015, provides a first glimpse regarding the direction of platform trading requirements for the Canadian market. The consultative period for this paper remains open until March 30th 2015 and we expect that the regulatory process for finalizing these proposals could feasibly stretch for 16-24 months; eventual trading mandates, if any, could be years away.

Two areas of eventual platform trading regulation are discussed in the CSA's consultation paper, specifically:

- a provincial regulatory regime and registration requirement for Derivatives Trading Facilities (DTFs) –multilateral facilities or markets that bring together many buyers and sellers of OTC derivatives; and,
- early thinking regarding potential mandatory trading requirements for certain products.

Again we reiterate that the above proposals represent a first consultation. Canadian authorities suggest that mandatory trading requirements for any product would be determined by a number of criteria, including whether a product is subject to a clearing mandate, sufficiently standardised and liquid, subject to a trading mandate in other jurisdictions and available on a DTF. CSA members would also require that clearing and trade reporting data be available, for some time, before forming a trading mandate, if any.

As an overview of the CSA's proposals, the Appendix compares the CSA's DTF proposals to the existing Swap Execution Facility (SEF) framework in the US as well as the European Union's proposal for Organized Trading Facilities (OTFs).

Margin Requirements on Non-Centrally Cleared OTC Derivatives

A late addition to the global reform agenda, margin requirements for non-cleared derivatives will have a profound impact across countries and categories of markets participants. Collateralization decisions, which were once the purview of bilateral trading counterparties, will be engrained through principles set out by the Basel Committee on Banking Supervision (BCBS) and IOSCO sponsored Working Group on Margining Requirements (WGMR).

At their core, margin requirements will require the exchange of variation margin and, at times, initial margin between market participants deemed to be "covered entities". Although such a premise may sound simple, in practice these principles will give rise to a multitude of new requirements: legal representations, new collateral documentation, segregated collateral accounts and other examples provided below.

Such a profound change to market practice has been rendered all the more complex by the absence of final implementing rules across jurisdictions. Since the release of the BCBS-IOSCO principles in late 2013, only the US, European Union and Japanese regulators have proposed margin rules – with none yet reaching a final set of

requirements. In Canada, neither OSFI nor the CSA have released rule proposals.

Taking into account the implementation complexity, the lack of final regulatory guidance and the current state of market readiness associated with regulatory margin exchange, industry groups such as the International Swaps and Derivatives Association (ISDA) advocated for a delay to international implementation timelines. BCBS-IOSCO, recognizing the complexity of implementing its margin principles, released a revised framework and associated timelines on March 18th 2015. In this release, dates for the

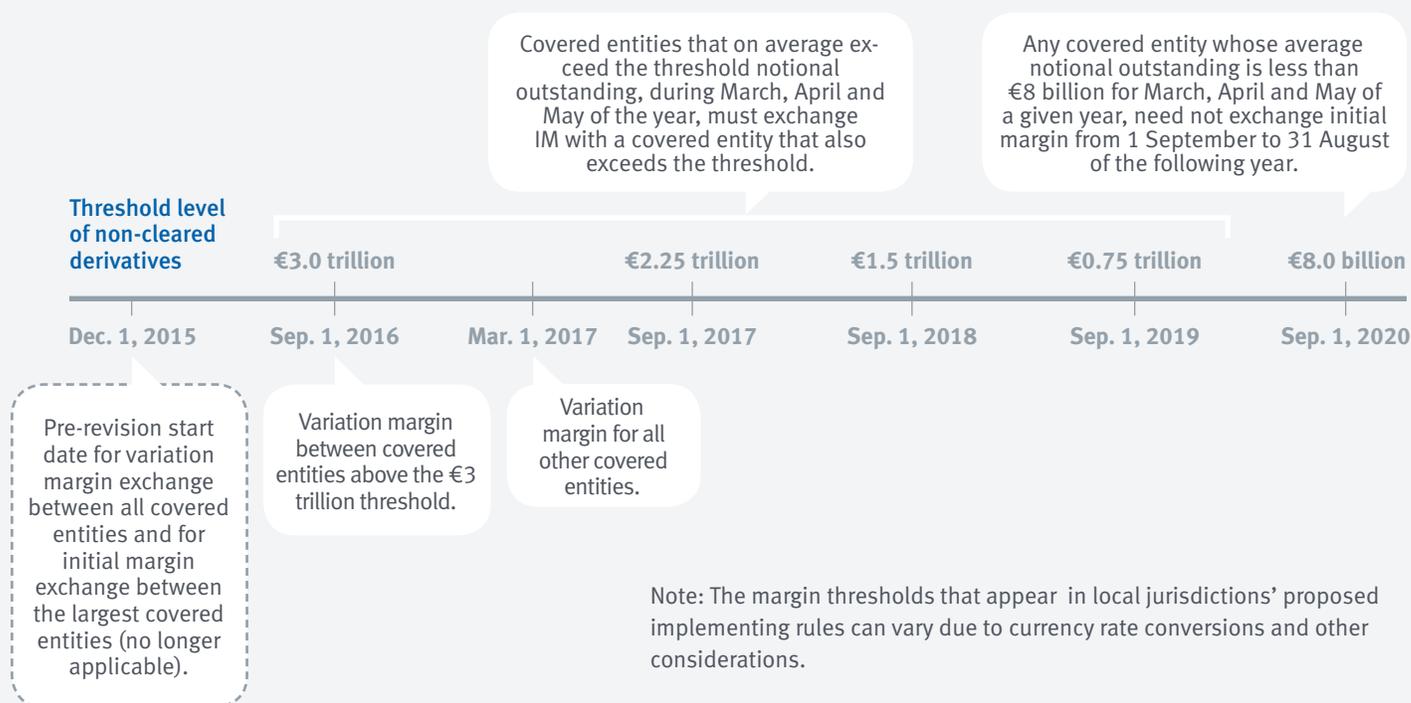
Figure 8: Examples of Changes to Market Practice From Regulatory Margin Requirements

Area	International principle	Market practice change
Covered entities	<ul style="list-style-type: none"> VM and IM principles apply, at the broadest level, to financial entities and systemically important non-financial entities. 	<ul style="list-style-type: none"> Counterparties will be required to represent their entity status to each other, once defined under local rules.⁴
Variation margin (VM)	<ul style="list-style-type: none"> VM should be exchanged regularly (e.g. daily), but parties may agree to a minimum transfer amount not exceeding €500,000 (both IM and VM combined). 	<ul style="list-style-type: none"> Bilateral derivatives documentation must be amended to reflect new VM and IM requirements.
Initial margin (IM)	<ul style="list-style-type: none"> Covered entities will be scoped into IM exchange based on their total notional outstanding derivatives activity. All covered entities must exchange, on a bilateral basis, IM with a threshold not to exceed €50 MM (determined on a consolidated basis) IM can be determined based on a standardised approach or approved internal models. 	<ul style="list-style-type: none"> Covered entities will be required to represent their categorization, based on notional derivatives, to counterparties. Counterparties will need to monitor and manage thresholds on a consolidated basis. Covered entities could be required to implement industry-standard margin models.
Segregation	<ul style="list-style-type: none"> IM should be immediately available to a collecting party in the event of their counterparty's default. The collected IM must be subject to arrangements that protect the posting party, to the extent possible under applicable law, in the event of the collecting party's bankruptcy. 	<ul style="list-style-type: none"> In certain cases, requirements to open segregated collateral accounts with a custodian or other third party and enter into tri-party custodial agreements with the counterparty and the custodian.

4 For purposes of regulatory margin requirements in Canada, one could question whether CSA members will apply the same definition of “financial entity” as currently outlined in proposed central clearing rules; potentially eliminating a need for new representations.

exchange of initial margin and variation margin were pushed back by nine months, while a phased approach to variation margin exchange was added. The resultant revised international margin framework is illustrated in the figure below.

Figure 9 – Revised Internationally-Agreed Phase-In Period for Margin Requirements



Other areas of Forthcoming Canadian Requirements

Two remaining areas of CSA rulemaking are outlined in the table below.

Registration requirements for provincial derivatives market participants have been a contested issue since the CSA first released a registration consultation paper in April 2013; of interest to our foreign clients, the level of regulation that should be extended to foreign market participants has been the target of industry comments.

Second is the CSA's consultation paper on the provincial surveillance and enforcement approach to OTC derivatives requirements, including discussion of the legislative

authority necessary to implement components of their framework. We anticipate that this framework will continue to evolve given the participation of several provinces in the Cooperative Capital Markets System, alongside the Government of Canada. We do not discuss this topic further given the last consultation on this topic was released in November 2011; several portions of this paper are likely outdated.

Figure 10: Summary of CSA’s 2013 Consultative Proposals on Registration

Registrants	<ul style="list-style-type: none"> Market participants would be required to register in each province where they conduct derivatives activities. Foreign participants with activity in the Canadian market could be required to register even if they do not have a local head-office or principal place of business in a province.
Categories of registration	<ul style="list-style-type: none"> Derivatives dealer; similar to US Swap Dealer category, although no de minimis level of activity was proposed for triggering registration in Canada. Derivatives advisor; advises others in relation to derivatives or provides advice in relation to the management of a derivatives portfolio (e.g. fund manager). Large derivatives participant; similar to US Major Swap Participant; participant has exposures in derivatives markets that could pose a serious risk.
Registration requirements	<ul style="list-style-type: none"> Certain OTC derivative requirements may be tied to registration, for example, current trade reporting obligations in Ontario, Quebec and Manitoba apply to registered dealers. Other proposals included entity-level types of requirements, including capital and margin obligations, as well as market conducts requirements.
Exemptions from registration	<ul style="list-style-type: none"> Persons in Canada that are subject to an existing regulatory regime imposed by other Canadian regulators, if its outcomes are seen as equivalent to CSA requirements. Foreign derivatives dealers, derivatives advisors or large derivatives participants are proposed to be exempt from certain requirements, but not registration entirely, if subject to an equivalent regulatory regime in their home jurisdiction.

Conclusion

The next two years promise to be an intense period for regulatory reform in Canada as local regulators introduce requirements that bring Canada closer to the post-crisis market standard, emerging across jurisdictions.

Through this implementation, RBC Capital Markets will continue to work diligently to ensure both that clients remain aware of emerging requirements affecting their transactions with RBC and that these transactions remain compliant with global norms.

Should you have questions on the content of this report we encourage you to speak to your RBC Capital Markets sales representative.

Appendix

Appendix A: Comparison of OTC Derivative Platform Registration and Trading Requirements (Proposals) across Jurisdictions

	Canada	U.S. (CFTC rules)	Europe (EMIR)
Rulemaking Status	<ul style="list-style-type: none"> • First Consultation Paper released by CSA in January 2015; to be followed by consultative model rule(s) and final rule. • Federal Regulatory Guidance outlines expectations that Federally Regulated Financial Institutions “support efforts to increase the movement of OTC derivatives trading to organized platforms”. 	<ul style="list-style-type: none"> • CFTC rules began to phase-in August 2013. • Forthcoming rules from the Securities Exchange Commission (SEC). 	<ul style="list-style-type: none"> • ESMA’s latest consultation paper on market structure and transparency aspects of The Markets in Financial Instruments Directive (MiFID II) and Markets in Financial Instruments Regulation (MIFIR) was released in December 2014. • Regulations will develop over 2016 and apply across the EU from January 2017.
New Trading Platform Categories Introduced	<ul style="list-style-type: none"> • Derivatives Trading Facility (DTF) • A person or company that maintains a facility or market that brings together buyers and sellers of OTC derivatives, brings together the orders of multiple buyers and sellers, and uses methods under which the orders interact with each other and the buyers and sellers agree to the terms of trades. 	<ul style="list-style-type: none"> • Swap Execution Facility (SEF) • A trading system or platform created by the <i>Dodd-Frank Act</i> in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce. The <i>Dodd-Frank Act</i> imposed different statutory provisions on SEFs than on designated contract markets (see below). 	<ul style="list-style-type: none"> • Organised Trading Facility (OTF) • Multilateral system in which multiple third-party buying and selling interests in non-equity instruments (bonds, structured finance products, emission allowances, derivatives) interact in a way that results in a contract. • Operator can engage in matched principal trading only where a client has consented.
Registration Requirement	<ul style="list-style-type: none"> • Yes. All DTFs may require authorization or exemption from Provincial authorities. • Extends to any platform trading OTC derivatives; not just those subject to a mandatory trading requirement. 	<ul style="list-style-type: none"> • Yes. Any multi-multi platform for swaps must register as a SEF with the CFTC. 	<ul style="list-style-type: none"> • Yes, operating an OTF will be a regulated activity and authorisation will be required.)

continued

	Canada	U.S. (CFTC rules)	Europe (EMIR)
Other Pre-Existing Registration Categories	<ul style="list-style-type: none"> • “Marketplaces” as regulated by CSA National Instrument 21-101, include securities exchanges, alternative trading systems (ATS) and quotation and trade reporting systems (QTRS). • Existing marketplaces trading derivatives that are not OTC derivatives would not be regulated as a DTF for those operations. • Existing marketplaces wishing to add a platform for trading OTC derivatives would need to apply for authorization to do so. • Depending on the products traded, a platform may be both a DTF and marketplace. 	<ul style="list-style-type: none"> • “Designated Contract Markets” (DCM); boards of trade or exchanges for futures or options trading by traders, including brokers and retail customers. 	<ul style="list-style-type: none"> • Regulated market (RM): multilateral system, which brings together multiple third-party buying and selling interests in financial instruments in a way that results in a contract and which is authorised under MiFID 2. • Multilateral trading facility (MTF): multilateral system which brings together multiple third-party buying and selling interests in financial instruments in a way that results in a contract. • Investment firms’ internal matching systems, which execute client orders in equity instruments on a multilateral basis, will need to become MTFs.
Minimum Execution Requirement	<ul style="list-style-type: none"> • DTFs may require minimum order book functionality only for products subject to mandatory trading on a DTF; a combined order book & Request for Quote (RFQ) approach may also be allowed for mandated products. • The question is posed as to whether DTFs should generally face minimum execution requirements (i.e. for all products). 	<ul style="list-style-type: none"> • “Required transactions”, those subject to mandatory trading on a SEF, must be executed through the following unless a specific exemption applies: <ul style="list-style-type: none"> - through an order book; or, - through a request for quote (RFQ) to three market participants. • Requirements were relaxed for certain block and package transactions. 	<ul style="list-style-type: none"> • TBD
Platform Discretion in Executing Transactions	<ul style="list-style-type: none"> • DTF discretion may be allowed, but could be prohibited for trades subject to mandatory trading. This is clearly an area of consultation. 	<ul style="list-style-type: none"> • Only authorized traders on boarded on a particular SEF platform are permitted to transact over the SEF. 	<p>OTF operators have conditional discretion to:</p> <ul style="list-style-type: none"> • place an order or retract it; or, • not match a specific order with orders available in the system at a given time.

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	Canada	U.S. (CFTC rules)	Europe (EMIR)
Pre-Trade Transparency Requirements	<ul style="list-style-type: none"> • DTFs may be required to display bid / offer and market depth at each price, only for products subject to mandatory trading. • If RFQ is used, there may be a minimum bid requirement (yet unspecified number of bid participants). • Pre-arranged transactions may require to be “exposed” in the order book for a minimum time (e.g. 15 seconds). • Certain large orders or quotes may be exempt for pre-trade requirements (size thresholds are TBD). 	<ul style="list-style-type: none"> • Pre-trade transparency is achieved through the order book for all products. • RFQ must include at least 3 potential bidders unless specific regulatory exemptions are provided. • Brokers or dealers executing pre-arranged client orders must ‘expose’ one side of the trade in the order book for 5-15 seconds (varies by SEF) before executing the other side. (SEFs have some discretion in setting lower time delays). • Block trades are exempt from minimum execution and pre-trade transparency requirements. 	<ul style="list-style-type: none"> • MiFIR defines pre-trade transparency as a requirement to make public bid and offer prices and depth of trading interests. • The current transparency regime for shares will be extended to cover many products on RMs, MTF and OTFs. Requirements are being calibrated for different types of systems (e.g. order book, RFQ, hybrid). • A waiver from pre-trade transparency may be available for large orders relative to normal market size (i.e. block trades), actionable indications of interest in RFQ or voice systems, derivatives not subject to the clearing obligation and other illiquid financial instruments.
Post-Trade Transparency Requirements	<ul style="list-style-type: none"> • DTFs may face real-time reporting requirement for all transactions. • The paper contemplates deferred public reporting for certain transactions, specifically block-trades (yet undefined), and asks if such a deferral is appropriate for other products. • Public reporting could occur directly at the DTF or by reporting to a trade repository, which handles public reporting, feedback is sought on these approaches. 	<ul style="list-style-type: none"> • Block trades can benefit from delays in public dissemination of reported information; required transaction block trades will ultimately benefit from a 15 minute delay before public dissemination. • Public dissemination is handled by the swap data repository, to which the SEF reports. 	<ul style="list-style-type: none"> • MiFIR defines post-trade transparency as a requirement to make public volume, price and time of transactions as close to real time as technically possible. • The regime contemplates time delays and volume omissions for certain products, similar to pre-trade transparency above, to avoid harm to liquidity providers. • Regulators can suspend disclosure requirements if liquidity falls below a threshold level.

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	Canada	U.S. (CFTC rules)	Europe (EMIR)
Products Subject to Mandatory Trading Requirement	<ul style="list-style-type: none"> • CSA are unlikely to make a product determination until trade reporting and clearing data is available for a sufficient period of time for analysis. • In determining which products should be subject to mandatory trading, the CSA would consider, amongst other factors, whether the product is: <ul style="list-style-type: none"> - subject to mandatory clearing in Canada; - liquid and traded by many participants; - mandated for trading in other jurisdictions; and, - available to be traded on a DTF. 	<ul style="list-style-type: none"> • Certain rates and credit products are mandated for trade execution on a SEF or “made available to trade” (MAT). This includes a subset of USD, EUR and GBP products mandated for clearing. • MAT swaps with US persons that do not claim an exemption to clearing must be executed and/or processed on a SEF (i.e. required transactions). • Packaged transactions including MAT components will face trade execution or processing requirements on a SEF, with staggered compliance dates. • Outside the trade execution mandate, generally CFTC swaps with US persons on a many to many platform must be executed on a SEF; this covers all CFTC asset classes. 	<ul style="list-style-type: none"> • Financial counterparties and certain Non-Financial counterparties will be required to trade certain OTC derivatives on an RM, MTF, OTF or equivalent foreign platform. • Products subject to the trading obligation will be those: <ul style="list-style-type: none"> - subject to EMIR mandatory clearing; - admitted to trading on at least one venue (or foreign venue); and, - sufficiently liquid.

Other RBC Reports in this Series

[OTC Derivatives: Update on Canadian Reforms, October 1st 2013](#)

[OTC Derivatives: Update on CCP Clearing in Canada, January 30th 2014](#)

[OTC Derivatives: Update on Trade Reporting in Canada, June 10th 2014](#)

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Guideline B-7: Derivatives Sound Practices. Available at: <http://www.osfi-bsif.gc.ca/Eng/finif/rg-ro/gdn-ort/gl-ld/Pages/b7.aspx>

Trade Reporting

Latest amendments to Ontario Securities Commission Rule 91-507 Trade Repositories and Derivatives Data Reporting and Companion Policy 91-506 CP to Ontario Securities Commission Rule 91-506 Derivatives: Product Determination. Available at: http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20150212_91-507_derivatives-data-reporting.htm

CSA Notice and Request for Comment Proposed Multilateral Instrument 91-101 Derivatives Product Determination and Proposed Multilateral Instrument 96-101 Trade Repositories and Derivatives Data Reporting. Available at: http://www.albertasecurities.com/Regulatory%20Instruments/5042659-v1-CSA_Notice_and_RFC_on_Proposed_MI_91-101_and_96-101_91.101.pdf

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Margin Requirements for Non-Centrally Cleared Derivatives

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<http://www.bis.org/publ/bcbs261.htm>

Registration Requirements

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Surveillance and Enforcement

CSA Consultation Paper 91-403, Derivatives: Surveillance and Enforcement. Available at:
http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20111125_91-403_cp-derivatives.htm

Glossary

BCBS	Basel Committee on Banking Supervision; a forum for regulatory cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.
CCP	Central counterparty; infrastructure that places itself between counterparties to a transaction, becoming buyer to each seller and seller to each buyer, thereby providing a high degree of assurance regarding contract performance. CCPs apply rigorous risk management standards to cleared transactions
Central clearing	Clearing refers to the management (risk management, transaction monitoring, netting) of a transaction after the matching of a buy and sale trade and prior to the legal fulfillment of the respective obligation. Occurs as the CCP becomes the counterparty of the original buyer and seller through novation (ESMA definition).
CFTC	United States Commodity Futures Trading Commission; conducts oversight and regulation of derivatives and other products subject to the <i>Commodity Exchange Act</i> .

CPMI	Committee on Payments and Market Infrastructures; formerly the Committee on Payment and Settlement Systems (CPSS); it's mandate includes promoting the safety and efficiency of payment, clearing, settlement and related arrangements, thereby supporting financial stability and the wider economy.
CSA	The 10 provinces and 3 territories in Canada are each responsible for securities regulations in their home market. Authorities from each province and territory formed the Canadian Securities Administrators (CSA) to help develop a harmonized approach to regulation.
ESMA	European Securities and Markets Authority; an independent European Union Authority that contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection.
FRFI	Federally Regulated Financial Institution; used in this report to denote entities subject to OSFI Guidance and regulation.
G20	The Group of 20; a premier forum for its members' international economic cooperation and decision-making. Its membership comprises 19 countries plus the European Union. G20 leaders meet annually. In 2008, the first G20 Leaders' Summit was held, and the group played a key role in responding to the global financial crisis.
Initial Margin	Cash or collateral that is deposited to ensure performance of a party's obligations to its counterparty. Often calibrated to cover potential future exposure on a contract from the time a counterparty defaults until exposure can be mitigated.
IOSCO	International Organization of Securities Commissions; the international body that brings together the world's securities regulators and is recognized as the global standard setter for the securities sector. IOSCO develops, implements and promotes adherence to internationally recognized standards for securities regulation.
LEI	Legal Entity Identifier (LEI); a 20-digit, alpha-numeric code, to uniquely identify legally distinct entities that engage in financial transactions. LEIs are issued by Local Operating Units (LOUs) of the Global LEI System.
MiFID II	Revision to the Markets in Financial Instruments Directive; within the European Union, MiFID governs the provision of investment services in financial instruments by banks and investment firms and the operation of traditional stock exchanges and alternative trading venues. In October 2011, the European Commission tabled proposals to revise the Markets in Financial Instruments Directive (MiFID II) with the aim of making financial markets more efficient, resilient and transparent, and to strengthen the protection of investors.

OSFI	Office of the Superintendent of Financial Institutions (OSFI); OSFI regulates and supervises financial institutions and private pension plans subject to federal oversight. It is an independent, self-financing agency that reports to Parliament through the Minister of Finance.
SEC	United States Securities and Exchange Commission; the primary overseer and regulator of the U.S. securities markets, including certain security-based swaps.
Trade Repository	Market infrastructure that collects and maintains records of transactions.
Variation Margin	Funds paid to or received from a counterparty to settle gains or losses from marking a contract to market value.