CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

CSA Notice and Second Request for Comment Proposed Amendments to National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* and Proposed Changes to Companion Policy 94-101 *Mandatory Central Counterparty Clearing of Derivatives*

September 3, 2020

Introduction

The Canadian Securities Administrators (the **CSA** or **we**) are publishing the following for a second comment period of 90 days, expiring on December 2, 2020:

- proposed amendments to National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (the **National Instrument)**, and

- proposed changes to Companion Policy 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (the **CP**).

Collectively, the proposed amendments to the National Instrument (the **Proposed Rule Amendments**) and the proposed changes to the CP are referred to as the **Proposed Amendments**.

The CSA is of the view that Proposed Rule Amendments are necessary to address issues raised by market participants following the CSA's publication for comment of proposed amendments and changes to the National Instrument and the CP on October 12, 2017 (the **2017 Proposed Amendments**). The issues relate largely to the scope of market participants that are required to clear an over-the-counter (**OTC**) derivative prescribed in Appendix A to the National Instrument through a central clearing counterparty (the **Clearing Requirement**).

We are issuing this CSA Notice to solicit comments on the Proposed Amendments.

Background

The Proposed Amendments are a response to feedback received from various market participants, and are intended to more effectively and efficiently promote the underlying policy aims of the National Instrument.

The National Instrument was published on January 19, 2017 and came into force on April 4, 2017 (except in Saskatchewan where it came into force on April 5, 2017). The purpose of the National Instrument is to reduce counterparty risk in the OTC derivatives

market by requiring certain counterparties to clear certain prescribed derivatives through a central clearing counterparty.

The Clearing Requirement became effective for certain counterparties specified in paragraph 3(1)(a) of the National Instrument (*i.e.*, a local counterparty that is a participant of a regulated clearing agency that subscribes for clearing services for the applicable class of derivatives) on the coming-into-force date of the National Instrument, and was initially scheduled to become effective for certain other counterparties specified in paragraphs 3(1)(b) and 3(1)(c) on October 4, 2017.

On October 12, 2017 the CSA published for comment proposed amendments and changes to the National Instrument and CP. However, in order to facilitate the rule-making process for these amendments and to refine the scope of market participants that are subject to the Clearing Requirement, the CSA jurisdictions (except Ontario) exempted counterparties specified in paragraphs 3(1)(b) and (c) of the National Instrument from the Clearing Requirement.[1]

The Ontario Securities Commission (the **OSC**) similarly amended the National Instrument to extend the effective date of the Clearing Requirement for those counterparties until August 20, 2018.[2]

While the Clearing Requirement took effect in Ontario on August 20, 2018 for all categories of counterparties specified in subsection 3(1) of the National Instrument, OSC staff expressed the view that only counterparties specified under paragraph 3(1)(a) are expected to comply with the Clearing Requirement until the CSA finalizes the amendments to the National Instrument to narrow the scope of market participants that would be subject to the Clearing Requirement[3].

Substance and Purpose of the Proposed Amendments

Following the comments received on the 2017 Proposed Amendments, the CSA is proposing further amendments to the National Instrument. These include amendments that reflect issues raised by commenters relating to the scope of the counterparties that are subject to the National Instrument, and amendments to refine the scope of products that are mandated to be cleared. Minor non-material changes are also being proposed.

The Proposed Amendments reflect our consideration of the comments received from

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[1] Blanket Order 94-501, available on the website of the securities regulatory authority in the local jurisdiction.

[2] See, in Ontario, Amendment to National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives*, published July 6, 2017.

[3] As explained further in CSA Staff Notice 94-303, on May 31st 2018 the CSA jurisdictions (except Ontario) extended the blanket order relief under Blanket Order 94-501 until the earlier of its revocation or the coming into force of amendments to the National Instrument with respect to the scope of counterparties subject to the Clearing Requirement. Since blanket orders were not authorized under Ontario securities law, the OSC was unable to follow the approach of the other CSA jurisdictions.

market participants on the 2017 Proposed Amendments, as well as our ongoing review of the National Instrument's impact on market participants.

Summary of the Proposed Amendments

(a) Subsection 1(2): interpretation of "affiliated entity"

The proposed amendments to the interpretation of "affiliated entity" are based on the concept of consolidated financial statements under IFRS or U.S. generally accepted accounting principles[4]. Proposed subsection 1(2), in conjunction with the proposed repeal of subsection 1(3) and the introduction of subsections 3(0.1) and (0.2), would affect the circumstances in which an entity is considered an affiliated entity.

The proposed amendments reflect a CSA policy decision in 2016, in response to our evaluation of the size and nature of the Canadian OTC derivatives market, to design the Clearing Requirement so that it applied to specific types of transactions and to the market participants that had access to clearing agencies that offered clearing services for the mandated derivatives, or because certain market participants' derivatives exposure represented a potential systemic risk. Considering the scope of the application of the National Instrument and review of the comments received following the publication of the 2017 Proposed Amendments, the previous interpretation of "affiliated entity" could subject certain entities to the Clearing Requirement unintentionally while other market participants could unintentionally be excluded from the National Instrument.

(b) De minimis exclusion

Consistent with the CSA's intention to apply the Clearing Requirement only to market participants that, together with affiliated entities, might present systemic risk, the CSA is still proposing to exclude from the scope of the National Instrument entities that have a month-end gross notional amount under all outstanding derivatives of less than $1 billion and are part of a large derivative participant group from the Clearing Requirement.

Paragraph 3(1)(c) was originally designed to capture certain large local counterparties and all their local affiliated entities. In substance, adding the notional amount of all outstanding derivatives of affiliated entities to the calculation of the threshold stated in paragraph 3(1)(c) was intended to prevent market participants from creating multiple sub-entities to avoid being subject to the Clearing Requirement. However, the CSA is of the view that entities with less than $1 billion of notional derivatives exposure should not be required to clear.

In response to comments we received following the publication of the 2017 Proposed Amendments to reduce the monitoring frequency of the $1 billion threshold under

[4] Refer to IFRS 10 Consolidated Financial Statements and US FASB Accounting Standards Codification Topic 810.

paragraphs 3(1)(b) and (c), the CSA is proposing to establish an annual three-month monitoring period during which counterparties will need to determine if they are subject to the Clearing Requirement for the subsequent one-year period.

(c) Investment funds and special purpose entities

The CSA has come to the view that a further subset of market participants should be excluded. With the introduction of subsections 3(0.1) and (0.2), it is proposed to exclude investment funds and certain types of consolidated entities (commonly referred to as special purpose entities) from being treated as affiliated entities for the purpose of paragraphs 3(1)(b) and (c), with the effect that such entities would only be potentially subject to the Clearing Requirement in circumstances where paragraph 3(1)(c) applies, i.e. when these entities exceed on their own the $500 billion threshold in that paragraph.

(d) Determination of mandatory clearable derivatives

As previously published in the 2017 Proposed Amendments, Appendix A of the National Instrument will remove overnight index swaps with variable notional type and forward rate agreements with variable notional type from the list of mandatory clearable derivatives as those are not currently offered for clearing by regulated clearing agencies.

(e) Appendix B Laws, Regulations or Instruments of foreign jurisdiction applicable for substituted compliance

The CSA continues to follow developments regarding Brexit and other international actions being taken in that regard to ensure the substituted compliance provision reflect any changes that are necessary to address these developments.

(f) Removal of the requirement to deliver Form 94-101F1 Intragroup Exemption and Form 94-101F2 Derivatives Clearing Services

The CSA is proposing to remove the requirement to deliver Form 94-101F1 *Intragroup Exemption* and Form 94-101F2 *Derivatives Clearing Services* from the National Instrument because we have found alternative sources for obtaining the information included in these forms that does not result in additional regulatory burden for participants.

Contents of Annexes
The following annexes form part of this CSA Notice:

Annex A Summary of comments and CSA responses and list of commenters

Annex B Proposed amendments to National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives*

Annex C Proposed Changes to Companion Policy 94-101 *Mandatory Central Counterparty Clearing of Derivatives*

Request for Comments

Please provide your comments in writing by December 2, 2020. We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period.

In addition, all comments received will be posted on the websites of the Alberta Securities Commission (www.albertasecurities.com), the Autorité des marchés financiers (www.lautorite.qc.ca) and the Ontario Securities Commission (www.osc.gov.on.ca).

Therefore, you should not include personal information directly in comments to be published.

It is important that you state on whose behalf you are making the submission.

Thank you in advance for your comments.

Please address your comments to each of the following:

British Columbia Securities Commission;

Alberta Securities Commission;

Financial and Consumer Affairs Authority of Saskatchewan;

Manitoba Securities Commission;

Ontario Securities Commission;

Autorité des marchés financiers ;

Financial and Consumer Services Commission (New Brunswick);

Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island;

Nova Scotia Securities Commission;

Office of the Superintendent of Securities, Newfoundland and Labrador;

Office of the Superintendent of Securities, Northwest Territories;

Office of the Yukon Superintendent of Securities; and

Nunavut Securities Office;

Please send your comments only to the following addresses. Your comments will be forwarded to the remaining jurisdictions:

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Questions

If you have questions about this CSA Notice, please contact any of the following:

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ANNEX A

SUMMARY OF COMMENTS AND CSA RESPONSES

Section Reference	Issue/Comment	Response
S. 1 – Definitions: Affiliated entity	Two commenters pointed out that there is a potential for confusion around the interpretation of the term "affiliate" due to the lack of harmonization throughout the rules.	No change. Given the specific scopes and objectives of each rule published by the CSA, having a harmonized interpretation of "affiliated entity" is currently difficult. The CSA will however continue exploring further options to harmonize definitions and interpretations as much as possible throughout its rules.
S. 3 – Duty to clear	Two commenters suggested that the exclusion of trusts and investments funds in former paragraphs 3(1)(b) and 3(1)(c) should be done under Section 1 to avoid amendments to the existing ISDA Canadian Clearing Classification Letter.	Change made. These exemptions were moved to new subsections 3(0.1) and 3(0.2).
S. 3 – Duty to clear	A commenter asked if the proposed additional exemption in subparagraph 3(1)(c)(iv) was intentional.	No change. The CSA's intent is to consistently exempt from the clearing requirement any local counterparty that does not exceed the $1 000 000 000 threshold.
S. 3 – Duty to clear	Two commenters suggested annual testing of the thresholds on a predetermined date in order to facilitate operational monitoring.	Change made for the $1 000 000 000 threshold, no change for the $500 000 000 000 threshold. An annual three-month monitoring window has been introduced for testing of the $1 000 000 000 threshold.
S. 3 – Duty to clear	A commenter pointed out that a derivative market participant may be above the $500 000 000 000 threshold when the mandatory clearing requirement	Change made. The CSA is proposing that a person or entity that has been required to clear under paragraph 3(1)(c) would benefit from an exemption from

	comes into force but this same participant could be under the threshold the following months causing this participant to be subject to our National Instrument even if they no longer meet the threshold.	the clearing obligation if it has not exceeded the $500 000 000 000 threshold for 12 consecutive months.

List of Commenters

1. The Canadian Advocacy Council for Canadian CFA Institute Societies
2. Canadian Market Infrastructure Committee
3. International Swaps and Derivatives Association

ANNEX B

PROPOSED AMENDMENTS TO
NATIONAL INSTRUMENT 94-101 *MANDATORY CENTRAL COUNTERPARTY CLEARING OF DERIVATIVES*

1. National Instrument 94-101 Mandatory Central Counterparty Clearing of Derivatives is amended by this Instrument.

2. Section 1 is amended

(a) in subsection (1), by adding the following definitions:

"investment fund" has the meaning ascribed to it in National Instrument 81-106 *Investment Fund Continuous Disclosure*;

"prudentially regulated entity" means a person or company that is subject to and in compliance with the laws of Canada, a jurisdiction of Canada or a foreign jurisdiction where the head office or principal place of business of a Schedule III bank is located, and a political subdivision of that foreign jurisdiction, relating to minimum capital requirements, financial soundness and risk management, or the guidelines of a regulatory authority of Canada or a jurisdiction of Canada relating to minimum capital requirements, financial soundness and risk management;

"reference period" means, for a given year after 2019, the period beginning on September 1 in a year and ending on August 31 of the following year**,**

(b) by replacing subsection (2) with the following:

(2) In this Instrument, a person or company (the first party) is an affiliated entity of another person or company (the second party) if any of the following apply:

(a) the first party and the second party are consolidated in consolidated financial statements prepared in accordance with one of the following:

(i) IFRS;

(ii) generally accepted accounting principles in the United States of America;

(b) all of the following apply:

(i) the first party and the second party would have been, at the relevant time, required to be consolidated in consolidated financial statements prepared by the first party, the second party or another person or company, if the consolidated financial statements were prepared in accordance with the principles or standards referred to in subparagraphs (a)(i) or (ii);

(ii) neither the first party's nor the second party's financial statements, nor the financial statements of the other person or company, were prepared in accordance with the principles or standards referred to in subparagraph (a)(i) or (ii);

(c) the first party and second party are both prudentially regulated entities supervised together on a consolidated basis.

(c) by repealing subsection (3).

3. Section 3 is amended

(a) by adding the following subsections:

(0.1) Despite subsection 1(2), an investment fund is not an affiliated entity of another person or company for the purposes of paragraphs 3(1)(b) and (c);

(0.2) Despite subsection 1(2), a person or company is not an affiliated entity of another person or company for the purposes of paragraphs 3(1)(b) and (c) if the following apply:

(a) the person or company has, as its primary purpose, one of the following:

(i) financing a specific pool or pools of assets;

(ii) providing investors with exposure to a specific set of risks;

(iii) acquiring or investing in real estate or other physical assets;

(b) all the incurred indebtedness by the person or company whose primary purpose is one set out in subparagraphs (a)(i) or (ii), including obligations owing to its counterparty to a derivative, are solely secured by the assets of that person or company.

(b) by replacing paragraphs (1)(b) and (c) with the following:

(b) the counterparty

(i) is an affiliated entity of a participant referred to in paragraph (a), and

(ii) had, for the months of March, April and May preceding the reference period in which the transaction was executed, an average month-end gross notional amount under all outstanding derivatives exceeding $1 000 000 000 excluding derivatives to which paragraph 7(1)(a) applies;

(c) the counterparty

(i) is a local counterparty in any jurisdiction of Canada,

(ii) had, during the previous 12-month period, a month-end gross notional amount under all outstanding derivatives, combined with each affiliated entity that is a local counterparty in any jurisdiction of Canada, exceeding $500 000 000 000 excluding derivatives to which paragraph 7(1)(a) applies, and

(iii) had, for the months of March, April and May preceding the reference period in which the transaction was executed, an average month-end gross notional amount under all outstanding derivatives exceeding $1 000 000 000 excluding derivatives to which paragraph 7(1)(a) applies.**,** ***and***

(c) in subsection (2), by deleting "(1)(b) or***", "***(1)(b)(ii) or***" and "***, as applicable***".***

4. Section 6 is amended by replacing "the following counterparties***" with "***a counterparty in respect of a mandatory clearable derivative if any counterparty to the mandatory clearable derivative is one of the following**".**

5. Section 7 is amended

(a) by deleting "the application of***",***

(b) in paragraph (1)(a), by deleting "if each of the counterparty and the affiliated entity are consolidated as part of the same audited consolidated financial statements prepared in accordance with "accounting principles" as defined in National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards****", and***

(c) by repealing subsections (2) and (3).

6. Section 8 is amended

(a) by deleting "the application of***",***

(b) by replacing paragraph (d) with the following:

(d) the multilateral portfolio compression exercise involved both counterparties to the mandatory clearable derivative;***, and***

(c) in paragraph (e), by replacing "is***" with "***was***".***

7. Part 4 is repealed.

8. Appendix A is replaced with the following:

APPENDIX A
TO
NATIONAL INSTRUMENT 94-101 *MANDATORY CENTRAL COUNTERPARTY CLEARING OF DERIVATIVES*

MANDATORY CLEARABLE DERIVATIVES
(Subsection 1(1))

Interest Rate Swaps

Type	**Floating index**	**Settlement currency**	**Maturity**	**Settlement currency type**	**Optionality**	**Notional type**
Fixed-to-float	CDOR	CAD	28 days to 30 years	Single currency	No	Constant or variable
Fixed-to-float	LIBOR	USD	28 days to 50 years	Single currency	No	Constant or variable

Fixed-to-float	EURIBOR	EUR	28 days to 50 years	Single currency	No	Constant or variable
Fixed-to-float	LIBOR	GBP	28 days to 50 years	Single currency	No	Constant or variable
Basis	LIBOR	USD	28 days to 50 years	Single currency	No	Constant or variable
Basis	EURIBOR	EUR	28 days to 50 years	Single currency	No	Constant or variable
Basis	LIBOR	GBP	28 days to 50 years	Single currency	No	Constant or variable
Overnight index swap	CORRA	CAD	7 days to 2 years	Single currency	No	Constant
Overnight index swap	FedFunds	USD	7 days to 3 years	Single currency	No	Constant
Overnight index swap	EONIA	EUR	7 days to 3 years	Single currency	No	Constant
Overnight index swap	SONIA	GBP	7 days to 3 years	Single currency	No	Constant

Forward Rate Agreements

Type	**Floating index**	**Settlement currency**	**Maturity**	**Settlement currency type**	**Optionality**	**Notional type**
Forward rate agreement	LIBOR	USD	3 days to 3 years	Single currency	No	Constant
Forward rate agreement	EURIBOR	EUR	3 days to 3 years	Single currency	No	Constant
Forward	LIBOR	GBP	3 days to 3	Single	No	Constant

rate agreement			years	currency		

9. Form 94-101F1 Intragroup Exemption and Form 94-101F2 Derivatives Clearing Services are repealed.

10. This Instrument comes into force on [*insert date here*].

ANNEX C

PROPOSED CHANGES TO COMPANION POLICY 94-101 MANDATORY CENTRAL COUNTERPARTY CLEARING OF DERIVATIVES

1. Companion Policy 94-101 Mandatory Central Counterparty Clearing of Derivatives is changed by this Document.

2. Part 1 is changed by adding the following subsection:

Subsection 1(2) – Interpretation of "affiliated entity"

To determine whether two entities are affiliates, the Instrument uses an approach based on the concept of consolidated financial statements under IFRS or U.S. Generally Accepted Accounting Principles (U.S. GAAP). Consequently, two entities whose financial statements are consolidated, or would be consolidated if any financial statements were required, would be considered affiliated entities under the Instrument. We expect corporate groups that do not prepare financial statements in accordance with IFRS or U.S. GAAP to apply the consolidation test under either IFRS or U.S. GAAP to determine whether entities within the corporate group meet the "affiliated entity" interpretation.

3. Part 2 is replaced with the following:

PART 2 MANDATORY CENTRAL COUNTERPARTY CLEARING

Subsections 3(0.1) and (0.2) – Exclusion of investment funds and certain entities

An investment fund whose financial statements are consolidated with those of another entity should not be considered an affiliated entity of the other entity for the application of paragraphs 3(1)(b) and (c). In addition, the month-end exposure should not be considered when calculating the month-end gross notional amount in accordance with those paragraphs.

However, an investment fund will be subject to the clearing requirements if it, on its own, exceeds the $500 000 000 000 month-end gross notional amount for all outstanding

derivatives.

Similarly, certain consolidated structured entities (commonly known as special purpose entities) should not be considered as affiliates for the purpose of paragraphs 3(1)(b) and (c) if they meet the conditions stated in subsection 3(0.2). An entity, including an entity such as a credit card securitization vehicle or an entity created to guarantee interest and principal payments under a covered bond program, that meets the conditions in subsection 3(0.2) would not be an affiliated entity. All obligations of such entities are required to be exclusively secured by their own assets to meet the condition in paragraph 3(0.2)(b). Also, a vehicle created to invest in real estate or an infrastructure that meets the conditions in subparagraph 3(0.2)(a)(iii) would not be an affiliated entity of another entity even if its financial statements are consolidated with the other entity.

Subsection 3(1) – Duty to submit for clearing

The duty to submit a mandatory clearable derivative for clearing to a regulated clearing agency only applies at the time the transaction is executed. If a derivative or class of derivatives is determined to be a mandatory clearable derivative after the date of execution of a transaction in that derivative or class of derivatives, we would not expect a local counterparty to submit the mandatory clearable derivative for clearing. Therefore, we would not expect a local counterparty to clear a mandatory clearable derivative entered into as a result of a counterparty exercising a swaption that was entered into before the date on which the requirement to submit a mandatory clearable derivative for clearing is applicable to that counterparty or the date on which the derivative became a mandatory clearable derivative. Similarly, we would not expect a local counterparty to clear an extendible swap that was entered into before the date on which the requirement to submit a mandatory clearable derivative for clearing is applicable to that counterparty or the date on which the derivative became a mandatory clearable derivative and extended in accordance with the terms of the contract after such date.

However, if after a derivative or class of derivatives is determined to be a mandatory clearable derivative, there is another transaction in that same derivative, including a material amendment to a previous transaction (as discussed in subsection 1(1) above), that derivative will be subject to the mandatory central counterparty clearing requirement.

Where a derivative is not subject to the mandatory central counterparty clearing requirement but the derivative is clearable through a regulated clearing agency, the counterparties have the option to submit the derivative for clearing at any time. For a complex swap with non-standard terms that regulated clearing agencies cannot accept for clearing, adherence to the Instrument would not require market participants to structure such derivative in a particular manner or disentangle the derivative in order to clear the component which is a mandatory clearable derivative if it serves legitimate business purposes. However, considering that it would not require disentangling, we would expect the component of a packaged transaction that is a mandatory clearable derivative to be cleared.

For a local counterparty that is not a participant of a regulated clearing agency, we have used the phrase "cause to be submitted" to refer to the local counterparty's obligation. In order to comply with subsection (1), a local counterparty would need to have arrangements in place with a participant for clearing services in advance of entering into a mandatory clearable derivative.

A transaction in a mandatory clearable derivative is required to be cleared when at least one of the counterparties is a local counterparty and one or more of paragraphs (a), (b) or (c) apply to both counterparties. For example, a local counterparty under any of paragraphs (a), (b) or (c) must clear a mandatory clearable derivative entered into with another local counterparty under any of paragraphs (a), (b) or (c). As a further example, a local counterparty under any of paragraphs (a), (b) or (c) must also clear a mandatory clearable derivative with a foreign counterparty under paragraphs (a) or (b). For instance, a local counterparty that is an affiliated entity of a foreign participant would be subject to mandatory central counterparty clearing for a mandatory clearable derivative with a foreign counterparty that is an affiliated entity of another foreign participant considering that there is one local counterparty to the transaction and both counterparties meet the criteria under paragraph (b).

Pursuant to paragraph (c) a local counterparty that had a month-end gross notional amount of outstanding derivatives exceeding the $500 000 000 000 threshold in subparagraph (c)(ii) must clear a mandatory clearable derivative entered into with another counterparty that meets the criteria under paragraph (a), (b) or (c). In order to determine whether the $500 000 000 000 threshold in subparagraph (c)(ii) is exceeded, a local counterparty must add the gross notional amount of all outstanding derivatives of its affiliated entities that are also local counterparties, to its own. However, investments funds and consolidated structured entities that meet the criteria under subsections 3(0.1) and (0.2) are not included in the calculation.

Where a local counterparty is a member of a group of affiliated entities that exceeds the $500 000 000 000 threshold but is not itself a counterparty to derivatives that have an average month-end gross notional amount exceeding the $1 000 000 000 threshold, calculated in accordance with subparagraph (c)(iii), it is not required to clear a mandatory clearable derivative.

A person or company that exceeds the $1 000 000 000 notional exposure, calculated according to paragraphs (b) and (c), is required to fulfill the mandatory clearing requirement from September 1 of a given year until August 31 of the next year. This is referred to as the "reference period" in the Instrument.

For example, local counterparty XYZ has had an average month-end gross notional amount under all outstanding derivatives of $75 000 000 000 for the months of March, April and May of 2021. Counterparty XYZ has also had, combined with each of its affiliated entities that are local counterparties, a month-end gross notional amount for all derivatives of $525 000 000 000 at the end of November 2020. Considering that the aggregated month-end gross notional amount outstanding of $525 000 000 000 exceeds

the $500 000 000 000 threshold and that it occurred during the previous 12 months, and that the average month-end gross notional amount of the $75 000 000 000 for March, April and May exceeds the $1 000 000 000 threshold, counterparty XYZ will need to comply with the Instrument. As such, a local counterparty that does not exceed, on its own, the $1 000 000 000 threshold is not required to clear even if the aggregated month-end gross notional amount outstanding with all of its affiliated entities exceeds the $500 000 000 000 threshold.

Furthermore, in the example, a local counterparty that was subject to mandatory clearing from September 1, 2022 until August 31, 2023, and that no longer exceeds the $1 000 000 000 threshold for the months of March, April and May of 2023, will no longer be required to comply with section 3 for the next reference period starting September 1, 2023. However, the local counterparty will have to evaluate its application every year. Consequently, if a local counterparty exceeds the $1 000 000 000 threshold again in a future year, it will become subject to the requirements of the Instrument until the following year.

The calculation of the gross notional amount outstanding under paragraphs (b) and (c) excludes derivatives with affiliated entities whose financial statements are prepared on a consolidated basis, which would be exempted under section 7 if they were mandatory clearable derivatives.

In addition, a local counterparty determines whether it exceeds the threshold in subparagraph (c)(ii) by adding the gross notional amount of all outstanding derivatives of its affiliated entities that are also local counterparties, to its own.

A local counterparty that is a participant at a regulated clearing agency, but does not subscribe to clearing services for the class of derivatives to which the mandatory clearable derivative belongs would still be required to clear if it is subject to paragraph (c).

A local counterparty subject to mandatory central counterparty clearing that engages in a mandatory clearable derivative is responsible for determining whether the other counterparty is also subject to mandatory central counterparty clearing. To do so, the local counterparty may rely on the factual statements made by the other counterparty, provided that it does not have reasonable grounds to believe that such statements are false.

We would not expect that all the counterparties of a local counterparty provide their status as most counterparties would not be subject to the Instrument. However, a local counterparty cannot rely on the absence of a declaration from a counterparty to avoid the requirement to clear. Instead, when no information is provided by a counterparty, the local counterparty may use factual statements or available information to assess whether the mandatory clearable derivative is required to be cleared in accordance with the Instrument.

We would expect counterparties subject to the Instrument to exercise reasonable judgement in determining whether a person or company may be near or above the thresholds set out in paragraphs (b) and (c). We would expect a counterparty subject to the Instrument to solicit confirmation from its counterparty where there is reasonable basis to believe that the counterparty may be near or above any of the thresholds.

The status of a counterparty under this subsection should be determined before entering into a mandatory clearable derivative. We would not expect a local counterparty to clear a mandatory clearable derivative entered into after the date on which the requirement to submit a mandatory clearable derivative for clearing is applicable to that counterparty, but before one of the counterparties was captured under one of paragraphs (a), (b) or (c) unless there is a material amendment to the derivative.

Subsection 3(2) – 90-day transition

This subsection provides that only transactions in mandatory clearable derivatives executed on or after the 90th day after the end of the month in which the local counterparty first exceeded the threshold are subject to subsection 3(1). We do not intend that transactions executed between the 1st day on which the local counterparty became subject to subsection 3(1) and the 90th day be back-loaded after the 90th day.

Subsection 3(3) – Submission to a regulated clearing agency

We would expect that a transaction subject to mandatory central counterparty clearing be submitted to a regulated clearing agency as soon as practicable, but no later than the end of the day on which the transaction was executed or if the transaction occurs after business hours of the regulated clearing agency, the next business day.

Subsection 3(5) – Substituted compliance

Substituted compliance is only available to a local counterparty that is a foreign affiliated entity of a counterparty organized under the laws of the local jurisdiction or with a head office or principal place of business in the local jurisdiction and that is responsible for all or substantially all the liabilities of the affiliated entity. The local counterparty would still be subject to the Instrument, but its mandatory clearable derivatives, as per the definition under the Instrument, may be cleared at a clearing agency pursuant to a foreign law listed in Appendix B if the counterparty is subject to and compliant with that foreign law.

Despite the ability to clear pursuant to a foreign law listed in Appendix B, the local counterparty is still required to fulfill the other requirements in the Instrument, as applicable. This includes the retention period for the record keeping requirement.

4. The third paragraph of subsection 7(1) is deleted.

5. Subsections 7(2) and (3) are deleted.

6. PART 4 MANDATORY CLEARABLE DERIVATIVES and PART 6 TRANSITION AND EFFECTIVE DATE are replaced with the following:

APPENDIX A MANDATORY CLEARABLE DERIVATIVES

In the course of determining whether a derivative or class of derivatives will be subject to mandatory central counterparty clearing, the factors we will consider include the following:

- the derivative is available to be cleared on a regulated clearing agency;
- the level of standardization of the derivative, such as the availability of electronic processing, the existence of master agreements, product definitions and short form confirmations;
- the effect of central clearing of the derivative on the mitigation of systemic risk, taking into account the size of the market for the derivative and the available resources of the regulated clearing agency to clear the derivative;
- whether mandating the derivative or class of derivatives to be cleared would bring undue risk to regulated clearing agencies;
- the outstanding notional amount of the counterparties transacting in the derivative or class of derivatives, the current liquidity in the market for the derivative or class of derivatives, the concentration of participants active in the market for the derivative or class of derivatives, and the availability of reliable and timely pricing data;
- the existence of third-party vendors providing pricing services;
- with regards to a regulated clearing agency, the existence of an appropriate rule framework, and the existence of capacity, operational expertise and resources, and credit support infrastructure to clear the derivative on terms that are consistent with the material terms and trading conventions on which the derivative is traded;
- whether a regulated clearing agency would be able to manage the risk of the additional derivatives that might be submitted due to the mandatory central counterparty clearing requirement determination;
- the effect on competition, taking into account appropriate fees and charges applied to clearing, and whether mandating clearing of the derivative could harm competition;
- alternative derivatives or clearing services co-existing in the same market;
- the public interest.

7. Form 94-101F1 Intragroup Exemption and Form 94-101F2 Derivatives Clearing Services are deleled.

8. These changes become effective on (insert date).