

## **Canadian Securities Administrators (CSA) Consultation Paper 92-401 – Derivatives Trading Facilities**

On January 29, 2015, the CSA released for public comment a consultation paper on the subject of trading of over-the-counter (OTC) derivatives in Canada. The paper sets out a policy framework for implementing in Canada the G20 commitment to require that standardized OTC derivatives be traded on exchanges or electronic trading platforms.

The paper outlines a two-pronged approach to meeting the G20 commitment. The focus is on two key outcomes:

- developing a regulatory framework for a new category of regulated facility for the trading of derivatives to be known as a “derivatives trading facility” (DTF)
- determining criteria for identifying appropriate OTC derivatives to be mandated to be traded exclusively through a DTF

### **What is a DTF?**

Under the CSA proposal, a DTF is defined as a facility or market that brings together the orders of multiple buyers and multiple sellers of OTC derivatives, and uses methods under which the orders interact with each other and the buyers and sellers agree to the terms of trades.

The definition will not capture bilateral or one-to-many facilities such as single-dealer platforms. Any OTC derivatives mandated to trade exclusively on DTFs in the future (see “Mandatory Trading” below) will not be eligible for trading on such bilateral facilities.

DTFs will be permitted to use a variety of execution methods, including request-for-quote, continuous or periodic order book, request-for-stream, voice, or hybrid voice-electronic execution methods. The CSA is considering whether to require a DTF that offers trading in a class of derivatives that is the subject of a future DTF-trading mandate to provide a minimum order book functionality—comparable to that required of SEFs in the US - by way of an RFQ system in conjunction with an order book.

### **DERIVATIVES TRADING FACILITY (DTF)**

A facility or market that brings together the orders of multiple buyers and multiple sellers of OTC derivatives, and uses methods under which the orders interact with each other and the buyers and sellers agree to the terms of trades.

### **Transparency Requirements**

DTFs will not be required to provide a particular level of pre-trade transparency for OTC derivatives that are not subject to a mandatory trading requirement. However, where transactions are executed by a method (such as an order book) that inherently provides a degree of pre-trade transparency, DTFs will not be permitted to unreasonably limit participants’ access to such information.

With regard to post-trade transparency, DTFs will be required to report to the public transactions executed on its facility in as close to real-time as possible. Deferred publication would be permitted in certain circumstances, such as for block trades. Additionally, DTFs would be required to provide certain market information to the general public at no charge on a delayed basis. Although there is no requirement to do so, a DTF may disseminate real-time data.

The CSA is considering enhanced transparency requirements for DTFs where an OTC derivative becomes subject to a trading mandate. For example, a DTF that offers order book trading would be required to provide pre-trade disclosure to all users of its facilities of current bid and offer prices and market depths. Pre-trade transparency would be tailored to the form of execution method. Exemptions from pre-trade transparency requirements would also be available for orders that, because of their size, would expose liquidity providers to undue risk.

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## Mandatory Trading

The CSA does not propose to immediately implement mandatory trading of OTC derivatives, stating that it first needs more data on liquidity of various classes of OTC derivatives in Canada. However, the CSA recommends in principle that sufficiently liquid and standardized OTC derivatives will be required to trade exclusively through a DTF.

The CSA proposes the following factors be considered in determining whether a class of OTC derivatives will be subject to trade on a DTF:

- whether or not the class of OTC derivatives is subject to a clearing mandate
- whether or not the class is sufficient liquid and standardized
- whether or not the class is subject to a similar trading mandate in other jurisdictions, or already trading through a DTF or foreign trading platform

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## Further Study

The CSA anticipates being able to recommend particular OTC derivatives as suitable for mandatory DTF trading after trade reporting and clearing obligations have been in effect for a period of time and member jurisdictions have had sufficient time to analyze the resulting data and carry out further consultations with other Canadian authorities and the public. The CSA has published a model rule for mandatory clearing of OTC derivatives in Canada, while CSA rules requiring reporting of OTC derivatives are in various stages of implementation by member jurisdictions.

The CSA will continue to monitor developments in the marketplace in respect of the trading mandate that has recently come into effect in the US for certain interest rate and credit derivatives and that it will closely gauge the level of adoption and the consequences, intended or otherwise, of the DTF trading mandate on OTC derivatives markets.

## Looking Forward

The CSA acknowledges that the OTC derivatives market in Canada could benefit from a regulatory framework that has sufficient flexibility to accommodate the unique features of OTC derivatives trading, including discretionary execution methods. While this is positive news for market participants in Canada, there will be some discussion surrounding the timing of implementing these rules, and whether or not Canada is falling behind its G20 counterparts in the US and EU with respect to the requirement that standardized OTC derivatives trade on multilateral platforms.

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