

CSA Notice and Request for Comment

Proposed National Instrument 93-101 *Derivatives: Business Conduct*

Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*

April 4, 2017

Introduction

We, the Canadian Securities Administrators (the **CSA** or **we**), are publishing the following for a 150-day comment period, expiring on September 1, 2017:

- Proposed National Instrument 93-101 *Derivatives: Business Conduct* (the **Instrument**);
- Proposed Companion Policy 93-101 *Derivatives: Business Conduct* (the **CP**).

Collectively, the Instrument and the CP are referred to as the **Proposed Instrument** in this Notice.

We are issuing this Notice to solicit comments on the Proposed Instrument. We welcome all comments on this publication and have also included specific questions in the Comments section.

The CSA intends to collaborate with the Bank of Canada, the Office of the Superintendent of Financial Institutions (Canada), and the Department of Finance (Canada) on the Proposed Instrument throughout its development.

We are also in the process of developing a proposed registration regime for derivatives dealers, derivatives advisers and potentially other derivatives market participants. We expect to publish Proposed National Instrument 93-102 *Derivatives: Registration* and a related companion policy (collectively the **Proposed Registration Instrument**) for comment during the consultation period for the Proposed Instrument.

We have extended the comment period on the Proposed Instrument to 150 days in order to allow investors, derivatives market participants and other stakeholders an opportunity to consider both of the proposed instruments before the comment period for the Proposed Instrument expires.

Background

In April 2013, the CSA published for comment a consultation paper, CSA Consultation Paper 91-407 *Derivatives: Registration* (the **Consultation Paper**), that outlined a proposed registration and business conduct regime for derivatives market participants.

Based on our consideration of comments received on the Consultation Paper as well as our review of developments internationally, including the introduction of registration and market conduct regimes for swap dealers and major swap participants in the U.S.,¹ we have developed the Proposed Instrument and are in the process of developing the Proposed Registration Instrument for the purpose of adopting a harmonized derivatives registration and business conduct regime across Canada.

The CSA have chosen to split the proposed derivatives registration and business conduct regimes into two separate rules. This approach is intended to ensure that all derivatives firms remain subject to certain minimum standards in relation to their business conduct towards their customers and counterparties.

The Proposed Instrument applies to a person or company that meets the definition of “derivatives adviser” or “derivatives dealer” regardless of whether it is registered or exempted from the requirement to be registered in a jurisdiction.

Substance and Purpose of the Proposed Instrument

The CSA have developed the Proposed Instrument to help protect investors, reduce risk, improve transparency and accountability and promote responsible business conduct in the over-the-counter (**OTC**) derivatives markets.

During the financial crisis of 2008, the inappropriate sale of financial investments led to major losses for retail and institutional investors. The International Organization of Securities Commissions (**IOSCO**) noted in 2012 that “until recently, OTC derivatives markets have not been subject to the same level of regulation as securities markets. Insufficient regulation allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008.”² Since the financial crisis, there have been numerous cases of serious market misconduct in the global derivatives market including, for example, misconduct relating to the manipulation of benchmarks and alleged front-running of customer orders.

¹ In this Notice, we use the terms “swap dealer” and “major swap participant” to refer to both swap dealers and major swap participants regulated by the Commodity Futures Trading Commission (**CFTC**) and securities-based swap dealers and securities-based swap participants regulated by the Securities and Exchange Commission (the **SEC**). In Canada, the distinction between security-based swaps and other swaps will generally not be relevant.

² <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD381.pdf> (DMI Report) at p 1.

The Proposed Instrument establishes a robust investor protection regime that meets IOSCO’s international standards and takes into account CSA jurisdictions’ commitments to create a derivatives dealer regime that is also consistent with the regulatory approach taken by most IOSCO jurisdictions with active derivatives markets.³ The Proposed Instrument will help to protect participants in the OTC derivatives markets from unfair, improper or fraudulent practices.

The Proposed Instrument is intended to create a uniform approach to derivatives market conduct regulation in Canada and will promote consistent protections for market participants regardless of the type of firms they deal with while also providing that persons or companies that are subject to requirements under the Proposed Instrument are subject to consistent regulation that does not result in a competitive advantage.

A person or company is subject to the Proposed Instrument only if it is a “derivatives adviser” or a “derivatives dealer”. As described below in the Summary of the Instrument, generally this is determined using a test to determine if the person or company is in the business of trading or advising in OTC derivatives.⁴ Furthermore, a person or company that may be in the business of trading in OTC derivatives may nevertheless be exempt from the requirements of the Proposed Instrument if they qualify for the end-user exemption described further below. Finally, even if a person or company is subject to the requirements of the Proposed Instrument, those requirements are tailored depending on the nature of the dealer or adviser’s derivatives party (refer to the description of the two-tiered structure of the Instrument, below).

The Proposed Instrument sets out a comprehensive regime regulating the conduct of derivatives market participants, including requirements relating to the following:

- Fair dealing
- Conflicts of interest
- Know your client (KYC)
- Suitability
- Pre-trade disclosure
- Reporting
- Compliance
- Senior management duties
- Recordkeeping
- Treatment of derivative party assets

Many of the requirements in the Proposed Instrument are similar to existing market conduct requirements applicable to registered dealers and advisers under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) but have been modified to reflect the different nature of derivatives markets.

³ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD497.pdf> (DMI Implementation Review) at p. 13.

⁴ Only those OTC derivatives set out in the applicable Product Determination Rule are relevant.

Much like NI 31-103, the Proposed Instrument takes a two-tiered approach to investor/customer protection, as follows:

- certain obligations apply in all cases when a derivatives firm is dealing with or advising a derivatives party, regardless of the level of sophistication or financial resources of the derivatives party; and
- certain obligations:
 - do not apply if the derivatives firm is dealing with or advising a derivatives party that is an “eligible derivatives party” and that is not an individual, and
 - apply but may be waived if the derivatives firm is dealing with or advising a derivatives party who is an “eligible derivatives party” and is an individual.

The concept of “eligible derivatives party” and the extent to which obligations do not apply, or apply unless waived, when dealing with or advising an eligible derivatives party are explained in Part 1 of the summary of the Instrument below.

Summary of the Instrument

Part 1 – Definitions

Part 1 of the Instrument sets out relevant definitions and principles of interpretation.

Some of the most important definitions in the Instrument are as follows.

Derivatives adviser and derivatives dealer

The definitions of “derivatives adviser” and “derivatives dealer” incorporate a “business trigger” similar to the business trigger for registration in Canadian securities legislation.

As previously mentioned, it is important to note that the Instrument applies to a person or company that meets the definition of “derivatives adviser” or “derivatives dealer” regardless of whether they are registered or exempted from the requirement to be registered in a jurisdiction. This is intended to ensure that certain derivatives market participants that may benefit from an exemption from registration in certain jurisdictions nevertheless remain subject to certain minimum standards in relation to their business conduct towards their customers.

Clause (b) in the definitions of “derivatives adviser” and “derivatives dealer” has been included since the Proposed Registration Instrument may designate as or prescribe additional entities to be derivatives advisers or derivatives dealers based on specified activities (e.g., trading with non-eligible derivatives parties or engaging in certain market-making activities).

Derivatives party

In the Proposed Instrument, the term “derivatives party” refers to a derivatives firm’s counterparties, customers, and other persons or companies that the derivatives firm may deal with or advise (e.g., affiliates or other derivatives firms).

Eligible derivatives party

The term “eligible derivatives party” refers to those derivatives parties that do not require the full set of protections afforded to “retail” customers or investors, either because they may reasonably be considered sophisticated or because they have sufficient financial resources to purchase professional advice or otherwise protect themselves through contractual negotiation with the derivatives firm.

As currently drafted, the definition of “eligible derivatives party” is generally consistent with the current regulatory regimes in the U.S. and Canada in relation to OTC derivatives.⁵ In addition, the eligible derivatives party concept should be familiar to market participants because it is similar to the definition of “permitted client” in NI 31-103, with a few modifications to reflect the different nature of derivatives markets and participants.

We are seeking comment on a number of elements of the definition of “eligible derivatives party” and have included specific questions about the definition in the Comments section, including a question related to the proposed definition of “institutional client” included in the CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives toward their Clients (CSA Consultation Paper 33-404)* published in April 2016.

As the CSA staff responsible for CSA Consultation Paper 33-404 continue to review comments received during the consultation period and engage in various stakeholder consultations, we propose to monitor the work on this project, and may recommend amendments to the Proposed Instrument at a later date based on this work.

Part 2 – Application of the Instrument

Part 2 of the Instrument sets out a number of provisions relating to the application and scope of the Instrument.

⁵ See, for example, the definition of “eligible contract participant” under the U.S. *Commodity Exchange Act* and the *Securities Exchange Act of 1934* applicable to CFTC and SEC swap dealers and major swap participants, the definition of “qualified party” in British Columbia Blanket Order 91-501 *Over-the-Counter Derivatives*, the definition of “qualified party” in Alberta Blanket Order 91-507 *Over-the-Counter Derivatives*, the definition of “accredited counterparty” in section 3 of the *Quebec Derivatives Act*, the definition of “qualified party” in New Brunswick Local Rule 91-501 *Derivatives*, the definition of “qualified party” in Nova Scotia Blanket Order 91-501 *Over The Counter Trades in Derivatives* and the definition of “qualified party” in Saskatchewan General Order 91-908 *Over-the-Counter Derivatives*.

Section 3 is a scope provision intended to ensure that the Instrument applies to the same contracts and instruments in all jurisdictions of Canada. Each jurisdiction has adopted a Product Determination Rule that excludes certain types of contracts and instruments from being derivatives for the purpose of the Instrument.

Section 7 provides that the requirements of the Instrument, other than the specific requirements listed in subsection 7(1), do not apply to a derivatives firm if it is dealing with or advising an eligible derivatives party that is not an individual, or an eligible derivatives party that is an individual that has waived these protections in writing (collectively, a **specified eligible derivatives party**).

When a derivatives firm is dealing with or advising a specified eligible derivatives party, the derivatives firm will only be subject to the following requirements of the Instrument:

- (a) Division 1 [*General obligations towards all derivatives parties*] of Part 3 [*Dealing with or advising derivatives parties*];
- (b) Sections 24 [*Interaction with NI 94-102*] and 25 [*Segregating derivatives party assets*] of Part 4 [*Derivatives party accounts*];
- (c) Subsection 29(1) [*Content and delivery of transaction confirmations*] of Part 4 [*Derivatives party accounts*]; and
- (d) Part 5 [*Compliance and recordkeeping*].

A derivatives firm and a specified eligible derivatives party may choose to incorporate additional protections in the contracts that govern their relationship and their derivatives trading activities. However, the CSA are of the view that, in the case of a derivatives firm dealing with or advising a specified eligible derivatives party these protections should not be required but rather should be a matter of contract for the parties.

Despite the foregoing, section 7 does not limit the requirements that apply to a derivatives firm acting as an adviser in respect of a managed account of an eligible derivatives party.

We have included specific questions about the differential treatment of derivatives parties and specified eligible derivatives parties in the Comments section.

We have also included a table that compares the approach in the Instrument with the approach under NI 31-103 in Appendix B.

Part 3 – Dealing with or advising derivatives parties

DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES

Division 1 of Part 3 sets out the fundamental business conduct obligations that the CSA

have recommended should apply to all derivatives firms when dealing with or advising derivatives parties, including eligible derivatives parties, namely

- fair dealing,
- responding to conflicts of interest, and
- general (or “gatekeeper”) know-your-derivatives party obligations.

Fair dealing

The fair dealing obligation proposed in section 8 of this Instrument is consistent with international practice and is in line with the standards set by NI 31-103 while keeping in mind the differences between derivatives and securities markets. The CSA believe that the fair dealing obligation in section 8, as a principles-based obligation, should be interpreted flexibly and in a manner that is sensitive to context and to derivatives market participants’ reasonable expectations; the expectation is that it will be applied differently depending on the sophistication of the market participant.

Identifying and responding to conflicts of interest

Section 9 of the Instrument contains obligations to identify and respond to conflicts of interest. This obligation applies when dealing with or advising market participants of all levels of sophistication. It is a principles-based obligation, which should be interpreted flexibly and in a manner that is sensitive to context and to derivatives market participants’ reasonable expectations. Furthermore, it is expected that in responding to any conflict of interest, the derivatives party will consider the fair dealing obligation in Part 3 as well as any other standard of care that may apply when dealing with or advising a derivatives party.

General (or “gatekeeper”) know-your-derivatives party obligations

Section 10 of the Instrument sets out the general “gatekeeper” know-your-derivatives party (**KYDP**) obligations. These obligations include requirements to: verify the identity of a derivatives party, verify that the derivatives party is an eligible derivatives party, determine if the derivatives party is an insider of a reporting issuer, and comply with anti-money-laundering and terrorist financing obligations.

We would anticipate that many derivatives firms, including Canadian financial institutions, will already have policies and procedures in place to address these obligations and that section 10 should not result in any significant new obligations for these entities.

DIVISION 2 – ADDITIONAL OBLIGATIONS WHEN DEALING WITH OR ADVISING CERTAIN DERIVATIVES PARTIES

The obligations in Division 2 of Part 3 do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

These obligations are intended to protect less sophisticated market participants. These include but are not limited to:

Derivatives-party-specific needs and objectives

Section 11 sets out the obligation on a derivatives firm to obtain information about a derivatives party's specific investment needs and objectives in order for the derivatives firm to meet its suitability obligations under section 12 and to assess a transaction under subsection 19(1).

Information on a derivatives party's specific needs and objectives (sometimes referred to as "client-specific KYC information") forms the basis for determining whether transactions in derivatives are suitable for a derivatives party or the terms of the transaction are the most advantageous. The obligations in section 11 require a derivatives firm to take reasonable steps to obtain and periodically update information about its derivatives parties.

Suitability

Section 12 requires a derivatives firm to take reasonable steps to ensure that a proposed transaction is suitable for a derivatives party before making a recommendation or accepting instructions from the derivatives party to transact in a derivative.

Disclosure regarding the use of borrowed money or leverage

Section 16 requires a derivatives firm to provide a risk disclosure to a derivatives party before a transaction takes place, which explains that the leverage inherent in derivatives may require the derivatives party to deposit additional funds if the value of the derivative declines and that borrowing money or using leverage to fund a derivatives transaction carries additional risk.

DIVISION 3 – RESTRICTIONS ON CERTAIN BUSINESS PRACTICES WHEN DEALING WITH CERTAIN DERIVATIVES PARTIES

The obligations in Division 3 focus on restricting certain business activities when dealing with less sophisticated derivatives parties. These obligations relate to tied selling and fair terms and pricing. The obligations in this Division do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

Tied selling

Section 18 prohibits a derivatives firm from engaging in certain sales practices that would pressure or require a derivatives party to obtain a product or service as a condition of obtaining other products or services from the derivatives firm. An example of tied selling would be offering a loan on the condition that the derivatives party purchase another product or service, such as a swap to hedge the loan from the derivatives firm or one of its affiliates.

As explained in the CP, section 18 is not intended to prohibit relationship pricing or other beneficial selling arrangements similar to relationship pricing. Relationship pricing refers to the practice of industry participants offering financial incentives or advantages to certain derivatives parties.

Fair terms and pricing

Subsection 19(1) imposes an obligation on derivatives firms to implement policies and procedures that are reasonably designed to obtain the most advantageous terms reasonably available when acting as agent for a derivatives party. Subsection 19(2) requires derivatives dealers, when transacting with a derivatives party as principal to make a reasonable effort to provide a price that is fair and reasonable taking into account all relevant factors.

Part 4 – Derivatives Party Accounts

DIVISION 1 - DISCLOSURE TO DERIVATIVES PARTIES

The CSA believe that less sophisticated derivatives parties, or those individuals who would like a higher level of protection, need more detailed information concerning their transactions and their accounts. Below are some of the requirements designed to keep derivatives parties informed. The obligations in this Division do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

Section 20 requires a derivatives firm to provide a derivatives party with all information that the derivatives party needs to understand not only their relationship with the derivatives firm but also the products and services that the derivatives firm will or may provide and the fees or other charges that the derivatives party may be required to pay.

Subsection 21(1) sets out the obligation for a derivatives firm to provide a derivatives party with disclosure relating to the type of derivative that is reasonably designed to allow the derivatives party to assess the material risks of transacting in the derivative. This includes the derivatives party's potential exposure and the material characteristics of the derivative which include the material economic terms and the rights and obligations of the counterparties to the type of derivative.

In addition, subsection 21(2) establishes obligations, before transacting a specific derivative, to advise the derivatives party about material risks in relation to the specific derivative that are materially different than the risks disclosed under subsection 21(1) and, if applicable, the price of the derivative to be transacted and the most recent valuation.

Further to these obligations, section 22 requires a derivatives firm to provide a derivatives party with daily valuation of the derivatives that it has transacted with or on behalf of that derivatives party.

DIVISION 2 - DERIVATIVES PARTY ASSETS

Division 2 sets out certain requirements related to segregation and holding of derivatives party assets held by a derivatives firm, as well as restrictions on the use and investment of those assets.

The obligations in this Division, other than section 24 and section 25, do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

DIVISION 3 - REPORTING TO DERIVATIVES PARTIES

Division 3 sets out obligations of derivatives firms to provide certain reports to derivatives parties.

Section 29 provides that a derivatives firm must provide a confirmation of the key elements of a derivatives transaction. The contents of this confirmation are set out in subsection 29(2).

Section 30 sets out the obligations of a derivatives firm to provide monthly statements to derivatives parties. Subsection 30(2) describes the information that must be provided in the monthly statement.

The obligations in this Division, other than the fundamental transaction confirmation requirement in subsection 29(1), do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

Part 5 - Compliance and recordkeeping

DIVISION 1 - COMPLIANCE

Section 32 provides that a derivatives firm must have policies and procedures that establish a system of controls to assure that, with respect to transacting or advising on derivatives, the firms and individuals acting on its behalf comply with applicable laws, to manage risk and to ensure that individuals have the necessary training and expertise.

Section 33 imposes certain supervisory, management, and reporting obligations on

“senior derivatives managers”. These requirements are intended to create accountability at the senior management level. The CSA are monitoring international regulatory initiatives⁶ designed to ensure that senior managers bear responsibility for the effective and efficient management of their business units. A senior derivatives manager is an individual that is responsible for the derivatives activities of a particular business unit (e.g., the individual responsible for, or head of, interest rate trading or the “rates desk” at a derivatives firm). Senior derivatives managers must supervise compliance activities, promote compliance, and take steps to prevent and respond to non-compliance. At least annually, senior derivatives managers must also report to the firm’s board of directors, either to certify that the business unit is in material compliance with all applicable securities legislation, or to specify circumstances of material non-compliance.

Section 34 sets out the requirement of a derivatives firm to respond to material non-compliance, and in certain circumstances to report material non-compliance to the regulator or securities regulatory authority.

Part 6 - Exemptions

DIVISION 1 - EXEMPTIONS FROM THE INSTRUMENT

Section 38 provides that persons or companies that are registered under securities legislation, in Canada or a foreign jurisdiction, do not qualify for the exemption in section 39.

Section 39 provides that derivatives end-users (e.g., entities that trade derivatives for their own account for commercial purposes) are exempt from the Instrument provided they do not do any of the following:

- solicit or otherwise transact in a derivative with, for or on behalf of a person or company that is not an eligible derivatives party;
- advise persons or companies in respect of transactions in derivatives, if the person or company is not an eligible derivatives party, other than general advice that is provided in accordance with the conditions of section 43;
- regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party;
- regularly facilitate or otherwise intermediate transactions in derivatives for another person or company;
- facilitate the clearing of a transaction in a derivative through the facilities of a clearing agency for a third-party, other than an affiliated entity.

⁶ See for example <https://www.fca.org.uk/firms/senior-managers-certification-regime> and <http://www.sfc.hk/web/EN/faqs/intermediaries/licensing/manager-in-charge-regime.html>

DIVISION 2 AND DIVISION 3 - EXEMPTIONS FROM SPECIFIC REQUIREMENTS OF THE INSTRUMENT

Foreign derivatives dealers and foreign derivatives advisers

These Divisions provide, under certain conditions, an exemption from requirements in the Instrument for foreign derivatives dealers and foreign derivatives advisers that are regulated under the laws of a foreign jurisdiction that achieve substantially the same objectives, on an outcomes basis, as the Proposed Instrument.

These exemptions apply to the provisions of the Instrument where the derivatives dealer or derivatives adviser is subject to and in compliance with the laws of a foreign jurisdiction set out in Appendix A and Appendix D of the Instrument opposite the name of the foreign jurisdiction. The jurisdictions specified in Appendices A and D will be determined on a jurisdiction-by-jurisdiction basis, and based on a review of the laws and regulatory framework of the jurisdiction.

Note that as of the time of this publication for comment, the equivalence analysis required to populate Appendices A and D of the Instrument has not been completed.

DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS

Advising generally

Division 3 provides an exemption for persons and companies that provide general advice in relation to derivatives, where the advice is not tailored to the needs of the person or company receiving the advice (e.g., analysis published in mass media), and the person or company discloses all financial or other interests in relation to the advice.

Anticipated Costs and Benefits

The CSA have developed the Proposed Instrument to help protect investors and counterparties, reduce risk, improve transparency and accountability and promote responsible business conduct in the OTC derivatives markets.

We are proposing an investor protection regime for Canadian OTC derivatives parties that is equivalent to the protections offered in major international markets and also targets misconduct that could impact the Canadian market.

There will be compliance costs for derivatives firms that may increase the cost of trading or receiving advice for market participants. In the CSA's view, the compliance costs to market participants are proportionate to the benefits to the Canadian market of implementing the Proposed Instrument. The major benefits and costs of the Proposed Instrument are described below.

(a) Benefits

The Proposed Instrument will protect participants in the Canadian OTC derivatives market by reducing the likelihood of suffering loss through inappropriate transactions, inappropriate sale of derivatives and market misconduct. The Proposed Instrument offers protections not only to retail market participants but also large market participants whose derivatives losses could impact their business operations and potentially the Canadian economy more broadly. The Proposed Instrument fills a regulatory gap in the Canadian OTC derivatives market for certain derivatives firms that are not subject to business conduct regulation and oversight. It is intended to foster confidence in the Canadian derivatives market by creating a regime that meets international standards and is equivalent to the regimes in major trading jurisdictions. Currently, OTC derivatives are regulated differently across Canadian jurisdictions, and there is inconsistency in regulation of business conduct in OTC derivatives markets. The Proposed Instrument aims to reduce compliance costs for derivatives firms by harmonizing the rules across Canadian jurisdictions and establishing a regime that is tailored for the derivatives market.

(b) Costs

Generally, any increased costs resulting from compliance with the Proposed Instrument are expected to arise from analysing the requirements put forth and establishing policies and procedures for compliance. Any costs associated with complying with the Proposed Instrument are expected to be borne by derivatives firms and in certain circumstances may be passed on to derivatives parties. There is also a possibility that foreign derivatives firms may be dissuaded from entering or remaining in the Canadian market due to the costs of complying with the Proposed Instrument, which would reduce Canadian derivatives parties' options for derivatives services. However the Proposed Instrument contemplates an exemption for derivatives firms located in foreign jurisdictions, which are subject to and in compliance with equivalent exemptions under foreign laws. This exemption could significantly reduce compliance costs associated with the Proposed Instrument for derivatives firms located in and complying with the laws of approved foreign jurisdictions.

(c) Conclusion

Protection of derivatives parties and the integrity of the Canadian derivatives market are the fundamental principles of the Proposed Instrument. The CSA are of the view that the impact of the Proposed Instrument, tailored for the OTC derivatives market, including anticipated compliance costs for derivatives firms, is proportional to the benefits sought. The Proposed Instrument aims to provide a level of protection similar to that offered to derivatives parties in other jurisdictions with significant OTC derivatives markets. To achieve a balance of interests, the Proposed Instrument is designed to promote a safer environment in the Canadian derivatives market by delivering a high level of protection to customers transacting in OTC derivatives and also facilitate a flexible and competitive market for derivatives firms to operate in.

Contents of Annexes

The following annexes form part of this CSA Notice:

- Annex I – Proposed National Instrument 93-101 *Derivatives: Business Conduct*
- Annex II – Proposed Companion Policy 93-101 *Derivatives: Business Conduct*
- Annex III – Local Matters

Comments

In addition to your comments on all aspects of the Proposed Instrument, the CSA also seek specific feedback on the following questions:

1) Definition of “eligible derivatives party”

As currently drafted, the definition of “eligible derivatives party” is generally similar to the definition of “permitted client” in NI 31-103, with a few modifications to reflect the different nature of derivatives markets and participants.

Do you agree this is the appropriate definition for this term? Are there additional categories that we should consider including, or categories that we should consider removing from this definition?

Should an individual qualify as an eligible derivatives party or should individuals always benefit from market conduct protections available to persons that are not eligible derivatives parties?

2) Alternative definition of “eligible derivatives party”

In the CSA Consultation Paper 33-404, it was put forth that certain proposed targeted reforms relating to the client-registrant relationship be tailored in their application to “institutional clients.” Proposed targeted reforms relating to suitability and KYC requirements would, for instance, not apply to registrants dealing with an institutional client.⁷

The CSA Consultation Paper 33-404 proposed a definition of “institutional client”⁸ which is generally similar to the definition of a “permitted client” in section 1.1 of NI 31-103. However, in comparison to the definition of “permitted client” in NI 31-103 (which refers in paragraph (o) to individuals that beneficially own a specified threshold of financial assets), the definition of “institutional client” in the Consultation Paper did not include individuals. Moreover, in comparison to paragraph (q) of the definition of

⁷ See (2016), 39 OSCB 3964 et seq.

⁸ For the proposed definition of “institutional client”, see (2016), 39 OSCB 3978 et seq.

“permitted client” (which refers to “a person or company, other than an individual or an investment fund, that has net assets of at least \$25 million as shown on its most recently prepared financial statements”), the following branch of the definition of “institutional client” proposed in the CSA Consultation Paper 33-404 would establish a higher financial threshold for non-individual entities:

(x) any other person or company, other than an individual, with financial assets, as defined in section 1.1 of National Instrument 45-106 Prospectus Exemptions, having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds \$100 million.

Please comment on whether it would be appropriate to use the definition of “institutional client” proposed in the April 28, 2016 CSA Consultation Paper 33-404 as the basis for definition of “eligible derivatives party” in the Proposed Instrument.

3) Knowledge and experience requirements in clauses (m) and (n) of the definition of “eligible derivatives party”

Clauses (m) and (n) of the definition of “eligible derivatives party” provide that a person or company may be an eligible derivatives party if they have represented in writing that they have the requisite knowledge and experience to evaluate, among other things, “the characteristics of the derivatives to be transacted”. The corresponding section of the companion policy notes that “some people or companies may only have the requisite knowledge and experience pertaining to derivatives of a certain asset class or product type”.

If a person or company only has the knowledge or experience to evaluate a specific type of derivative (for example a commodity derivative), should they be limited to being an eligible derivatives party for that type of derivative or should they be considered to be an eligible derivatives party for all types of derivatives?

Is it practical for a derivatives dealer or adviser to make the eligible derivatives party determination (and manage its relationships accordingly) at the product-type level, or it is only practicable for a derivatives dealer or adviser to treat a derivatives party as an eligible derivatives party (or not) for all purposes?

4) Two-tiered approach to requirements: eligible derivatives parties vs. all derivatives parties

Do you agree with the two-tiered approach to investor/customer protection in the Instrument? Are there additional requirements that a derivatives firm should be subject to even when dealing with or advising an eligible derivatives party? For example, should best execution or tied selling obligations, or other obligations in Division 2 of Part 3, also apply when a derivatives firm is dealing with or advising an eligible derivatives party?

Does the Proposed Instrument adequately account for current institutional OTC trading

practices? Are there requirements that apply to a derivatives firm in respect of an eligible derivatives party that should not apply, or that impose unreasonable burdens that would unnecessarily discourage trading in OTC derivatives in Canada?

Should the two-tiered approach apply to a derivatives adviser that is advising an eligible derivatives party?

5) Business trigger guidance

Part 1 of the CP sets out factors that are considered relevant in determining whether a person or company is in the business of trading or advising in derivatives. One of those factors is as follows:

Quoting prices or acting as a market maker – The person or company makes a two-way market in a derivative or routinely quotes prices at which they would be willing to transact in a derivative or offers to make a market in a derivative or derivatives.

Similarly, paragraph 39(c) of the Instrument provides that the exemption described therein is only available if “the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party”.

Does the guidance in the CP, along with 39(c) of the Instrument, appropriately describe the situation in which a person or company should be considered to be a derivatives dealer because they are functioning in the role of a market maker?

6) Fair Dealing

Is the proposed application of a flexible fair dealing model that is dependent on the relationship between the derivatives firm and its derivatives party appropriate?

7) Fair terms and pricing

Are the proposed requirements in section 19 of the Instrument relating to fair terms and pricing appropriate?

8) Derivatives Party Assets

National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* imposes obligations on clearing intermediaries that hold collateral on behalf of customers relating to derivatives cleared through a clearing agency that is a central counterparty. These requirements apply regardless of the sophistication of the customer. Division 2 of Part 4 of the Instrument imposes comparable obligations but does not apply if the derivatives party is not an eligible derivatives party.

Should Division 2 of Part 4 apply if the derivatives party is an eligible derivatives party?

9) Valuations for derivatives

Section 21, 22 and 30 require a derivatives firm to provide valuations for derivatives to their derivatives party. Should these valuations be accompanied by information on the inputs and assumptions that were used to create the valuation?

10) Senior derivatives managers

Section 33 of the Instrument imposes certain supervisory, management, and reporting obligations on “senior derivatives managers”, and section 34 imposes related duties on the firm to respond to reports of non-compliance, and in certain circumstances to report non-compliance to the regulator or securities regulatory authority.

Please comment on the proposed senior management requirements including whether the proposed obligations are practical to comply with, and the extent to which they do or do not reflect existing best practices.

11) Exemptions

Sections 40, 41, 42, and 44 of the Instrument contemplate exemptions for derivatives firms, conditional on being subject to and complying with equivalent domestic or foreign regulations. Please provide information on regulations that the CSA should consider for the equivalency analysis. Where possible, please provide specific references and information on relevant requirements and why they are equivalent, on an outcomes basis, to the requirements in the Instrument.

Please provide your comments in writing by **September 1, 2017**.

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 each of the Alberta Securities Commission at www.albertasecurities.com, the *Autorité des marchés financiers* at www.lautorite.qc.ca and the Ontario Securities Commission at 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:

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)

Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario 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
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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

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Appendix A

Comparison of protections that do not apply to, or may be waived by, “eligible derivatives parties” under Proposed NI 93-101 *Derivatives: Business Conduct* and “permitted clients” under NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

Certain requirements in the Proposed Instrument are similar to existing market conduct requirements applicable to registered dealers and advisers under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103)* but have been modified to reflect the different nature of derivatives markets.

The extent to which obligations do not apply, or apply unless waived, when dealing with or advising an eligible derivatives party is set out in the following chart:

Obligation	Approach under NI 31-103	Approach under NI 93-101
Fair dealing ⁹	Applies in respect of all clients	Applies in respect of all derivatives parties (s. 8)
Identifying and responding to conflicts of interest	Applies in respect of all clients (s. 13.4) However, client relationship disclosure obligations in relation to conflicts of interest do not apply in respect of a permitted client that is not an individual (s. 14.2(6))	Applies in respect of all derivatives parties (s. 9) However, relationship disclosure obligations in Part 4 in relation to conflicts of interest do not apply in respect of <ul style="list-style-type: none"> • an EDP that is not an individual

⁹ See section 2.1 of OSC Rule 31-505 *Conditions of Registration*; section 14 of the Securities Rules, B.C. Reg. 194/97 [**B.C. Regulations**] under the *Securities Act* (British Columbia), R.S.B.C. 1996, c. 418 [**B.C. Act**]; section 75.2 of the *Securities Act* (Alberta) R.S.A. 2000, c.S-4 [**Alberta Act**]; section 33.1 of *The Securities Act, 1988* (Saskatchewan), S.S. 1988-89, c. S-42.2 [**Saskatchewan Act**]; subsection 154.2(3) of *The Securities Act* (Manitoba) C.C.S.M. c. S50 [**Manitoba Act**]; section 65 of the *Derivatives Act* (Québec), R.S.Q., c. 14.01 [**Québec Act**]; section 39A of the *Securities Act* (Nova Scotia), R.S.N.S. 1989, c. 418 [**N.S. Act**]; subsection 54(1) of the *Securities Act* (New Brunswick) S.N.B. 2004, c. S-5.5 [**N.B. Act**]; section 90 of the *Securities Act* (Prince Edward Island), R.S.P.E.I. 1988, c. S-3.1 [**P.E.I. Act**]; subsection 26.2(1) of the *Securities Act* (Newfoundland and Labrador), R.S.N.L.1990, c. S-13 [**Newfoundland Act**]; section 90 of the *Securities Act* (Nunavut), S.Nu. 2008, c. 12 [**Nunavut Act**]; section 90 of the *Securities Act* (Northwest Territories), S.N.W.T. 2008, c. 10 [**N.W.T. Act**]; and section 90 of the *Securities Act* (Yukon), S.Y. 2007, c. 16 [**Yukon Act**].

		<ul style="list-style-type: none"> • an EDP that is an individual that has waived this disclosure
Gatekeeper KYC (AML, etc.)	<p>Applies in respect of all clients (s. 13.2)</p> <p>However, this does not apply if the client is a registered firm, Canadian financial institution or Schedule III bank (s. 13.2(5))</p>	<p>Applies in respect of all derivatives parties (s. 10)</p> <p>However, this does not apply if the derivatives party is a registered firm or a Canadian financial institution (including a Schedule III bank)</p>
Client-specific KYC (investment needs and objectives, etc.) Suitability	<p>Applies in respect of all clients (ss. 13.2(2)(c) and 13.3)</p> <p>May be waived in writing by a permitted client (including an individual permitted client) if registrant does not act as an adviser in respect of a managed account for the client</p> <p>(ss. 13.2(6) and 13.3(4))</p>	<p>Applies in respect of all derivatives parties other than</p> <ul style="list-style-type: none"> • an EDP that is not an individual • an EDP that is an individual that has waived in writing this obligation <p>(ss. 7, 11 and 12)</p>
Miscellaneous other obligations	<p>Do not apply to a permitted client</p> <ul style="list-style-type: none"> • Disclosure when recommending the use of borrowed money – s. 13.13(2) • When the firm has a relationship with a financial institution – s. 14.4(3) 	<p>Apply in respect of all derivatives parties other than</p> <ul style="list-style-type: none"> • an EDP that is not an individual • an EDP that is an individual that has waived in writing this obligation <p>(ss. 7 and 16)</p>
Miscellaneous other obligations	<p>Do not apply to a permitted client that is not an individual</p> <ul style="list-style-type: none"> • Dispute resolution service – s. 13.16(8) • Relationship disclosure information – s. 14.2(6) • Pre-trade disclosure of charges – s. 14.2.1(2), • Restriction on self-custody and qualified custodian requirement – s. 14.5.2 • Additional statements – s. 14.14.1 • Security position cost information – s. 14.14.2 • Report on charges and other compensation – s. 14.17 • Investment performance report – s. 14.18 	<p>Apply in respect of all derivatives parties other than</p> <ul style="list-style-type: none"> • an EDP that is not an individual • an EDP that is an individual that has waived in writing this obligation <p>(See s. 7 and Part 4)</p>

Appendix B

Application of business conduct requirements

Regulatory Requirement	Derivatives firms dealing only with EDPs	Derivatives firms dealing with non-EDPs	Derivatives advisers acting for managed account
General obligations toward all (Part 3 Div 1) <ul style="list-style-type: none"> Fair dealing Conflict of interest management General/gatekeeper know-your-derivatives party 	•	•	•
Additional obligations and restrictions (Part 3 Div 2–3) <ul style="list-style-type: none"> Derivatives-party-specific know-your-derivatives party Product suitability Permitted referral arrangements Leverage/borrowing disclosure Complaint handling Prohibition on tied selling Fair terms and pricing 		•	•
Client and counterparty accounts (Part 4) <ul style="list-style-type: none"> Relationship disclosure Pre-trade disclosures re. risk, product, price, and compensation Report daily valuations Notice by non-resident registrants Holding of assets¹⁰ Use and investment of assets Transaction confirmations¹¹ Monthly statements 		•	•
Compliance and recordkeeping (Part 5) <ul style="list-style-type: none"> Compliance and risk management systems Senior manager certification Client/counterparty agreement Recordkeeping 	•	•	•

¹⁰ A basic segregation requirement applies in all circumstances, but most of the asset requirements only apply in the non-EDP context.

¹¹ A basic transaction confirmation requirement applies in all circumstances, but the more detailed requirement applies only in the non-EDP context.

ANNEX I
PROPOSED NATIONAL INSTRUMENT 93-101
DERIVATIVES: BUSINESS CONDUCT

PART 1
DEFINITIONS AND INTERPRETATION

Definitions and interpretation

1. (1) In this Instrument

“Canadian financial institution” means

- (a) an association governed by the *Cooperative Credit Associations Act* (Canada) or a central cooperative credit society for which an order has been made under section 473(1) of that Act, or
- (b) a bank, loan corporation, trust company, trust corporation, insurance company, treasury branch, credit union, caisse populaire, financial services cooperative, or league that, in each case, is authorized by an enactment of Canada or a jurisdiction of Canada to carry on business in Canada or a jurisdiction of Canada;

“derivatives adviser” means

- (a) a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others as to transacting in derivatives, and
- (b) any other person or company required to be registered as a derivatives adviser under the securities legislation of a jurisdiction of Canada;

“derivatives dealer” means

- (a) a person or company engaging in or holding himself, herself or itself out as engaging in the business of trading in derivatives as principal or agent, and
- (b) any other person or company required to be registered as a derivatives dealer under the securities legislation of a jurisdiction of Canada;

“derivatives firm” means a derivatives dealer or a derivatives adviser, as applicable;

“derivatives party” means

- (a) in the case of a derivatives dealer,
 - (i) a person or company for which the derivatives dealer acts or proposes to act as an agent in relation to a transaction in a derivative, or

- (ii) a person or company that is or is proposed to be a party to a derivative where the derivatives dealer is the counterparty, and
- (b) in the case of a derivatives adviser, a person or company to which the adviser provides or proposes to provide advice in relation to derivatives;

“derivatives party assets” means any asset received or held by a derivatives firm, for or on behalf of a derivatives party;

“eligible derivatives party” means any of the following:

- (a) a Canadian financial institution;
- (b) the Business Development Bank of Canada incorporated under the *Business Development Bank of Canada Act* (Canada);
- (c) a subsidiary of a person or company referred to in paragraph (a) or (b), if the person or company owns all of the voting securities of the subsidiary, except the voting securities required by law to be owned by directors of the subsidiary;
- (d) a person or company registered under the securities legislation of a jurisdiction of Canada as at least one of the following:
 - (i) a derivatives dealer;
 - (ii) a derivatives adviser;
 - (iii) an adviser;
 - (iv) an investment dealer;
- (e) a pension fund that is regulated by either the federal Office of the Superintendent of Financial Institutions or a pension commission or similar regulatory authority of a jurisdiction of Canada or a wholly-owned subsidiary of such a pension fund;
- (f) an entity organized in a foreign jurisdiction that is analogous to any of the entities referred to in paragraphs (a) to (e);
- (g) the Government of Canada or a jurisdiction of Canada, or any Crown corporation, agency or wholly-owned entity of the Government of Canada or a jurisdiction of Canada;
- (h) any national, federal, state, provincial, territorial or municipal government of or in any foreign jurisdiction, or any agency of that government;
- (i) a municipality, public board or commission in Canada and a metropolitan community, school board, the Comité de gestion de la taxe scolaire de l’île de Montréal or an intermunicipal management board in Québec;

- (j) a trust company or trust corporation registered or authorized to carry on business under the *Trust and Loan Companies Act* (Canada) or under comparable legislation in a jurisdiction of Canada or a foreign jurisdiction, acting on behalf of a managed derivatives account managed by the trust company or trust corporation, as the case may be;
- (k) a person or company acting on behalf of a managed account that is managed by the person or company, if the person or company is registered or authorized to carry on business as an adviser or a derivatives adviser or the equivalent under the securities legislation of a jurisdiction of Canada or a foreign jurisdiction;
- (l) an investment fund that is advised by an adviser registered or exempted from registration under securities or commodity futures legislation in Canada;
- (m) a person or company, other than an individual,
 - (i) that has represented in writing that it has the requisite knowledge and experience to evaluate the information provided to the person or company about derivatives, the suitability of the derivatives for that person or company, and the characteristics of the derivatives to be transacted on the person or company's behalf, and
 - (ii) that has net assets of at least \$25 million as shown on its most recently prepared financial statements;
- (n) an individual
 - (i) who has represented in writing that he or she has the requisite knowledge and experience to evaluate the information provided to the individual about derivatives, the suitability of the derivatives for that individual, and the characteristics of the derivatives to be transacted on the individual's behalf, and
 - (ii) that beneficially owns financial assets, as defined in section 1.1 of National Instrument 45-106 *Prospectus Exemptions*, that have an aggregate realizable value before tax but net of any related liabilities of at least \$5 million;

“investment dealer” means a person or company registered as an investment dealer under the securities legislation of a jurisdiction of Canada;

“managed account” means an account of a derivatives party for which a person or company makes the trading decisions if that person or company has discretion to trade securities for the account or transact in a derivative for the account without requiring the derivatives party’s express consent to the transaction;

“permitted depository” means a person or company that is any of the following:

- (a) a Canadian financial institution;
- (b) a regulated clearing agency;

- (c) the central bank of Canada or of a permitted jurisdiction;
- (d) in Québec, a person recognized or exempted from recognition as a central securities depository under the *Securities Act* (Québec);
- (e) a person or company
 - (i) whose head office or principal place of business is in a permitted jurisdiction,
 - (ii) that is a banking institution or trust company of a permitted jurisdiction, and
 - (iii) that has shareholders' equity, as reported in its most recent audited financial statements, of not less than the equivalent of \$100 000 000;
- (f) with respect to derivatives party assets that it receives from a derivatives party, a derivatives dealer;

“permitted investment” means cash, or a security or other financial instrument with minimal market and credit risk that is capable of being liquidated rapidly with minimal adverse price effect;

“permitted jurisdiction” means a foreign jurisdiction that is any of the following:

- (a) a country where the head office or principal place of business of a Schedule III bank is located, and a political subdivision of that country;
- (b) if a derivatives party has provided express written consent to the derivatives dealer entering into a derivative in a foreign currency, the country of origin of the foreign currency used to denominate the rights and obligations under the derivative entered into by, for or on behalf of the derivatives party, and a political subdivision of that country;

“referral arrangement” means any arrangement in which a derivatives firm agrees to pay or receive a referral fee;

“referral fee” means any form of compensation, direct or indirect, paid for the referral of a derivatives party to or from a derivatives firm;

“registered derivatives firm” means a derivatives dealer or a derivatives adviser that is registered under securities legislation of a jurisdiction in Canada;

“registered firm” means a registered derivatives firm or a registered firm, as that term is defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;

“regulated clearing agency” has the meaning ascribed to that term in National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives*;

“Schedule III bank” means an authorised foreign bank named in Schedule III of the *Bank Act* (Canada);

“segregate” means to separately hold or separately account for a derivatives party’s positions or collateral;

“transaction” means any of the following:

- (a) entering into a derivative or making a material amendment to, terminating, assigning, selling or otherwise acquiring or disposing of a derivative;
- (b) the novation of a derivative, other than a novation with a clearing agency;

“valuation” means the current value of a derivative.

(2) In this Instrument, “adviser” includes

- (a) in Manitoba, an “adviser” as defined in the *Commodity Futures Act* (Manitoba),
- (b) in Ontario, an “adviser” as defined in the *Commodity Futures Act* (Ontario), and
- (c) in Québec, an “adviser” as defined in the *Securities Act* (Québec).

(3) In this Instrument, a person or company is an affiliated entity of another person or company if one of them controls the other or each of them is controlled by the same person or company.

(4) In this Instrument, a person or company (the first party) is considered to control another person or company (the second party) if any of the following apply:

- (a) the first party beneficially owns or directly or indirectly exercises control or direction over securities of the second party carrying votes which, if exercised, would entitle the first party to elect a majority of the directors of the second party unless the first party holds the voting securities only to secure an obligation;
- (b) the second party is a partnership, other than a limited partnership, and the first party holds more than 50% of the interests of the partnership;
- (c) the second party is a limited partnership and the general partner of the limited partnership is the first party;
- (d) the second party is a trust and a trustee of the trust is the first party.

(5) In this Instrument, a person or company is a subsidiary of another person or company if

- (a) it is controlled by
 - (i) that other,
 - (ii) that other and one or more persons or companies, each of which is controlled by that other, or

- (iii) two or more persons or companies, each of which is controlled by that other, or
 - (b) it is a subsidiary of a person or company that is that other's subsidiary.
- (6) In this Instrument, in Alberta, British Columbia, New Brunswick, Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island, Saskatchewan and Yukon, "derivative" means a "specified derivative" as defined in Multilateral Instrument 91-101 *Derivatives: Product Determination*.

PART 2 APPLICATION

Application to registered and unregistered derivatives firms

2. This Instrument applies to a derivatives firm, whether or not it is a registered derivatives firm.

Scope of Instrument

3. This Instrument applies to
- (a) in Manitoba,
 - (i) a derivative other than a contract or instrument that, for any purpose, is prescribed by any of sections 2, 4 and 5 of Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination* not to be a derivative, and
 - (ii) a derivative that is otherwise a security and that, for any purpose, is prescribed by section 3 of Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination* not to be a security,
 - (b) in Ontario,
 - (i) a derivative other than a contract or instrument that, for any purpose, is prescribed by any of sections 2, 4 and 5 of Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination* not to be a derivative, and
 - (ii) a derivative that is otherwise a security and that, for any purpose, is prescribed by section 3 of Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination* not to be a security, and
 - (c) in Québec, a derivative specified in section 1.2 of *Regulation 91-506 respecting Derivatives Determination*, other than a contract or instrument specified in section 2 of that regulation.

In each other local jurisdiction, this Instrument applies to a derivative as defined in subsection 1(6) of this Instrument. The text boxes in this Instrument do not form part of this Instrument and have no official status.

Affiliated entities

4. This Instrument does not apply to a person or company in respect of dealing with or advising an affiliated entity of the person or company.

Regulated clearing agencies

5. This Instrument does not apply to a regulated clearing agency.

Governments, central banks and international organizations

6. This Instrument does not apply to any of the following:
 - (a) the government of Canada, the government of a jurisdiction of Canada or the government of a foreign jurisdiction;
 - (b) the Bank of Canada or a central bank of a foreign jurisdiction;
 - (c) the Bank for International Settlements;
 - (d) the International Monetary Fund.

Requirements that apply when dealing with or advising an eligible derivatives party

7. (1) The requirements of this Instrument, other than the following requirements, do not apply to a derivatives firm in respect of a derivatives party that is an eligible derivatives party and that is not an individual:
 - (a) Division 1 [*General obligations towards all derivatives parties*] of Part 3 [*Dealing with or advising derivatives parties*];
 - (b) Sections 24 [*Interaction with NI 94-102*] and 25 [*Segregating derivatives party assets*];
 - (c) Subsection 29(1) [*Content and delivery of transaction confirmations*]; and
 - (d) Part 5 [*Compliance and recordkeeping*].
- (2) The requirements of this Instrument, other than the requirements specified in subsection (1), do not apply to a derivatives firm in respect of a derivatives party who is an eligible derivatives party and who is an individual if
 - (a) the individual has waived in writing the protections under the Instrument, other than as specified in subsection (1), and
 - (b) the individual has signed the waiver no earlier than 365 days before the derivatives firm transacts with or provides advice to the individual.

- (3) Despite subsections (1) and (2), the requirements of the Instrument apply to a derivatives firm acting as an adviser in respect of a managed account of an eligible derivatives party.

PART 3 DEALING WITH OR ADVISING DERIVATIVES PARTIES

DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES

Fair dealing

8. (1) A derivatives firm must deal fairly, honestly and in good faith with a derivatives party.
- (2) An individual acting on behalf of a derivatives firm must deal fairly, honestly and in good faith with a derivatives party.
- (3) A derivatives adviser must allocate transaction opportunities fairly among its derivatives parties.

Conflicts of interest

9. (1) A derivatives firm must establish, maintain and apply policies and procedures reasonably designed to identify existing material conflicts of interest, and material conflicts of interest that the derivatives firm in its reasonable opinion would expect to arise, between the derivatives firm, including each individual acting on behalf of the derivatives firm, and a derivatives party.
- (2) A derivatives firm must respond to an existing or potential conflict of interest identified under subsection (1).
- (3) If a reasonable derivatives party would expect to be informed of a conflict of interest identified under subsection (1), the derivatives firm must disclose, in a timely manner, the nature and extent of the conflict of interest to the derivatives party whose interest conflicts with the interest identified.

Know your derivatives party

10. (1) For the purpose of paragraph 2(c) in Ontario, Nova Scotia and New Brunswick, “insider” has the meaning ascribed to that term in the *Securities Act* of these jurisdictions except that “reporting issuer”, as it appears in the definition of “insider”, is to be read as “reporting issuer or any other issuer whose securities are publicly traded”.
- (2) A derivatives firm must establish, maintain and apply reasonable policies and procedures to
- (a) obtain such facts as are necessary to comply with applicable federal and provincial legislation relating to the verification of a derivatives party’s identity,
 - (b) establish the identity of a derivatives party and, if the derivatives firm has cause for concern, make reasonable inquiries as to the reputation of the derivatives party,

- (c) if transacting with, for or on behalf of, or advising a derivatives party in connection with derivatives that have securities as an underlying interest, establish whether either of the following applies:
 - (i) the derivatives party is an insider of a reporting issuer or any other issuer whose securities are publicly traded,
 - (ii) the derivatives party would reasonably be expected to have access to material non-public information relating to any interest underlying the derivative, and
 - (d) if the derivatives firm will, as a result of its relationship with the derivatives party have any credit risk in relation to the derivatives party, establish the creditworthiness of the derivatives party.
- (3) For the purpose of establishing the identity of a derivatives party that is a corporation, partnership or trust, each derivatives firm must establish both of the following:
- (a) the nature of the derivatives party's business;
 - (b) the identity of any individual who meets either of the following:
 - (i) in the case of a corporation, is a beneficial owner of, or exercises direct or indirect control or direction over, more than 25% of the voting rights attached to the outstanding voting securities of the corporation;
 - (ii) in the case of a partnership or trust, exercises control over the affairs of the partnership or trust.
- (4) A derivatives firm must take reasonable steps to keep the information required under this section current.
- (5) This section does not apply if the derivatives party is a registered firm or a Canadian financial institution.

DIVISION 2 – ADDITIONAL OBLIGATIONS WHEN DEALING WITH OR ADVISING CERTAIN DERIVATIVES PARTIES

The obligations in Division 2 of Part 3 do not apply if a derivatives firm is dealing with an eligible derivatives party that is not an individual or an eligible derivatives party who is an individual that has waived these protections – see section 7

Derivatives-party-specific needs and objectives

11. A derivatives firm must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a derivatives party to transact in a derivative, or transact in a derivative for a derivatives party's managed account, it has sufficient information regarding all of the following to enable it to meet its obligations under section 12 [*Suitability*]:

- (a) the derivatives party's needs and objectives with respect to its transacting in derivatives;
- (b) the derivatives party's financial circumstances;
- (c) the derivatives party's risk tolerance;
- (d) if applicable, the nature of the derivatives party's business and the operational risks it wants to manage.

Suitability

- 12. (1)** A derivatives firm must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a derivatives party to transact in a derivative, the transaction is suitable for the derivatives party.
- (2)** If a derivatives party instructs a derivatives firm to transact in a derivative and, in the derivatives firm's reasonable opinion, following the instruction would not be suitable for the derivatives party, the derivatives firm must inform the derivatives party in writing of the derivatives firm's opinion and must not transact in the derivative unless the derivatives party instructs the derivatives firm to proceed anyway.

Permitted referral arrangements

- 13.** A derivatives firm, or an individual acting on behalf of a derivatives firm, must not participate in a referral arrangement with another person or company unless
- (a) before a derivatives party is referred by or to the derivatives firm, the terms of the referral arrangement are set out in a written agreement between the derivatives firm and the person or company,
 - (b) the derivatives firm records all referral fees, and
 - (c) the derivatives firm or individual acting on behalf of the derivatives firm ensures that the information prescribed by section 15 [*Disclosing referral arrangements to a derivatives party*] is provided to the derivatives party in writing before the derivatives firm or individual receiving the referral either opens an account for the derivatives party or provides services to the derivatives party.

Verifying the qualifications of the person or company receiving the referral

- 14.** A derivatives firm, or an individual acting on behalf of a derivatives firm, must not refer a derivatives party to another person or company unless the derivatives firm first takes reasonable steps to verify and conclude that the person or company has the appropriate qualifications to provide the services, and, if applicable, is registered to provide those services.

Disclosing referral arrangements to a derivatives party

- 15. (1)** The written disclosure of the referral arrangement required by paragraph 13(c) [*Permitted referral arrangements*] must include all of the following:
- (a) the name of each party to the agreement referred to in paragraph 13(a) [*Permitted referral arrangements*];
 - (b) the purpose and material terms of the agreement, including the nature of the services to be provided by each party;
 - (c) any conflicts of interest resulting from the relationship between the parties to the agreement and from any other element of the referral arrangement;
 - (d) the method of calculating the referral fee and, to the extent possible, the amount of the fee;
 - (e) the category of registration, or exemption from registration, of each derivatives firm and individual acting on behalf of the derivatives firm that is a party to the agreement with a description of the activities that the derivatives firm or individual is authorized to engage in under that category or exemption and, giving consideration to the nature of the referral, the activities that the derivatives firm or individual is not permitted to engage in;
 - (f) any other information that a reasonable derivatives party would consider important in evaluating the referral arrangement.
- (2)** If there is a change to the information set out in subsection (1), the derivatives firm must ensure that written disclosure of that change is provided to each derivatives party affected by the change as soon as possible and no later than the 30th day before the date on which a referral fee is next paid or received.

Disclosure regarding the use of borrowed money or leverage

- 16. (1)** A derivatives firm must, before transacting in a derivative with or on behalf of a derivatives party, provide the derivatives party with a written statement that is substantially similar to the following:

“A characteristic of many derivatives is that you are only required to deposit funds that correspond to a portion of your total potential obligations when entering into the derivative. However, your profits or losses from the derivative are based on changes in the total value of the derivative. This means the leverage characteristic magnifies the profit or loss under a derivative, and losses can greatly exceed the amount of funds deposited. Your derivatives firm may require you to deposit additional funds to cover your obligations under a derivative as the value of the derivative changes. If you fail to deposit these funds, your derivatives firm may close out your position without warning. You should understand all of your obligations under a derivative, including your obligations where the value of the derivative declines.”

Using borrowed money to finance a derivatives transaction involves greater risk than using cash resources only. If you borrow money, your responsibility to repay the loan and pay interest as required by its terms remains the same even if the value of the derivative declines.”

- (2) Subsection (1) does not apply if the derivatives firm has provided the derivatives party with the statement described under subsection (1) no earlier than the 180th day before the date of the proposed transaction.

Handling complaints

17. A derivatives firm must document and, in a manner that a reasonable person would consider fair and effective, respond to each complaint made to the derivatives firm about any product or service offered by the derivatives firm or an individual acting on behalf of the derivatives firm.

The obligations in Division 3 of Part 3 do not apply if a derivatives firm is dealing with an eligible derivatives party that is not an individual or an eligible derivatives party who is an individual that has waived these protections – see section 7

DIVISION 3 – RESTRICTIONS ON CERTAIN BUSINESS PRACTICES WHEN DEALING WITH CERTAIN DERIVATIVES PARTIES

Tied Selling

18. (1) A derivatives firm must not impose undue pressure on or coerce a person or company to obtain a product or service from a particular person or company, including the derivatives firm or any of its affiliates, as a condition of obtaining another product or service from the derivatives firm.
- (2) A derivatives firm must, before the derivatives firm first transacts in a derivative with or on behalf of the derivatives party or advises the derivatives party in respect of a derivative, disclose to a derivatives party the prohibition on coercive tied selling set out in subsection (1) in a statement in writing.

Fair terms and pricing

19. (1) A derivatives firm that acts as agent for a derivatives party in connection with a transaction in a derivative must establish, maintain and apply written policies and procedures that are reasonably designed to obtain the most advantageous terms reasonably available when acting as agent for a derivatives party.
- (2) When transacting in a derivative with a derivatives party, as principal, a derivatives dealer, or an individual acting on behalf of the derivatives dealer, must make a reasonable effort to provide a price for the derivatives party that is fair and reasonable taking into consideration all relevant factors.

PART 4 DERIVATIVES PARTY ACCOUNTS

DIVISION 1 – DISCLOSURE TO DERIVATIVES PARTIES

The obligations in this Division do not apply if a derivatives firm is dealing with an eligible derivatives party that is not an individual or an eligible derivatives party who is an individual that has waived these protections – see section 7

Relationship disclosure information

20. (1) A derivatives firm must deliver to a derivatives party all information that a reasonable person would consider important about the derivatives party's relationship with the derivatives firm and each individual acting on behalf of the derivatives firm that is providing derivatives-related services to the derivatives party.
- (2) Without limiting subsection (1), the information delivered under that subsection must include all of the following:
- (a) a description of the nature or type of the derivatives party's account;
 - (b) a general description of the products and services the derivatives firm offers;
 - (c) a general description of the types of risks that a derivatives party should consider when making a decision relating to derivatives;
 - (d) a description of the risks to a derivatives party of using borrowed money to finance a derivative;
 - (e) a description of the conflicts of interest that the derivatives firm is required to disclose to a derivatives party under securities legislation;
 - (f) disclosure of the fees or other charges the derivatives party might be required to pay related to the derivatives party's account;
 - (g) a general description of the types of transaction fees or other charges the derivatives party might be required to pay;
 - (h) a general description of any compensation paid to the derivatives firm by any other party in relation to the different types of products that a derivatives party may transact in through the derivatives firm;
 - (i) a description of the content and frequency of reporting for each account or portfolio of a derivatives party;
 - (j) disclosure of the derivatives firm's obligations if a derivatives party has a complaint contemplated under section 17 [*Handling complaints*];
 - (k) a statement that the derivatives firm has an obligation to assess whether a derivative is suitable for a derivatives party prior to executing a transaction for the derivative or at any other time or a statement identifying the exemption the derivatives firm is relying on in respect of this obligation;

- (l) the information a derivatives firm must collect about the derivatives party under section 10 [*Know your derivatives party*] and 11 [*Derivatives-party-specific needs and objectives*] or a statement identifying the exemption the derivatives firm is relying on in respect of this obligation;
 - (m) a general explanation of how performance benchmarks might be used to assess the performance of a derivatives party's derivatives and any options for benchmark information that might be made available to the derivatives party by the derivatives firm.
- (3) A derivatives firm must deliver the information in subsection (1), if applicable, and subsection (2) to the derivatives party in writing, before the derivatives firm
- (a) transacts in a derivative with or on behalf of the derivatives party, or
 - (b) advises the derivatives party in respect of a derivative.
- (4) If there is a significant change in respect of the information delivered to a derivatives party under subsections (1) or (2), the derivatives firm must take reasonable steps to notify the derivatives party of the change in a timely manner and, if possible, before the derivatives firm next
- (a) transacts in a derivative with or on behalf of the derivatives party, or
 - (b) advises the derivatives party in respect of a derivative.
- (5) A derivatives firm must not impose any new fee or other charge in respect of an account of a derivatives party, or increase the amount of any fee or other charge in respect of an account of a derivatives party, unless written notice of the new or increased fee or charge is provided to the derivatives party at least 60 days before the date on which the imposition or increase becomes effective.
- (6) Subsections (1), (2), (3) and (4) do not apply to a derivatives dealer in respect of a derivatives party for whom the derivatives dealer transacts in a derivatives only as directed by a derivatives adviser acting for the derivatives party.
- (7) A derivatives dealer referred to in subsection (6) must deliver the information required under paragraphs (2)(a) and (e) to (j) to the derivatives party in writing before the derivatives dealer first transacts in a derivative for the derivatives party.

Pre-transaction disclosure

21. (1) Before transacting in a type of derivative with or on behalf of a derivatives party for the first time, a derivatives dealer must deliver a document reasonably designed to allow the derivatives party to assess each of the following:
- (a) the material risks of the type of derivative transacted, including an analysis of the derivatives party's potential exposure under the type of derivative;
 - (b) the material characteristics of the type of derivative, including the material economic terms and the rights and obligations of the counterparties to the type of derivative.

- (2) Before transacting in a derivative with or on behalf of a derivatives party, a derivatives dealer must advise the derivatives party of all of the following:
- (a) any material risks or material characteristics that are materially different from those described in the disclosure required under subsection (1);
 - (b) if applicable, the price of the derivative to be transacted and the most recent valuation;
 - (c) any compensation or other incentive payable by the derivatives party relating to the derivative or the transaction in the derivative.

Daily reporting

22. On each business day, a derivatives firm must make available to a derivatives party a valuation for each derivative that it has transacted with or on behalf of the derivatives party and with respect to which contractual obligations remain outstanding on that day.

Notice to derivatives parties by non-resident derivatives firms

23. A derivatives firm whose head office is not located in Canada must not transact in a derivative with a derivatives party in the local jurisdiction unless it has delivered to the derivatives party a statement in writing disclosing all of the following:
- (a) the jurisdiction in Canada or the foreign jurisdiction in which the head office or the principal place of business of the derivatives firm is located;
 - (b) that all or substantially all of the assets of the derivatives firm may be situated outside the local jurisdiction;
 - (c) that there may be difficulty enforcing legal rights against the derivatives firm because of the above;
 - (d) the name and address of the agent for service of process of the derivatives firm in the local jurisdiction.

DIVISION 2 – DERIVATIVES PARTY ASSETS

This Division, other than Sections 24 and 25, do not apply if a derivatives firm is dealing with an eligible derivatives party that is not an individual or an eligible derivatives party who is an individual that has waived these protections – see section 7

Interaction with NI 94-102

24. This Division does not apply to a derivatives firm in respect of derivatives party assets if the derivatives firm is subject to and complies with or is exempt from sections 3 through 8 of

National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* in respect of those derivatives party assets.

Segregating derivatives party assets

25. A derivatives firm that holds derivatives party assets must segregate those assets from the positions and property of other persons or companies including the positions and property of the derivatives firm.

Holding derivatives party assets

26. A derivatives firm must hold all of its derivatives party assets
- (a) in one or more accounts at a permitted depository that are clearly identified as holding derivatives party assets, and
 - (b) in separate accounts from the property of all persons who are not a derivatives party of the derivatives firm.

Use of derivatives party assets

27. (1) A derivatives firm must not use or permit the use of derivatives party assets except in accordance with this section and section 28 [*Investment of derivatives party assets*].
- (2) A derivatives firm must not use or permit the use of derivatives party assets except to do either of the following:
- (a) margin, guarantee, secure, settle or adjust the obligations of the derivatives party;
 - (b) secure or extend the credit of the derivatives party.
- (3) Other than with respect to derivatives party assets used in accordance with paragraph (2)(b), a derivatives firm must not create or permit to exist any lien or other encumbrance on the derivatives party assets unless the lien or other encumbrance secures an obligation in favour of the derivatives party.

Investment of derivatives party assets

28. (1) A derivatives firm must not invest derivatives party assets except in accordance with subsections (2) and (3).
- (2) Subject to subsection (3), a derivatives firm may
- (a) invest derivatives party assets in a permitted investment, and
 - (b) use derivatives party assets to purchase a permitted investment pursuant to an agreement for resale or repurchase if all of the following apply:
 - (i) the agreement is in writing;

- (ii) the term of the agreement is no more than one business day;
 - (iii) written confirmation specifying the terms of the agreement is delivered to the derivatives party immediately upon entering into the agreement;
 - (iv) the agreement is not entered into with an affiliated entity of the derivatives firm.
- (3) A loss resulting from an investment or use of a derivatives party's derivatives party assets in accordance with subsection (1) or subsection (2) by the derivatives firm must be borne by the derivatives firm making the investment and not by the derivatives party.

DIVISION 3 – REPORTING TO DERIVATIVES PARTIES

This Division, other than Subsection 29(1), do not apply if a derivatives firm is dealing with an eligible derivatives party that is not an individual or an eligible derivatives party who is an individual that has waived these protections – see section 7

Content and delivery of transaction confirmations

29. (1) A derivatives dealer that has transacted with, for or on behalf of a derivatives party must promptly deliver to the derivatives party or, if the derivatives party consents in writing, to a derivatives adviser acting for the derivatives party, a written confirmation of the transaction.
- (2) If the derivatives dealer has transacted with, for or on behalf of a derivatives party that is not an eligible derivatives party, the written confirmation of the transaction must set out all of the following, if and as applicable:
- (a) a description of the derivative;
 - (b) information sufficient to identify the agreement that governs the transaction;
 - (c) the notional value or amount, quantity or volume of the underlying asset of the derivative;
 - (d) the number of units of the derivative;
 - (e) the total price paid for the derivative and the per unit price of the derivative;
 - (f) the commission, sales charge, service charge and any other amount charged in respect of the transaction;
 - (g) whether the derivatives dealer acted as principal or agent in relation to the derivative;
 - (h) the date and the name of the trading facility, if any, on which the transaction took place;

- (i) the name of the individual acting on behalf of the derivatives firm, if any, that provided advice relating to the derivative or the transaction;
 - (j) the settlement date of the transaction;
 - (k) the name of the regulated clearing agency, if any, where the derivative was cleared.
- (3) For the purpose of paragraph (2)(i), an individual acting on behalf of a derivatives firm may be identified by means of a code or symbol if the confirmation also contains a statement that the name of the individual will be provided to the derivatives party on request of the derivatives party.
- (4) The confirmation required under this section must be delivered promptly following the date of the transaction.

Derivatives party statements

- 30. (1)** A derivatives firm must deliver a statement to a derivatives party promptly after the end of each month if either of the following applies:
- (a) within the month a derivative was transacted with, for or on behalf of the derivatives party;
 - (b) the derivatives party has an outstanding position resulting from a transaction where the derivatives firm acted as a derivatives dealer.
- (2) A statement delivered under this section must include all of the following information for each transaction made with, for or on behalf of the derivatives party by the derivatives firm during the period covered by the statement, if and as applicable:
- (a) the date of the transaction;
 - (b) a description of the derivative transaction;
 - (c) information sufficient to identify the agreement that governs the transaction;
 - (d) the number of units of the derivative transacted and the nature of the transaction;
 - (e) the total price paid for the derivative and the per unit price of the derivative.
- (3) A statement delivered under this section must include all of the following information about the derivatives party's account or position as at the date of the statement, if and as applicable:
- (a) a description of each outstanding derivative to which the derivatives party is a party;
 - (b) the valuation of each outstanding derivative to which the derivatives party is a party as at the statement date;

- (c) the final valuation of each derivative to which the derivatives party is a party that expired or terminated during the period covered by the statement as at the expiry or termination date;
- (d) a description of all derivatives party assets held by the derivatives firm as collateral;
- (e) any cash balance in the account;
- (f) a description of any other derivatives party asset held by the derivatives firm;
- (g) the total market value of all cash, outstanding derivatives and other derivatives party assets in the account, other than assets held as collateral.

PART 5 COMPLIANCE AND RECORDKEEPING

DIVISION 1 – COMPLIANCE

Definitions

31. In this Division,

“senior derivatives manager” means, in respect of a derivatives business unit of a derivatives firm, the individual designated by the derivatives firm as responsible for directing the derivatives activities of that unit;

“derivatives business unit” means, in respect of a derivatives firm, an organizational unit that transacts in or provides advice in relation to a derivative, or a class of derivatives, on behalf of the derivatives firm.

Policies and procedures

32. A derivatives firm must establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to

- (a) provide reasonable assurance that the derivatives firm and each individual acting on its behalf in relation to its activities relating to transacting in or advising on derivatives complies with applicable securities legislation,
- (b) manage the risks relating to its derivatives activities in accordance with prudent business practices, and
- (c) ensure that individuals that perform an activity relating to transacting in or advising on derivatives have, on an ongoing basis, the experience, the education and the training that a reasonable person would consider necessary to perform that activity competently, including understanding the structure, features and risks of each derivatives that the individual transacts in or recommends.

Responsibilities of senior derivatives managers

33. (1) Each senior derivatives manager of a derivatives firm must do all of the following:

- (a) supervise the activities conducted in his or her derivatives business unit that are directed towards ensuring compliance by the derivatives business unit, and each individual working in the derivatives business unit, with this Instrument, applicable securities legislation and the policies and procedures required under section 32 [*Policies and procedures*];
 - (b) with respect to the derivatives activities conducted in his or her derivatives business unit, promote compliance by the derivatives business unit, and each individual working in the derivatives business unit, with this Instrument, applicable securities legislation and the policies and procedures required under section 32 [*Policies and procedures*];
 - (c) take reasonable steps to prevent and respond to any non-compliance, with respect to the derivatives activities conducted in his or her derivatives business unit, with this Instrument, applicable securities legislation or the policies and procedures required under section 32 [*Policies and procedures*].
- (2) At least once per calendar year, each senior derivatives manager of a derivatives firm must, with respect to the derivatives activities conducted in his or her derivatives business unit, submit a report to the derivatives firm's board of directors, or individuals acting in a similar capacity for the derivatives firm,
- (a) certifying that the derivatives business unit is in material compliance with this Instrument, applicable securities legislation, and the policies and procedures required under section 32 [*Policies and procedures*], or
 - (b) specifying all circumstances where the derivatives business unit is not in material compliance with this Instrument, applicable securities legislation, or the policies and procedures required under section 32 [*Policies and procedures*].

Responsibility of derivatives firm to respond to material non-compliance

- 34.** If a senior derivatives manager specifies circumstances under paragraph 33(2)(b) where a derivatives business unit is not in material compliance with this Instrument, applicable securities legislation, or the policies and procedures required under section 32 [*Policies and procedures*], the derivatives firm must,
- (a) respond to the specified non-compliance in a timely manner, and document its response, and
 - (b) report to the regulator or securities regulatory authority in a timely manner any circumstance where, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with this Instrument, applicable securities legislation, or the policies and procedures required under section 32 [*Policies and procedures*].

DIVISION 2 – RECORDKEEPING

Derivatives party agreement

- 35. (1)** A derivatives firm must establish policies and procedures that are reasonably designed to ensure that the derivatives firm, before transacting in a derivative with or on behalf of a derivatives party, enters into an agreement with that derivatives party.
- (2)** The agreement referenced in subsection (1) must establish all of the material terms governing the relationship between the derivatives firm and the derivatives party including those relating to the rights and obligations of the derivatives firm and the derivatives party.

Records

- 36.** A derivatives firm must keep complete records of all its derivatives, transactions and advising activities, including, as applicable, all of the following:
- (a) general records of its derivatives business and activities conducted with derivatives parties, and compliance with applicable provisions of securities legislation, including
 - (i) records of derivatives party assets, and
 - (ii) evidence of the derivatives firm's compliance with internal policies and procedures;
 - (b) for each derivative, records that demonstrate the existence and nature of the derivative, including
 - (i) records of communications with derivatives parties relating to transacting in derivatives,
 - (ii) documents provided to derivatives parties to confirm the derivative and their terms and each transaction relating to the derivative,

- (iii) correspondence relating to the derivative and each transaction relating to the derivative, and
 - (iv) records made by staff relating to the derivative and transactions relating to the derivative, such as notes, memos or journals;
- (c) for each derivative, records that provide for a complete and accurate reconstruction of the derivative and all transactions relating to the derivative, including
- (i) records relating to pre-execution activity including all communications relating to quotes, solicitations, instructions, transactions and prices however they may be communicated,
 - (ii) reliable timing data for the execution of each transaction relating to the derivative, and
 - (iii) records relating to the execution of the transaction including
 - (A) information obtained to determine whether the counterparty qualifies as an eligible derivatives party,
 - (B) fees or commissions charged, and
 - (C) any other information relevant to the transaction;
- (d) an itemized record of post-transaction processing and events, including
- (i) data reported to a trade repository, including the time and date that the report is made,
 - (ii) transaction confirmations,
 - (iii) terminations of derivatives,
 - (iv) novations of derivatives,
 - (v) amendments to derivatives,
 - (vi) assignment of derivatives or rights under derivatives,
 - (vii) netting of derivatives, and
 - (viii) margining and collateralization.

Form, accessibility and retention of records

37. (1) A derivatives firm must keep a record that it is required to keep under this Part, and all supporting documentation,

- (a) in a readily accessible and safe location and in a durable form,
 - (b) in the case of a record or supporting documentation that relates to a derivative, for a period of 7 years following the date on which the derivative expires or is terminated, and
 - (c) in any other case, for a period of 7 years following the date on which a derivatives party's last derivative expires or is terminated.
- (2) Despite subsection (1), in Manitoba, with respect to a derivatives firm or a derivatives party located in Manitoba, the time period applicable to records and supporting documentation kept pursuant to subsection (1) is 8 years.

PART 6 EXEMPTIONS

DIVISION 1 – EXEMPTIONS FROM THIS INSTRUMENT

Limitation on the availability of exemptions in this Division

38. The exemptions in this Division are not available to a person or company if either of the following applies:
- (a) the person or company is a registered firm in any jurisdiction in Canada;
 - (b) the person or company is registered under the securities, commodity futures or derivatives legislation of the foreign jurisdiction in which its head office or principal place of business is located in a category of registration that permits it to carry on the activities in that jurisdiction that registration as a derivatives dealer or derivatives adviser would permit it to carry on in the local jurisdiction.

Exemption for certain derivatives end-users

39. A person or company is exempt from the requirements of this Instrument if each of the following applies:
- (a) the person or company does not solicit, or otherwise transact in a derivative with, for or on behalf of, a person or company that is not an eligible derivatives party;
 - (b) the person or company does not, in respect of transactions in derivatives, advise other persons or companies that are not eligible derivatives parties, other than general advice that is provided in accordance with the conditions of section 43 [*Advising generally*];
 - (c) the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party;

- (d) the person or company does not regularly facilitate or otherwise intermediate transactions in derivatives for another person or company;
- (e) the person or company does not facilitate the clearing of a transaction in a derivative through the facilities of a clearing agency for another person or company, other than for an affiliated entity.

DIVISION 2 – EXEMPTIONS FROM SPECIFIC REQUIREMENTS IN THIS INSTRUMENT

Foreign derivatives dealers

40. (1) A derivatives dealer whose head office or principal place of business is in a foreign jurisdiction is exempt from this Instrument in respect of a transaction if

- (a) the derivatives dealer does not solicit, or otherwise transact in a derivative with, for or on behalf of, a person or company in the local jurisdiction that is not an eligible derivatives party,
- (b) the derivatives dealer is registered, licensed or otherwise authorized under the securities, commodity futures or derivatives legislation of a foreign jurisdiction specified in Appendix A to conduct the derivatives activities in the foreign jurisdiction that it proposes to conduct with the derivatives party, and
- (c) the derivatives dealer complies with the laws of the foreign jurisdiction applicable to the derivatives dealer set out in Appendix A relating to the activities being conducted.

(2) Despite subsection (1), a derivatives dealer relying on the exemption set out in that subsection must comply with the provisions of this Instrument set out in Appendix A opposite the name of the foreign jurisdiction in respect of the transaction.

(3) The exemption in subsection (1) is not available to a person or company in respect of a transaction in a derivative unless all of the following apply:

- (a) the head office or principal place of business of the person or company is in the foreign jurisdiction in which it is registered, licensed or otherwise authorized;
- (b) the person or company engages in the business of a derivatives dealer in the foreign jurisdiction in which its head office or principal place of business is located;
- (c) the person or company has delivered to the derivatives party a statement in writing disclosing all of the following:
 - (i) the foreign jurisdiction in which the person or company's head office or principal place of business is located;
 - (ii) that all or substantially all of the assets of the person or company may be situated outside of the local jurisdiction;

- (iii) that there may be difficulty enforcing legal rights against the person or company because of the above;
 - (iv) the name and address of the agent for service of the person or company in the local jurisdiction;
- (d) the person or company has submitted to the securities regulatory authority a completed Form 31-103F2 *Submission to Jurisdiction and Appointment of Agent for Service* under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;
 - (e) the person or company is not in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in the jurisdiction;
 - (f) the person or company undertakes to the securities regulatory authority to provide the securities regulatory authority with prompt access to its books and records upon request.
- (4) A person or company that relied on the exemption in subsection (1) during the 12-month period preceding December 1 of a year must notify the regulator or, in Québec, the securities regulatory authority of that fact by December 1 of that year.
- (5) In Ontario, subsection (4) does not apply to a person or company that complies with the filing and fee payment requirements applicable to an unregistered exempt international firm under Ontario Securities Commission Rule 13-502 *Fees*.

Investment dealers

41. A derivatives dealer that is registered as an investment dealer and that is a member of the Investment Industry Regulatory Organization of Canada is exempt from the requirements set out in Appendix B if the derivatives dealer complies with the corresponding conduct and other regulatory requirements of that organization in connection with the transaction or other activity.

Canadian financial institutions

42. A derivatives dealer that is a Canadian financial institution is exempt from the requirements set out in Appendix C if the derivatives dealer is subject to and complies with the corresponding conduct and other regulatory requirements of its prudential regulator in connection with the transaction or other activity.

DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS

Advising generally

43. (1) For the purposes of subsection (3), “financial or other interest” includes the following:
- (a) ownership, beneficial or otherwise, of the underlying interest or underlying interests of the derivative;

- (b) ownership, beneficial or otherwise, of, or other interest in, a derivative that has the same underlying interest as the derivative;
 - (c) a commission or other compensation received or expected to be received from any person or company in relation to a transaction involving the derivative, an underlying interest in the derivative or a derivative that has the same underlying interest as the derivative;
 - (d) a financial arrangement in relation to the derivative, an underlying interest in the derivative or a derivative that has the same underlying interest as the derivative;
 - (e) any other interest that relates to the transaction.
- (2) The requirements of this Instrument applicable to a derivatives adviser do not apply to a person or company that acts as a derivatives adviser if the advice that the person or company provides does not purport to be tailored to the needs of the person or company receiving the advice.
- (3) If the person or company that is exempt under subsection (2) recommends a transaction involving a derivative, a class of derivatives or the underlying interest of a derivative or class of derivatives in which any of the following has a financial or other interest, the person or company must disclose the interest, including a description of the nature of the interest, concurrently with providing the advice:
- (a) the person or company;
 - (b) any partner, director or officer of the person or company;
 - (c) where the person or company is an individual, the spouse or child of the individual;
 - (d) any other person or company that would be an insider of the first mentioned person or company if the first mentioned persons or company were a reporting issuer.

Foreign derivatives advisers

- 44. (1)** A derivatives adviser whose head office or principal place of business is in a foreign jurisdiction is exempt from this Instrument in respect of advice provided to a derivatives party if
- (a) the derivatives adviser does not provide advice to a person or company in the local jurisdiction that is not an eligible derivatives party, other than general advice that is provided in accordance with the conditions of section 43 [*Advising generally*];
 - (b) the derivatives adviser is registered, licensed or otherwise authorized under the securities, commodity futures or derivatives legislation of a foreign jurisdiction specified in Appendix D to conduct the derivatives activities in the foreign jurisdiction that it proposes to conduct with the derivatives party; and
 - (c) the derivatives adviser complies with the laws of the foreign jurisdiction applicable to the derivatives adviser set out in Appendix D relating to the activities being conducted.

- (2) Despite subsection (1), a derivatives adviser relying on the exemption set out in that subsection must comply with the provisions of this Instrument set out in Appendix D opposite the name of the foreign jurisdiction in respect of the derivatives advice.
- (3) The exemption under subsection (1) is not available to a person or company in respect of advice provided to a derivatives party unless all of the following apply:
- (a) the head office or principal place of business of the person or company is in the foreign jurisdiction in which it is registered;
 - (b) the person or company engages in the business of a derivatives adviser in the foreign jurisdiction in which its head office or principal place of business is located;
 - (c) the person or company has delivered to the derivatives party a statement in writing disclosing the following:
 - (i) the foreign jurisdiction in which the person or company's head office or principal place of business is located;
 - (ii) that all or substantially all of the assets of the person or company may be situated outside of the local jurisdiction;
 - (iii) that there may be difficulty enforcing legal rights against the person or company because of the above;
 - (iv) the name and address of the agent for service of the person or company in the local jurisdiction;
 - (d) the person or company has submitted to the securities regulatory authority a completed Form 31-103F2 *Submission to Jurisdiction and Appointment of Agent for Service* under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;
 - (e) the person or company is not in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in the jurisdiction;
 - (f) the person or company undertakes to the securities regulatory authority to provide the securities regulatory authority with prompt access to its books and records upon request.
- (4) A person or company that relied on the exemption in subsection (1) during the 12-month period preceding December 1 of a year must notify the regulator or, in Québec, the securities regulatory authority of that fact by December 1 of that year.
- (5) In Ontario, subsection (4) does not apply to a person or company that complies with the filing and fee payment requirements applicable to an unregistered exempt international firm under Ontario Securities Commission Rule 13-502 *Fees*.

**PART 7
EXEMPTION**

Exemption

45. (1) The regulator or the securities regulatory authority may grant an exemption from this Instrument, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.
- (2) Despite subsection (1), in Ontario, only the regulator may grant such an exemption.
- (3) Except in Alberta and Ontario, an exemption referred to in subsection (1) is granted under the statute referred to in Appendix B of National Instrument 14-101 *Definitions* opposite the name of the local jurisdiction.

**PART 8
EFFECTIVE DATE**

Effective date

46. (1) This Instrument comes into force on *[insert date]*.
- (2) In Saskatchewan, despite subsection (1), if these regulations are filed with the Registrar of Regulations after *[insert date]*, these regulations come into force on the day on which they are filed with the Registrar of Regulations.
- (3) Despite subsection (1) and, in Saskatchewan, subject to subsection (2), **[part ●]** comes into force *[insert date + 6 months]*.
- (4) Despite subsections (1) to (3), Part ● does not apply to a transaction entered into before *[insert date]* if the derivative that is the subject of the transaction expires or terminates not later than 365 days after that day.

**APPENDIX A
TO NATIONAL INSTRUMENT 93-101 DERIVATIVES: BUSINESS CONDUCT**

**FOREIGN DERIVATIVES DEALERS
(Section 40)**

**LAWS, REGULATIONS OR INSTRUMENTS OF FOREIGN JURISDICTIONS APPLICABLE
TO FOREIGN DERIVATIVES DEALERS**

Foreign Jurisdiction	Laws, Regulations or Instruments	Provisions of this Instrument applicable to a foreign derivatives dealer despite compliance with the foreign jurisdiction's laws, regulations or instruments

**APPENDIX B
TO NATIONAL INSTRUMENT 93-101 DERIVATIVES: BUSINESS CONDUCT**

**INVESTMENT DEALERS
(Section 41)**

**LAWS, REGULATIONS OR INSTRUMENTS APPLICABLE TO
INVESTMENT DEALERS**

IIROC	Laws, Regulations or Instruments	Provisions of this Instrument applicable to an investment dealer despite compliance with IIROC requirements

APPENDIX C
TO NATIONAL INSTRUMENT 93-101 DERIVATIVES: BUSINESS CONDUCT

CANADIAN FINANCIAL INSTITUTIONS
(Section 42)

LAWS, REGULATIONS OR INSTRUMENTS APPLICABLE TO
CANADIAN FINANCIAL INSTITUTIONS

Federal or provincial prudential regulator	Laws, Regulations or Instruments	Provisions of this Instrument applicable to a Canadian Financial Institution despite compliance with applicable federal or provincial regulatory requirements

APPENDIX D
TO NATIONAL INSTRUMENT 93-101 DERIVATIVES: BUSINESS CONDUCT

FOREIGN DERIVATIVES ADVISERS
(Section 44)

LAWS, REGULATIONS OR INSTRUMENTS OF FOREIGN JURISDICTIONS APPLICABLE
TO FOREIGN DERIVATIVES ADVISERS

Foreign Jurisdiction	Laws, Regulations or Instruments	Provisions of this Instrument applicable to a foreign derivatives adviser despite compliance with the foreign jurisdiction's laws, regulations or instruments

ANNEX II
PART 1
GENERAL COMMENTS

Introduction

This companion policy (the **Policy**) sets out the views of the Canadian Securities Administrators (the **CSA** or **we**) on various matters relating to National Instrument 93-101 *Derivatives: Business Conduct* (the **Instrument**) and related securities legislation.

Except for Part 1, the numbering and headings of Parts, sections and subsections in this Policy correspond to the numbering and headings in the Instrument. Any general guidance for a Part or section appears immediately after the Part or section name. Any specific guidance on a section or subsection follows any general guidance. If there is no guidance for a Part or section, the numbering in this Policy will skip to the next provision that does have guidance.

Unless otherwise stated, any reference to a Part, section, subsection, paragraph, subparagraph or definition in this Policy is a reference to the corresponding Part, section, subsection, paragraph, subparagraph or definition in the Instrument.

Definitions and interpretation

Unless defined in the Instrument or this Policy, terms used in the Instrument and in this Policy have the meaning given to them in securities legislation, including in National Instrument 14-101 *Definitions*. “Securities legislation” is defined in National Instrument 14-101 *Definitions*, and includes statutes and other instruments related to both securities and derivatives.

In this Policy, “Product Determination Rule” means,

- in Alberta, British Columbia, New Brunswick, Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island, Saskatchewan and Yukon, Multilateral Instrument 91-101 *Derivatives: Product Determination*,
- in Manitoba, Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination*,
- in Ontario, Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination*, and
- in Québec, *Regulation 91-506 respecting Derivatives Determination*.

Interpretation of terms defined in the Instrument

Section 1 – Definition of Canadian financial institution

The definition of “Canadian financial institution” in the Instrument is consistent with the definition of this term in National Instrument 45-106 *Prospectus Exemptions* with one exception. The definition of this term in National Instrument 45-106 *Prospectus Exemptions* does not include a Schedule III bank (due to the separate definition of the term “bank” in National Instrument 45-106 *Prospectus Exemptions*), with the result that National Instrument 45-106 *Prospectus Exemptions* contains certain references to “a Canadian financial institution or a Schedule III bank”. The definition of this term in the Instrument includes a Schedule III bank.

Section 1 – Definition of derivatives adviser and derivatives dealer

A person or company that meets the definition of “derivatives adviser” or “derivatives dealer” in a local jurisdiction is subject to the Instrument in that jurisdiction, whether or not they are registered or exempted from the requirement to be registered in that jurisdiction.

A person or company will be subject to the requirements of the Instrument if they are

- in the business of trading derivatives or in the business of advising others in respect of derivatives, or
- otherwise required to register as a derivatives dealer or a derivatives adviser as a consequence of engaging in certain specified activities set out in Proposed National Instrument 93-102 *Derivatives: Registration*.

Factors in determining business purpose

In determining whether a person or company is in the business of trading or in the business of advising in derivatives, a number of factors should be considered. The factors are set out below.

This is not a complete list of factors and other factors may also be considered.

- *Quoting prices or acting as a market maker* – The person or company makes a two-way market in a derivative or routinely quotes prices at which they would be willing to transact in a derivative or offers to make a market in a derivative or derivatives.
- *Directly or indirectly carrying on the activity with repetition, regularity or continuity* – Frequent or regular transactions are a common indicator that a person or company may be engaged in trading or advising for a business purpose. The activity does not have to be their sole or even primary endeavour for them to be in the business. We consider regularly trading or advising in any way that produces, or is intended to produce, profits to be for a business purpose.

- *Facilitating or intermediating transactions* – The person or company provides services relating to the facilitation of trading or intermediation of transactions in derivatives between third-party counterparties to derivatives contracts. This typically takes the form of the business commonly referred to as a broker.
- *Transacting with the intention of being compensated* – The person or company receives, or expects to receive, any form of compensation for carrying on derivatives transaction activity. This would include any compensation that is transaction- or value-based including from spreads or built-in fees. It does not matter if the person or company actually receives compensation or what form the compensation takes. However, a person or company would not be considered to be a derivatives dealer solely by reason that it realizes a profit from changes in the market price for the derivative (or its underlying reference asset), regardless of whether the derivative is intended for the purpose of hedging or speculating.
- *Directly or indirectly soliciting in relation to derivatives transactions* – The person or company contacts others to solicit derivatives transactions. Solicitation includes contacting someone by any means, including communication that offers (i) transactions, (ii) participation in transactions or (iii) services relating to transactions. This includes advertising on the internet with the intention of encouraging transacting in derivatives by local persons or companies. A person or company might not be considered to be soliciting solely because it contacts a potential counterparty, or a potential counterparty contacts them to enquire about a transaction in a derivative, unless it is the person or company's intention or expectation to be compensated from the transaction. For example, a person or company that wishes to hedge a specific risk might not be considered to be soliciting for the purpose of the Instrument if they contacted multiple potential counterparties to enquire about potential derivatives transactions to hedge the risk.
- *Engaging in activities similar to a derivatives adviser or derivatives dealer* – The person or company carries out any activities related to transactions involving derivatives that would reasonably appear, to a third party, to be similar to the activities discussed above. This would not include the operator of an exchange or a clearing agency.
- *Providing derivatives clearing services* – The person or company provides services to allow third parties, including counterparties to transactions involving the person or company, to clear derivatives through a clearing agency. These services are actions in furtherance of a trade conducted by a person or company that would typically play the role of an intermediary in the derivatives market

In determining whether or not they are, for the purposes of the Instrument, a derivatives dealer or derivatives adviser, a person or company should consider their activities holistically. We do not consider that all of the factors discussed above necessarily carry the same weight or that any one factor will be determinative.

Generally, we would consider a person or company that engages in the activities discussed above in an organized and repetitive manner to be a derivatives dealer or, depending on the context, a

derivatives adviser. Ad hoc or isolated instances of the activities discussed above may not necessarily result in a person or company being a derivatives dealer or, depending on the context, a derivatives adviser. For example, if a person or company makes an effort to take a long and short position at the same time to manage business risk, this does not necessarily mean that the person or company is making a market. Similarly, organized and repetitive proprietary trading, in and of itself, absent other factors described above, may not result in a person or company being considered to be a derivatives dealer for the purpose of the Instrument.

A derivatives dealer or a derivatives adviser in a local jurisdiction is a person or company that conducts the activities described in this section in that jurisdiction. For example, this would include a person or company that is located in a local jurisdiction and that conducts dealing or advising activity in that local jurisdiction or in a foreign jurisdiction. This would also include a person or company located in a foreign jurisdiction that conducts dealing or advising activity with a counterparty located in the local jurisdiction. A person or company does not need to have a physical location, staff or other presence in the local jurisdiction to be a derivatives dealer or derivatives adviser in that jurisdiction.

A person or company's primary business activity does not need to include the activities described above for the person or company to be a derivatives dealer or derivatives adviser for the purpose of the Instrument. The factors described above could represent only a small portion of the person or company's overall business activities. However, if these factors are present, it may be a derivatives dealer or derivatives adviser in the jurisdiction in which it engages in those activities.

Section 4 provides that a person or company is not a derivatives dealer or derivatives adviser for the purpose of the Instrument if they would be a dealer or adviser solely as a result of carrying out the activities described above in relation to one or more affiliated entities of the person or company.

Section 1 – Definition of derivatives party assets

“Derivatives party assets” includes all assets of a derivatives party that are received or held by a derivatives firm for or on behalf of the derivatives party for any purpose relating to derivatives transactions. This will include collateral delivered as initial or variation margin.

Section 1 – Definition of eligible derivatives party

Certain requirements of the Instrument do not apply where a derivatives firm is dealing with or advising a derivatives party that is an eligible derivatives party that is not an individual. If the derivatives firm is dealing with or advising a derivatives party who is an eligible derivatives party and is an individual, these requirements apply but may be waived in writing. Section 7 of this Policy provides additional guidance relating to this waiver.

A derivatives firm should take reasonable steps to determine whether a derivatives party is an eligible derivatives party before transacting with or advising them. In determining whether the person or company that it transacts with or advises is an eligible derivatives party, the derivatives

firm may rely on factual representations made in writing by the derivatives party, unless a reasonable person would have grounds to believe that such statements are false or it is otherwise unreasonable to rely on the representation. The criteria for determining whether a derivatives party is an eligible derivatives party are to be applied at the time a particular derivative is first entered into. A derivatives firm is not required to ensure that the derivatives party continues to be an eligible derivatives party during the life of the particular derivative but must consider the derivative party's eligible derivatives party status before entering into a new transaction with that derivatives party.

Section 1 – Definition of eligible derivatives party – subsections (m) and (n)

Under paragraphs (m) and (n) of the definition of “eligible derivatives party”, a person or company will only be considered an eligible derivatives party if they have represented in writing to the derivatives firm that they have the requisite knowledge and experience, and they have the minimum assets specified in the applicable paragraph.

If the derivatives firm has not received a written factual statement from a derivatives party, the derivatives firm should consider the derivatives party not to be an eligible derivatives party.

We expect that a derivatives firm would maintain a copy of each derivatives party's written representation about its status as an eligible derivatives party and would have policies and procedures reasonably designed to ensure that the information relating to each derivatives party is up to date.

Whether it is reasonable for a derivatives firm to rely on a derivative's party's written representation will depend on the particular facts and circumstances of the derivatives party and its relationship with the derivatives firm.

For example, in determining whether it is reasonable to rely on a derivative's party's representation that it has the requisite knowledge and experience, a derivatives firm may consider factors such as

- whether the derivatives party enters into transactions with frequency and regularity,
- whether the derivatives party has staff who have experience in derivatives and risk management,
- whether the derivatives party has retained independent advice in relation to its derivatives, and
- publically available financial information.

Taking the above factors into consideration, some people or companies may only have the requisite knowledge and experience pertaining to derivatives of a certain asset class or product type.

Section 1 – Definition of permitted depository

In recognition of the international nature of the derivatives market, paragraph (e) of the definition of “permitted depository” permits a foreign bank or trust company with a minimum amount of reported shareholders’ equity to act as a permitted depository and hold derivatives party assets, provided its head office or principal place of business is located in a permitted jurisdiction and it is regulated as a bank or trust company in the permitted jurisdiction.

Section 1 – Definition of permitted investment

The term “permitted investment” sets out a principles-based approach to determining the types of instruments in which a derivatives firm may invest derivatives party assets, in accordance with the provisions of the Instrument. The term is intended to cover an investment in an instrument that is secured by, or is a claim on, high-quality debtors, and which allows for quick liquidation with little, if any, adverse price effect, for the purpose of mitigating market, credit and liquidity risk.

We expect that a derivatives firm that invests derivatives party assets in accordance with the Instrument would ensure such investment is:

- consistent with its overall risk-management strategy, and
- fully disclosed to its customers.

We are also of the view that it would be inconsistent with the principles-based approach to permitted investments for a derivatives firm to invest derivatives party assets in its own securities or those of its affiliated entities.

Examples of instruments that would be considered permitted investments by the local securities regulatory authority include the following:

- debt securities issued by or guaranteed by the Government of Canada or the government of a province or territory of Canada;
- debt securities that are issued or guaranteed by a municipal corporation in Canada;
- certificates of deposit, that are not securities, issued by a bank listed in Schedule I, II or III to the *Bank Act* (Canada) (the “Bank Act”);¹
- commercial paper fully guaranteed as to principal and interest by the Government of Canada;
- interests in money market mutual funds.

¹ *Bank Act* (SC 1991, c 46).

We are also of the view that foreign investments in high-quality obligors exhibiting the same conservative characteristics as the instruments listed above would be acceptable.

Section 1 – Definition of permitted jurisdiction

Paragraph (a) of the definition of “permitted jurisdiction” captures jurisdictions where foreign banks authorized under the Bank Act to carry on business in Canada, subject to supervision by the Office of the Superintendent of Financial Institutions (**OSFI**), are located.² As of the time of the publication of this Instrument the following countries and their political subdivisions are included: Belgium, France, Germany, Ireland, Japan, Netherlands, Singapore, Switzerland, United Kingdom, and the United States of America.

For paragraph (b) of the definition of “permitted jurisdiction,” in the case of the euro, where the currency does not have a single “country of origin”, the provision will be read to include all countries in the euro area³ and countries using the euro under a monetary agreement with the European Union.⁴

Section 1 – Definition of segregate

While the term “segregate” means to separately hold or separately account for derivatives party assets or positions, consistent with the PFMI Report and National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*, accounting segregation is acceptable.

For the purpose of this section “PFMI Report” means the April 2012 final report entitled *Principles for financial market infrastructures* published by the Bank for International Settlements’ Committee on Payments and Market Infrastructure (formerly the Committee on Payment and Settlement Systems) and the Technical Committee of the International Organization of Securities Commissions, as amended from time to time.

Section 1 – Definition of valuation

We are of the view that the valuation can be calculated based upon the use of an industry-accepted methodology that is in accordance with accounting principles and that results in a reasonable valuation of the derivative⁵ such as mark-to-market or mark-to-model. We expect that

² *Ibid.* at Part XII.1; For a list of authorized foreign banks regulated under the *Bank Act* and subject to OSFI supervision, see: Office of the Superintended of Financial Institutions, *Who We Regulate* (available: <http://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/wwr-er.aspx?sc=1&gc=1#WWRLink11>).

³ European Union, Economic and Financial Affairs, *What is the euro area?*, May 18, 2015, online: European Union (http://ec.europa.eu/economy_finance/euro/adoption/euro_area/index_en.htm).

⁴ European Union, Economic and Financial Affairs, *The euro outside the euro area*, April 9, 2014, online: European Union (https://ec.europa.eu/info/business-economy-euro/euro-area/euro/use-euro/euro-outside-euro-area_en).

⁵ For example, see International Financial Reporting Standard 13 *Fair Value Measurement*.

the methodology used to calculate the valuation that is reported with respect to a derivative would be consistent over the entire life of the derivative.

PART 2 APPLICATION

Section 2 – Application to registered and unregistered derivatives firms

The Instrument applies to “derivatives advisers” and “derivatives dealers” as defined in subsection 1(1) of the Instrument. These definitions include a person or company registered as a “derivatives dealer” or “derivatives adviser” under securities legislation. The Instrument applies even if the person or company is exempted or excluded from registration. Accordingly, derivatives firms that may be exempted from registration in a jurisdiction, such as Canadian financial institutions, will nevertheless be subject to a similar standard of conduct towards their derivatives parties as the standard of conduct applicable to registered derivatives firms and their representatives.

Section 3 – Scope of instrument

This section ensures that the Instrument applies to the same contracts and instruments in all jurisdictions of Canada. Each jurisdiction has adopted a Product Determination Rule that excludes certain types of contracts and instruments from being derivatives for the purpose of the Instrument.

Section 7 – Requirements that apply when dealing with or advising an eligible derivatives party

The term “eligible derivatives party” is intended to refer to those derivatives parties that do not require the full set of protections afforded to derivatives parties that do not have the financial resources or expertise to meet the eligible derivatives party thresholds.

The obligations of a derivatives firm and individuals acting on its behalf towards a derivatives party differ depending on the nature of the derivatives party.

Section 7 – Requirements that apply when dealing with or advising a derivatives party that is not an eligible derivatives party

All of the requirements in Parts 3, 4 and 5 of the Instrument apply to a derivatives firm when dealing with or advising a derivatives party that is not an eligible derivatives party.

Subsection 7(1) – Requirements that apply when dealing with or advising an eligible derivatives party that is not an individual

Only certain requirements in the Instrument apply to a derivatives firm when the derivatives firm is dealing with or advising a derivatives party that is an eligible derivatives party and that is not an individual:

In Part 3 Dealing With or Advising Derivatives Parties,

- all of Division 1 – General Obligations Towards All Derivatives Parties, comprising section 8 [*Fair dealing*], section 9 [*Conflicts of interest*] and section 10 [*Know your derivatives party*], applies, and
- all other requirements in Part 3 do not apply.

In Part 4 Derivatives Party Accounts,

- in Division 2 – Derivatives Party Assets, section 24 [*Interaction with NI 94-102*] and section 25 [*Segregating derivatives party assets*] apply, and
- all other requirements in Part 4 do not apply.

In Part 5 Compliance,

- all of Division 1 – Compliance applies, and
- all of Division 2 – Recordkeeping applies.

Subsection 7(2) – Requirements that apply when dealing with or advising an eligible derivatives party that is an individual but that may be waived by the individual

If the derivatives firm is dealing with or advising a derivatives party that is an eligible derivatives party and an individual, the requirements of the Instrument apply to the derivatives firm in respect of such dealing or advice. However, the individual eligible derivatives party may agree to waive in writing any or all of the requirements of the Instrument, other than the requirements set out in subsection 7(1).

In the case of a waiver by an individual eligible derivatives party, the waiver may be included in account-opening documentation or other relationship disclosure and will be valid for up to 365 days. If the derivatives firm wishes to continue to be able to rely on a waiver from the individual eligible derivatives party more than 365 days after it has been given, the derivatives firm will need to obtain a new waiver in writing from the derivatives party.

There is no prescribed form for the waiver contemplated by subsection 7(2) of the Instrument. However, consistent with the derivatives firm's obligation to deal fairly, honestly and in good faith with derivatives parties, we expect the waiver to be presented to the derivatives party in a clear and meaningful manner in order to ensure the derivatives party understands the information presented and the significance of the protections being waived.

PART 3 DEALING WITH OR ADVISING DERIVATIVES PARTIES

DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES

Section 8 – Fair dealing

The fair dealing obligation in section 8 is a principles-based obligation and is intended to be similar to the fair dealing obligation applicable to registered firms and registered individuals under Canadian securities legislation (the **registrant fair dealing obligation**).⁶

The fair dealing obligation should be interpreted flexibly and in a manner sensitive to context

We recognize that there are important differences between derivatives markets and securities markets, with the result that the fair dealing obligation under the Instrument may not always apply to derivatives market participants in the same manner as the registrant fair dealing obligation would apply to securities market participants. Accordingly, we believe that the fair dealing obligation in section 8, as a principles-based obligation, should be interpreted flexibly and in a manner that is sensitive to context and to derivatives market participants' reasonable expectations. For this reason, prior CSA guidance and case law on the registrant fair dealing obligation may not necessarily be relevant in interpreting the fair dealing obligation under the Instrument. Similarly, the guidance in this Policy is not necessarily applicable to registrants in their conduct with securities market participants.

We take the view that the concept of fairness when applied to derivatives market participants is context-specific. Conduct that may be considered unfair when dealing with a derivatives party that is not an eligible derivatives party may be considered fair and part of ordinary commercial practice when dealing with an eligible derivatives party. For example, the fair dealing obligation may be different if the derivative party is an individual or small business from what it would be if the derivative party were a sophisticated market participant such as a global financial institution. Similarly, conduct that may be considered to be unfair when acting as an agent to facilitate a derivatives transaction with a third-party may be considered fair when entering into a derivative as principal when it would be expected that each party negotiating the derivative is seeking to ensure favourable financial terms.

⁶ See section 14 of the Securities Rules, B.C. Reg. 194/97 [**B.C. Regulations**] under the *Securities Act* (British Columbia), R.S.B.C. 1996, c. 418 [**B.C. Act**]; section 75.2 of the *Securities Act* (Alberta) R.S.A. 2000, c.S-4 [**Alberta Act**]; section 33.1 of *The Securities Act, 1988* (Saskatchewan), S.S. 1988-89, c. S-42.2 [**Saskatchewan Act**]; subsection 154.2(3) of *The Securities Act* (Manitoba) C.C.S.M. c. S50 [**Manitoba Act**]; section 2.1 of OSC Rule 31-505 *Conditions of Registration*; section 65 of the *Derivatives Act* (Québec), R.S.Q., c. 14.01 [**Québec Act**]; section 39A of the *Securities Act* (Nova Scotia), R.S.N.S. 1989, c. 418 [**N.S. Act**]; subsection 54(1) of the *Securities Act* (New Brunswick) S.N.B. 2004, c. S-5.5 [**N.B. Act**]; section 90 of the *Securities Act* (Prince Edward Island), R.S.P.E.I. 1988, c. S-3.1 [**P.E.I. Act**]; subsection 26.2(1) of the *Securities Act* (Newfoundland and Labrador), R.S.N.L.1990, c. S-13 [**Newfoundland Act**]; section 90 of the *Securities Act* (Nunavut), S.Nu. 2008, c. 12 [**Nunavut Act**]; section 90 of the *Securities Act* (Northwest Territories), S.N.W.T. 2008, c. 10 [**N.W.T. Act**]; and section 90 of the *Securities Act* (Yukon), S.Y. 2007, c. 16 [**Yukon Act**].

Section 9 – Conflicts of interest

We recognize that there are important differences between derivatives markets and securities markets, with the result that the conflict of interest provisions under the Instrument may not always apply to derivatives market participants in the same manner as they would for securities market participants. Accordingly, we believe that the conflict of interest provisions in section 9 should be interpreted flexibly and in a manner that is sensitive to context and to derivatives market participants' reasonable expectations. For this reason, prior CSA guidance and case law on conflicts of interest may not necessarily be relevant in interpreting the conflict of interest provisions under the Instrument. Similarly, the guidance in this Policy is not necessarily applicable to registrants in their conduct with securities market participants.

We take the view that the concept of conflict of interest when applied to derivatives market participants is context-specific. Circumstances that may be considered to give rise to a conflict of interest when dealing with a derivatives party that is not an eligible derivatives party may be considered fair and part of ordinary commercial practice when dealing with an eligible derivatives party. For example, conflicts of interests may be treated differently when dealing with a derivative party that is an individual or small business from how they would be treated if the derivative party were a sophisticated market participant such as a global financial institution.

In addition, the circumstances that may be considered to give rise to a conflict of interest when acting as an intermediary on behalf of an eligible derivatives party may not represent a conflict of interest when entering into a derivative as principal where the derivatives party is reasonably aware that derivatives firm is negotiating the derivative as a commercial arrangement.

Subsection 9(1) – Identifying conflicts of interest

Section 9 of the Instrument requires a derivatives firm to take reasonable steps to identify existing material conflicts of interest and material conflicts that the derivatives firm reasonably expects to arise between the derivatives firm and their derivatives parties.

We consider a conflict of interest to be any circumstance where the interests of a derivatives party and those of a derivatives firm or its representatives, are inconsistent or divergent.

Subsection 9(2) – Responding to conflicts of interest

We expect that a derivatives firm's policies and procedures for managing conflicts would allow the firm and its staff to

- identify conflicts of interest,
- determine the level of risk that a conflict of interest raises, and
- respond appropriately to conflicts of interest.

When responding to any conflict of interest, we expect a derivatives firm to consider the fair dealing obligation in Part 3 of the Instrument as well as any other standard of care that may apply when dealing with or advising a derivatives party.

In general, we view three methods as reasonable to respond to a conflict of interest, depending on the circumstances: avoidance, control and disclosure.

If a derivatives firm allows a serious conflict of interest to continue, there is a high risk of harm to derivatives parties or to the market. We expect that if there is a material risk of harm to a derivatives party or the integrity of the markets, the derivatives firm will take all reasonable steps to avoid the conflict of interest. If the derivatives firm does not avoid the conflict of interest, we expect that it will take steps to either control or disclose the conflict, or both. We would also expect the derivatives firm to consider what internal structures or policies and procedures it should implement to reasonably respond to such a conflict of interest.

Avoiding conflicts of interest

A derivatives firm must avoid all conflicts of interest that are prohibited by law. If a conflict of interest is not prohibited by law, we expect the derivatives firm to avoid the conflict if it is sufficiently contrary to the interests of a derivatives party that there can be no other reasonable response. Conflicts that have a lesser impact on the interests of a derivatives party can be managed through controls or disclosure.

Where conflicts of interest are so contrary to another person's or company's interest that a derivatives party cannot use controls or disclosure to reasonably respond to them, we expect that the derivatives firm to avoid the conflict, stop providing the service or stop dealing with the derivatives party.

Controlling conflicts of interest

We would expect that a derivatives firm would design its organizational structures, lines of reporting and physical locations to control conflicts of interest effectively. For example, the following situations would likely raise a potential conflict of interest:

- advisory staff reporting to marketing staff,
- compliance or internal audit staff reporting to a business unit, and
- individuals acting on behalf of a derivatives firm and investment banking staff in the same physical location.

Depending on the conflict of interest, a derivative firm may control the conflict in an appropriate way, including by

- assigning a different individual to provide a service to the particular derivatives party,

- creating a group or committee to review, develop or approve responses,
- monitoring trading activity, or
- using information barriers for certain internal communication.

Subsection 9(3) – Disclosing conflicts of interest

When disclosure is appropriate

We expect a derivatives firm to inform its derivatives parties about any conflicts of interest that could affect the services the firm provides to them.

Timing of disclosure

Under subsection 9(3), a derivatives firm and individuals acting on its behalf must disclose the conflict in a timely manner. We expect a derivatives firm and its representatives to disclose a conflict of interest to a derivatives party before or at the time they recommend the transaction or provide the service that gives rise to the conflict.

Where this disclosure is provided to a derivatives party before the transaction takes place, we expect the disclosure to be provided shortly before the transaction takes place. For example, if it was initially provided with the derivative party's account-opening documentation months or years previously, we would expect that an individual acting on behalf of a derivatives firm to also disclose this conflict to the derivatives party shortly before the transaction or at the time the transaction is recommended.

When disclosure is not appropriate

Disclosure may not be appropriate if a conflict of interest involves confidential or commercially-sensitive information, or the information amounts to "inside information" under insider trading provisions in securities legislation. In these situations, a derivatives firm will need to assess whether there are other methods to adequately respond to the conflict of interest. If not, the firm may have to decline to provide the service to avoid the conflict of interest. We would also expect a derivatives firm to have specific procedures for responding to conflicts of interest that involve inside information and for complying with insider trading provisions.

How to disclose a conflict of interest

Subsection 9(3) provides that a derivatives firm must provide disclosure about a material conflict of interest to a derivatives party. When a derivatives firm provides this disclosure, we expect that the disclosure would

- be prominent, specific, clear and meaningful to the derivatives party, and
- explain the conflict of interest and how it could affect the service the derivatives party is

being offered.

We would expect that a derivatives firm would not

- provide only generic disclosure,
- provide only partial disclosure that could mislead the derivatives party, or
- obscure conflicts of interest in overly detailed disclosure.

Examples of conflicts of interest

Specific situations where a derivatives firm could be in a conflict of interest and how to manage the conflict are described below.

Acting as both dealer and counterparty

When a derivatives firm enters into a transaction with or recommends a transaction to a derivatives party, and the derivatives firm or an affiliated entity of the derivatives firm is the counterparty to the derivatives party in the transaction, we expect that the derivatives firm would respond to the resulting conflict of interest by disclosing it to the derivatives party.

Competing interests of derivatives parties

If a derivatives firm deals with or provides advice to multiple derivatives parties, we would expect the derivatives firm to make reasonable efforts to be fair to all such derivatives parties. We expect that a derivatives firm will have internal systems to evaluate the balance of these interests.

Compensation practices

We expect that a derivatives firm would consider whether any particular benefits, compensation or remuneration practices are inconsistent with their obligations to derivatives parties, especially if the firm relies heavily on commission-based remuneration. For example, if there is a complex product that carries a high commission but may not be appropriate for the derivatives firm's derivatives parties, the derivatives firm may decide that it is not appropriate to offer that product.

If such compensation practices are adopted, a derivatives firm might consider employing persons that do not receive compensation based on derivatives activity to conduct the supervision of staff receiving compensation based on derivatives activity.

DIVISION 2 – ADDITIONAL OBLIGATIONS WHEN DEALING WITH OR ADVISING CERTAIN DERIVATIVES PARTIES

The obligations in Division 2 of Part 3 do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or an eligible derivatives party that is an individual that has waived these obligations.

Section 11 – Derivatives-party-specific needs and objectives

Information on a derivatives party's specific needs and objectives (sometimes referred to as "derivatives-party-specific KYC information") forms the basis for determining whether transactions in derivatives are suitable for a derivatives party. The obligations in section 11 require a derivatives firm to take reasonable steps to obtain and periodically update information about their derivatives parties.

The derivatives-party-specific KYC information may also be relevant in complying with policies and procedures that are aimed at ensuring the most advantageous terms of a derivative for a derivatives party under subsection 19(1). Derivatives parties may have a variety of execution priorities. For example, a derivatives party may have as their primary objective the objective of having the transaction executed as quickly as possible rather than trying to obtain the best available price. Factors to consider when evaluating execution include price, certainty, timeliness, and minimizing impact cost of making a trading interest public.

Before transacting with a derivatives party, we expect a derivatives firm to have the appropriate information needed to assess the derivatives party's knowledge, experience and level of understanding of the relevant type of derivative, the derivative's party's objective in entering into the derivative and the risks involved in order to assess whether the derivative is suitable for the derivatives party. The derivatives-party-specific KYC information is obtained with this goal in mind.

If the derivatives party chooses not to provide the necessary information that would enable the derivatives firm to assess suitability, or if the derivatives party provides insufficient information, the firm should advise the derivatives party that it is required to request this information from them in order to determine whether the derivative is suitable for them or their priorities when transacting in the derivative. The derivatives firm should also indicate that without such information there is a strong risk that it will not be able to determine whether the derivatives party has the ability to understand the derivative and the risks involved with transacting the particular derivative.

Derivatives-party-specific KYC information for suitability depends on circumstances

The extent of derivatives-party-specific KYC information a derivatives firm needs to determine the suitability of a transaction or a derivatives party's priorities when transacting in the derivative will depend on factors that include

- the derivatives party's circumstances and objectives,

- the type of derivative,
- the derivatives party's relationship to the derivatives firm, and
- the derivatives firm's business model.

In some cases, a derivatives firm will need extensive KYC information, for example, where the derivatives party would like to enter into a derivatives strategy to hedge a commercial activity in a range of asset classes. In these cases, we would expect the derivatives firm to have a comprehensive understanding of the derivatives party's

- hedging needs and objectives, including the derivatives party's time horizon for their hedging strategy,
- overall financial circumstances, and
- risk tolerance for various types of derivatives, taking into account the derivative party's investment knowledge.

In other cases, a derivatives firm may need to obtain less KYC information, for example, if the derivatives firm enters into a single derivative with a derivatives party who needs to hedge a loan that the derivatives firm extended to the derivatives party.

Section 12 – Suitability

Subsection 12(1) requires a derivatives firm to take reasonable steps to ensure that a proposed transaction is suitable for a derivatives party before making a recommendation or accepting instructions from the derivatives party to transact in a derivative.

Suitability obligation

To meet the suitability obligation, the derivatives firm should have in-depth knowledge of all derivatives that it transacts in with or for, or is recommending to, its derivatives party. This is often referred to as the “know your product” or KYP obligation.

We expect a derivatives firm to know each derivative well enough to understand and explain to the derivatives party the derivative's risks, key features, and initial and ongoing obligations. The decision by a derivatives firm to include a type of derivative on its product shelf or approved list of products does not necessarily mean that the derivative will be suitable for each derivatives party. Individuals acting on behalf of a derivatives firm must still determine the suitability of each transaction for every derivatives party.

When assessing suitability, we expect a derivatives firm to take all reasonable steps to determine whether the derivatives party has the capability to understand the particular type of derivative and the risks involved.

In all cases, we expect derivatives firms to be able to demonstrate a process for making suitability determinations that are appropriate under the circumstances.

Suitability obligations cannot be delegated

A derivatives firm is not permitted to

- delegate its suitability obligations to anyone else, or
- satisfy the suitability obligation by simply disclosing the risks involved with a transaction.

Section 11 and 12 - Use of online services to determine derivatives party needs and objectives and suitability

The conduct obligations set out in the Instrument, including the KYC and suitability obligations in sections 11 and 12 of the Instrument, are “technology neutral”. This means that these obligations are the same for derivatives firms that interact with derivatives parties on a face-to-face basis or through an online platform.

Where the information necessary to fulfill derivatives firms’ obligations pursuant to sections 11 and 12 of the Instrument is solicited through an online service or questionnaire, the CSA expects that this process would amount to a meaningful discussion with the derivatives party.

An online service or questionnaire will achieve this objective if it

- uses a series of behavioural questions to establish risk tolerance and elicit other KYC information,
- prevents a derivatives party from progressing further until all questions have been answered,
- tests for inconsistencies or conflicts in the answers and will not let the derivatives party complete the questionnaire until the conflict is resolved,
- offers information about the terms and concepts involved, and
- reminds the derivatives party that an individual from the derivatives firm is available to help them throughout the process.

Section 13 – Permitted referral arrangements

Subsection 1(1) defines a “referral arrangement” in broad terms. Referral arrangement means an arrangement in which a derivatives firm agrees to pay or receive a referral fee. The definition is not limited to referrals for providing derivatives, financial services or services requiring

registration. It also includes receiving a referral fee for providing a derivatives party name and contact information to an individual or firm. “Referral fee” is also broadly defined. It includes sharing or splitting any commission resulting from a transaction.

Under section 13, parties to a referral arrangement are required to set out the terms of the arrangement in a written agreement. This is intended to ensure that each party’s roles and responsibilities are made clear. This includes obligations for a derivatives firm involved in referral arrangements to keep records of referral fees. Payments do not necessarily have to go through a derivatives firm, but a record of all payments related to a referral arrangement must be kept.

We expect referral agreements to include

- the roles and responsibilities of each party,
- limitations on any party that is not a derivatives firm,
- the disclosure to be provided to referred derivatives parties, and
- who provides the disclosure to referred derivatives parties.

If the individual or the derivatives firm receiving the referral is a derivatives firm or an individual acting on its behalf, they are responsible for carrying out all obligations of a derivatives firm towards a derivatives party and communicating with referred derivatives parties.

A derivatives firm is required to be a party to referral agreements. This ensures that it is aware of these arrangements so it can adequately supervise the individuals acting on its behalf and monitor compliance with the agreements. This does not preclude the individual acting on behalf of the derivatives firm from also being a party to the agreement.

A party to a referral arrangement may need to be registered depending on the activities that the party carries out. A derivatives firm cannot use a referral arrangement to assign, contract out of or otherwise avoid its regulatory obligations.

In making referrals, a derivatives firm should ensure that the referral does not itself constitute an activity that the derivatives firm is not authorized to engage in.

Section 14 – Verifying the qualifications of the person or company receiving the referral

Section 14 requires the derivatives firm making a referral to satisfy itself that the party receiving the referral is appropriately qualified to perform the services, and, if applicable, is appropriately registered. The derivatives firm is responsible for determining the steps that are appropriate in the particular circumstances. For example, this may include an assessment of the types of derivatives parties that the referred services would be appropriate for.

Section 15 – Disclosing referral arrangements to a derivatives party

The disclosure of information to a derivatives party required under section 15 is intended to help a derivatives party make an informed decision about the referral arrangement and to assess any conflicts of interest. We expect the disclosure to be provided to a derivatives party before or at the time the referred services are provided. We would also expect a derivatives firm, and any individuals acting on behalf of the derivatives firm who are directly participating in the referral arrangement, to take reasonable steps to ensure that a derivatives party understands

- which entity they are dealing with,
- what they can expect that entity to provide to them,
- the derivatives firm’s key responsibilities to them,
- if applicable, the limitations of the derivatives firm’s registration category,
- if applicable, any relevant terms and conditions imposed on the derivatives firm’s registration,
- the extent of the referrer’s financial interest in the referral arrangement, and
- the nature of any potential or actual conflict of interest that may arise from the referral arrangement.

Section 17 – Handling complaints

General duty to document and respond to complaints

Section 17 requires a derivatives firm to document complaints and to effectively and fairly respond to them. We expect that a derivatives firm would document and respond to all complaints received from a derivatives party who has dealt with the derivatives firm (in this section, a “complainant”).

Complaint handling policies

We are of the view that an effective complaint system would deal with all formal and informal complaints or disputes in a timely and fair manner. To achieve the objective of handling complaints fairly, we would expect the derivatives firm’s compliance system to include standards allowing for objective factual investigation and analysis of the matters specific to the complaint.

We expect a derivatives firm to take a balanced approach to the gathering of facts that objectively considers the interests of

- the complainant,

- the individual or individuals acting on behalf of the derivatives firm, and
- the derivatives firm.

We would also expect a derivatives firm to not limit its consideration and handling of complaints to those relating to possible violations of securities legislation.

Complaint monitoring

We would expect a derivatives firm's complaint handling policy to provide for specific procedures for reporting the complaints to superiors, in order to allow the detection of frequent and repetitive complaints made with respect to the same matter which may, on a cumulative basis, indicate a serious problem. We would also expect the derivatives firm to take appropriate measures to promptly address the cause of a problem, particularly a serious problem.

Responding to complaints

Types of complaints

We expect that all complaints relating to one of the following matters would be responded to by the derivatives firm by providing an initial and substantive response, both in writing and within a reasonable time:

- a trading or advising activity,
- a breach of the derivatives party's confidentiality,
- theft, fraud, misappropriation or forgery,
- misrepresentation,
- an undisclosed or prohibited conflict of interest, or
- personal financial dealings with a derivatives party.

A derivatives firm may determine that a complaint relating to matters other than the matters listed above is nevertheless of a sufficiently serious nature to be responded to in the manner described below. This determination should be made, in all cases, by considering if a derivatives party, acting reasonably, would expect a written response to their complaint.

When complaints are not made in writing

We would not expect that complaints relating to matters other than those listed above, when made orally and when not otherwise considered serious based on a derivatives party's reasonable expectation, would need to be responded to in writing. However, we do expect that oral

complaints be given as much attention as written complaints. If a complaint is made orally and is not clearly expressed, the derivatives firm may request the complainant to put the complaint in writing and we would expect a derivatives firm to offer reasonable assistance to do so.

A derivatives firm is entitled to expect the complainant to put unclear oral issues into written format in order to try to resolve confusion about the nature of the issue. If the oral complaint is clearly frivolous, we do not expect a derivatives firm to offer assistance to put the complaint in writing. The derivatives firm may nonetheless ask the complainant to put the complaint in writing on his or her own.

Timeline for responding to complaints

We expect that a derivatives firm would

- promptly send an initial written response to a complainant – we consider that an initial response should be provided to the complainant within 5 business days of receipt of the complaint, and
- provide a substantive response to all complaints relating to the matters listed under “Types of complaints” above, indicating the derivatives firm’s decision on the complaint.

A derivatives firm may also wish to use its initial response to seek clarification or additional information from the derivatives party.

We encourage derivatives firms to resolve complaints relating to the matters listed above within 90 days.

DIVISION 3 – RESTRICTIONS ON CERTAIN BUSINESS PRACTICES WHEN DEALING WITH NON-ELIGIBLE DERIVATIVES PARTIES

The obligations in Division 3 of Part 3 do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or an eligible derivatives party that is an individual that has waived these obligations.

Section 18 – Tied selling

Section 18 prohibits a derivatives firm from imposing undue pressure on or coercing a person or company to obtain a product or service from a particular person or company, including the derivatives firm or any of its affiliates, as a condition of obtaining another product or service from the derivatives firm. These types of practices are known as “tied selling”. In our view, this section would be contravened if, for example, a financial institution agreed to lend money to a derivatives party on the condition that the derivatives party hedged their loan through the same financial institution. In this example, we would take the view that a derivatives firm would not contravene section 18 if it required the derivatives party to enter into an interest rate derivative in connection with a loan agreement as long as the derivatives party were permitted to transact in this derivative with the counterparty of their choice.

However, section 18 is not intended to prohibit relationship pricing or other beneficial selling arrangements similar to relationship pricing. Relationship pricing refers to the practice of industry participants offering financial incentives or advantages to certain derivatives parties.

Subsection 19(1) – Fair terms and pricing when acting as agent

What constitutes “most advantageous terms” will vary depending on the particular circumstances and a derivatives firm may not be able to achieve the most advantageous terms for every single transaction that it executes on behalf of a derivatives party. The derivatives firm should be able to demonstrate that it has set and follows policies and procedures that are reasonably designed to achieve the most advantageous terms for the derivatives firm’s derivatives parties and that these policies and procedures are reviewed regularly and amended as required.

The policies and procedures required under this subsection should consider the following broad factors for the purpose of achieving the most advantageous terms for all derivatives party orders:

- price;
- the speed of execution;
- the certainty of execution;
- the overall cost of the transaction, when costs are passed on to derivatives parties.

These factors are not intended to be exhaustive and a derivatives firm should consider all other facts and circumstances that may be applicable to their derivatives parties

Subsection 19(2) – Fair terms and pricing when acting as principal

Both the compensation component and the market value or price component of the derivative is relevant in determining whether the price for a derivatives party is fair and reasonable. A derivatives firm’s policies and procedures must address both the market value of the derivative as well as the reasonableness of compensation.

In assessing the fairness and reasonableness of compensation, the derivatives firm should take into consideration all relevant factors, including the availability of the derivatives involved in the transaction, the expense of executing transaction to the derivatives firm including, when applicable, the costs to hedge the derivative firm’s exposure, the value of the services rendered by the derivatives firm, the risks incurred by the derivatives firm and the amount of any other compensation received or to be received by the derivatives firm in connection with the transaction.

PART 4 DERIVATIVES PARTY ACCOUNTS

DIVISION 1 – DISCLOSURE TO DERIVATIVES PARTIES

The obligations in this Division do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or an eligible derivatives party that is an individual that has waived these obligations.

Section 20 – Relationship disclosure information

Content of relationship disclosure information

There is no prescribed form for the relationship disclosure information required under section 20. A derivatives firm may provide this information in a single document, or in separate documents, which together give the derivatives party the prescribed information.

We would expect that relationship disclosure information would contain accurate, complete, and up-to-date information. We suggest that derivatives firms review their disclosures annually or more frequently, as necessary. A derivatives firm must take reasonable steps to notify a derivatives party, in a timely manner, of significant changes in respect of the relationship disclosure information that has been provided.

To satisfy their obligations under subsection 20(1), individuals acting on behalf of a derivatives firm must spend sufficient time with derivatives parties in a manner consistent with their operations to adequately explain the relationship disclosure information that is delivered to them. We expect a derivatives firm to have policies and procedures that reflect the derivatives firm's practices when preparing, reviewing, delivering and revising relationship disclosure documents.

Disclosure should occur before entering into an initial derivatives transaction, prior to advising a derivatives party in respect of a derivative and when there is a significant change in respect of the information delivered to a derivatives party. We expect that the derivatives firm will maintain evidence of compliance with their disclosure requirements.

Subsection 20(2) – Required relationship disclosure information

Description of the nature or type of the derivative party's account

Under paragraph 20(2)(a), a derivatives firm must provide derivatives parties with a description of the nature or type of account that the derivatives party holds with the derivatives firm. In particular, we would expect that a derivatives firm would provide sufficient information to enable the derivatives party to understand the manner in which transactions will be executed and any applicable contractual obligations. We would also expect a derivatives firm to provide information regarding margin and collateral requirements, if applicable, and disclose how the derivatives party assets will be held, used and invested. We would expect that the relationship disclosure information would also describe any related services that may be provided by the

derivatives firm. If the firm is advising in derivatives, and the adviser has discretion over the derivatives party's account, we would also expect this to be disclosed

Identify the products or services the derivatives firm offers

Under paragraph 20(2)(b) a derivatives firm must provide a general description of the products and services the derivatives firm offers to a derivatives party. We would expect the relationship disclosure information to explain which asset classes the derivatives firm deals in and explain the different types of derivative products that the derivatives firm can transact with the derivatives party.

Describe the types of risks that a derivatives party should consider

We would expect a derivatives firm to provide an explanation of the risks associated with the derivatives products being transacted, including any specific risks relevant to the derivatives offered and strategies recommended to the derivatives party. While not exhaustive, transactions will involve one or more of the following risks: market, credit, liquidity, operational, legal and currency risk.

Describe the risks to a derivatives party of using leverage to finance a derivative

In addition to the disclosure prescribed by section 16, paragraph 20(2)(d) contemplates that a derivatives firm will disclose the risk of leverage to all derivatives parties, regardless of whether or not the derivatives party uses leverage or the derivatives firm recommends the use of borrowed money to finance any part of a transaction. Using leverage means that investors are only required to deposit a percentage of the total value of the investment when entering into a transaction. This effectively amounts to a loan by the derivatives firm to the derivatives party. However, the derivatives party's profits or losses are based on changes in value of the total investment. This means leverage magnifies a derivatives party's profit or loss on a transaction, and losses can exceed the amount of funds deposited.

Describe the conflicts of interest

Under paragraph 20(2)(e) a derivatives firm must provide a description of the conflicts of interest that the derivatives firm is required to disclose under securities legislation. One such requirement is in section 9 of the Instrument, which provides that a firm must take reasonable steps to identify and then respond to existing and potential material conflicts of interest between the derivatives firm and the derivatives party. This includes disclosing the conflict, where appropriate.

Disclosure of charges and other compensation

Paragraphs 20(2)(f), (g) and (h) require a derivatives firm to provide a derivatives party information on fees and costs they might be charged when entering into a transaction in a derivative. These requirements ensure that a derivatives party receives all relevant information to evaluate the costs associated with the products and services they receive from the derivatives

firm. We expect this disclosure to include information related to compensation or other incentives that the derivatives party may pay relating to a transaction.

At the outset of their relationship, a derivatives firm must provide the derivatives party with general information on any transaction and other charges that a derivatives party may be required to pay, as well as other compensation the derivatives firms may receive as a result of their business relationship. We recognize that a derivatives firm may not be able to provide all cost information regarding a particular transaction until the terms of the contract have been agreed upon. However, before entering into an initial transaction, a derivatives firm must meet the applicable pre-trade disclosure requirements in section 21 of the Instrument.

Description of content and frequency of reporting

Under paragraph 20(2)(i) a derivatives firm is required to provide a description of the content and frequency of reporting to the derivatives party. Reporting to derivatives parties includes, as applicable

- daily reporting under section 22,
- transaction confirmations under section 29, and
- derivatives party statements under section 30.

Further guidance about a derivatives firm's reporting obligations to a derivatives party is provided in Division 3 of this Part.

Know your derivatives party information

Paragraph 20(2)(1) requires a derivatives firm to disclose the type of information that it must collect from the derivatives party and explain how this information will be used in assessing and determining the suitability of a derivatives party transaction.

Section 21 – Pre-transaction disclosure

There is no prescribed form for the pre-trade disclosure that must be provided to a derivatives party under section 21. The derivatives firm may provide this information in a single document, or in separate documents which together give the derivatives party the prescribed information.

The disclosure document required under subsection 21(1) must be delivered to the derivatives party at a reasonably sufficient time prior to entering into the first transaction with the derivatives firm to allow the derivatives party to assess the material risks and material characteristics of the type of derivative transacted.

We consider a material risk that a derivatives firm is required under paragraph 21(1)(a) to disclose to a derivatives party to include market, credit, liquidity, foreign currency, legal, operational and any other applicable risks.

In addition to the requirement to provide a general disclosure document under subsection (1), we understand that the use of the term “price” is not always appropriate in relation to a transaction in a derivative. In paragraph 21(2)(b), we also expect disclosure with respect to spreads, premiums, costs, etc.

DIVISION 2 – DERIVATIVES PARTY ASSETS

The obligations in this Division, other than section 24 [*Interaction with NI 94-102*] and section 25 [*Segregating derivatives party assets*], do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or an eligible derivatives party that is an individual that has waived these obligations.

Section 25 – Segregating derivatives party assets

A derivatives firm is required to segregate derivatives party assets from its own property either by separately holding or accounting for derivatives party assets. Records maintained by a derivatives firm must make it clear that accounts holding derivative party assets are for the benefit of derivatives parties only.

Section 26 – Holding derivatives party assets

We expect that a derivatives firm would take reasonable efforts to confirm that the permitted depository holding the derivatives party assets

- qualifies as a permitted depository under the Instrument,
- has appropriate rules, policies and procedures, including robust accounting practices, to help ensure the integrity of the derivatives party assets and minimize and manage the risks associated with the safekeeping and transfer of the derivatives party assets,
- maintains securities in an immobilised or dematerialised form for their transfer by book entry,
- protects derivatives party assets against custody risk through appropriate rules and procedures consistent with its legal framework,
- employs a robust system that ensures segregation between the permitted depository's own property and the property of its participants and segregation among the property of participants, and where supported by the legal framework, supports operationally the segregation of property belonging to a derivative party on the participant's books and facilitates the transfer of derivatives party assets,
- identifies, measures, monitors, and manages its risks from other activities that it may perform, and

- facilitates prompt access to derivatives party assets, when required.

If a derivatives firm is a permitted depository, as defined in the Instrument, it may hold derivatives party assets itself and is not required to hold derivatives party assets at a third party depository. For example, a Canadian financial institution that acts as a derivatives firm would be permitted to hold derivatives party assets provided it did so in accordance with the requirements of the Instrument. Where a derivatives firm deposits derivatives party assets with a permitted depository, the derivatives firm is responsible for ensuring the permitted depository maintains appropriate books and records to ensure the derivatives party assets can be attributed to the derivatives party.

Section 27 – Use of derivatives party assets

The use of derivatives party assets attributable to a derivatives party to satisfy the obligations of any other party is not permitted.

Subsection 27(3) allows a derivatives firm to place a lien on derivatives party assets where the lien arises in connection with an obligation of the derivatives party. This exception recognizes that certain arrangements involve the granting of security interests in derivatives party assets. A derivatives firm is prohibited from imposing or permitting a lien that is not expressly permitted by the Instrument on derivatives party assets and should such an improper lien be placed on derivatives party assets, the derivatives firm must take all reasonable steps to promptly address the improper lien.

Section 28 – Investment of derivatives party assets

Although losses in the value of invested derivatives party assets are not to be allocated to a derivatives party, we are of the view that parties should be free to contract for the allocation of gains resulting from a derivatives firm's investment activities in accordance with the Instrument.

DIVISION 3 – REPORTING TO DERIVATIVES PARTIES

The obligations in this Division, other than subsection 29(1) [*Content and delivery of transaction confirmations*], do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or an eligible derivatives party that is an individual that has waived these obligations.

Section 29 – Content and delivery of transaction confirmations

We are of the view that the description of the derivative transacted required by paragraph 29(2)(a) would be fulfilled by providing a plain language description of the asset class of the derivative and the features of the derivative (e.g., fixed for floating interest swap with CDOR as reference rate, single name credit default swap).

Section 30 – Derivatives party statements

We are of the view that the description of the derivative transacted required by paragraphs 30(2)(b) and 30(3)(a) would be fulfilled by providing a plain language description of the asset class of the derivative and the features of the derivative (e.g., fixed for floating interest swap with CDOR as reference rate, single name credit default swap).

PART 5 COMPLIANCE AND RECORDKEEPING

DIVISION 1 – COMPLIANCE

Section 31 – Definitions

For the purposes of this Division 1 – *Compliance* of Part 5, a “derivative business unit” refers to an organizational unit or division of a derivatives firm that conducts derivatives activities. A derivatives firm may have one or more organizational divisions that conduct derivatives activities. For example, a firm may divide its derivatives activities based on asset class or geographic location of trading. A derivatives business unit may conduct activities in addition to over-the-counter (OTC) derivatives trading such as exchange-traded derivatives or securities activities.

For the purposes of this Division, “senior derivatives manager” refers to each individual who is principally responsible for managing one or more derivatives business units at a derivatives firm. For example, an individual responsible for, or head of, interest rate trading or the “rates desk” at a derivatives firm would be considered a senior derivatives manager. Depending on its size, level of derivatives activity and structure, a derivatives firm may have a number of different derivatives business units. A derivatives firm would be required to have a senior derivatives manager who fulfills the requirements of this Division in respect of each derivatives business unit. A senior manager may be responsible for multiple business units.

The definition of “senior derivatives manager” is intended to capture individuals who are directly responsible for specific lines of derivatives activity and therefore this would not necessarily be the Chief Executive Officer or Chief Compliance Officer of a derivatives firm.

Section 32 – Policies and procedures

Section 32 requires a derivatives firm to establish, maintain and apply policies and procedures that establish a system of controls and supervision (i.e., a “compliance system”) that provides assurance that the derivatives firm and those acting for it, as applicable, comply with applicable securities legislation, manage risks prudently, and possess the requisite education and training to perform these activities in a competent manner.

We would expect that a compliance system that is sufficient to meet the requirements of this section would include internal controls and monitoring systems that are reasonably likely to identify non-compliance at an early stage and supervisory systems that allow the firm to correct non-compliant conduct in a timely manner. As more requirements apply to a derivatives firm when transacting with or advising a person or company that is not an eligible derivatives party, the monitoring and compliance systems that are appropriate when transacting with or advising such person or company would be commensurately more comprehensive.

“Securities legislation” is defined in National Instrument 14-101 *Definitions*, and includes statutes and other instruments related to both securities and derivatives. We do not expect that the compliance system established in accordance with the Instrument would be applicable to activities other than a derivatives firm’s derivatives activities. For example, a derivatives dealer may also be a reporting issuer. The compliance system established to monitor compliance with the Instrument would not necessarily be concerned with matters related only to the derivatives firm’s status as a reporting issuer, though it would be acceptable to have a single compliance system related to the derivatives firm’s compliance with all applicable securities laws.

The risks referred to in paragraph 32(b) include the risks inherent in derivatives trading (including credit risk, counterparty risk, and market risk), which relate to the derivatives firm’s overall financial viability.

The proficiency requirement in paragraph 32(c) imposes on a derivatives firm a duty to ensure that individuals acting for the derivatives firm in relation to its derivatives activities possess the required education and training to ensure competency. The Instrument establishes a reasonableness standard rather than setting out specific courses or other training requirements. However, a derivatives firm may also be required to be registered in accordance with securities legislation; more specific training and experience requirements apply to such a derivatives firm and its representatives under that instrument.

While a certain amount of industry experience could substitute for formal education and training, we would expect that all individuals connected with trading in or advising on derivatives receive appropriate recurring training, at least annually.

Section 33 – Responsibilities of senior derivatives managers

A senior derivative manager’s responsibilities under this Division apply to the senior derivative manager even in situations where that individual has delegated his or her responsibilities.

The requirement on a senior derivative manager in paragraph 33(1)(c) to take reasonable steps to prevent material non-compliance with respect to derivatives activities conducted in his or her business unit includes both preventative steps and reactive steps where a senior derivatives manager has discovered material non-compliance. Where a senior manager becomes aware of material non-compliance in his or her business unit but does not take reasonable steps to address it, that senior derivatives manager would be in breach of the Instrument. A senior manager would also be in breach of the Instrument in terms of identifying and reporting non-compliance even if

the senior manager has delegated responsibilities and has not been properly advised of the non-compliance.

Under section 33 of the Instrument, each senior derivatives manager of a derivatives firm must, at least once per calendar year, submit a report to the derivatives firm's board of directors

- certifying that the derivatives business unit is in material compliance with the Instrument, applicable securities legislation, and the policies and procedures of the derivatives firm under section 32, or
- specifying all circumstances where the derivatives business unit is not in material compliance with the Instrument, applicable securities legislation, or the policies and procedures of the derivatives firm under section 32.

We would expect that in complying with this requirement the senior derivatives manager will exercise reasonable care in determining when and how often material non-compliance should be reported to the board. For example, in a case of serious misconduct we would expect the board to be made aware promptly.

We consider non-compliance with the Instrument, applicable securities legislation and the policies and procedures of the derivatives firm required under section 32 to be material if the non-compliance

- has, or could have, a negative impact on the interest of a derivatives party,
- results, or could result, in a material harm to the derivatives firm, including causing the derivatives firm to incur
 - a material financial loss, or
 - a material increase in their business or financial risk,
- was part of a pattern on non-compliance, or
- would constitute bad faith or fraud or would be an offence under applicable securities legislation.

Section 34 – Responsibility of a derivatives firm to respond to material non-compliance

If a senior derivatives manager notifies the board of directors of a derivatives firm that his or her derivatives business unit is not in material compliance with the Instrument, applicable securities legislation, or the policies and procedures of the derivatives firm under section 32, the derivatives firm must,

- respond to the specified non-compliance in a timely manner, and document its response, and

- report to the regulator or securities regulatory authority in a timely manner any circumstance where, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with the Instrument, applicable securities legislation, or the policies and procedures of the derivatives firm required under section 32.

The obligation on the derivatives firm to make a report to the regulator under subsection 34(b) will depend on whether the specified non-compliance would reasonably be considered material non-compliance by the derivatives firm, with the Instrument, applicable securities legislation, or the policies and procedures required under section 32.

DIVISION 2 – RECORDKEEPING

Section 35 – Derivatives party agreement

Appropriate subject matter for the derivatives party agreement includes terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, governing law, valuation, and dispute resolution. We would expect that the agreement would also cover other areas as appropriate in the context of the transactions into which the parties will enter. For example, where transactions will be subject to margin, we would expect the agreement to cover margin requirements, assets that may be used, asset valuation methods, investment and rehypothecation terms, and custodial arrangements.

Section 36 – Records

Section 36 imposes a general obligation on a derivatives firm to keep full and complete records relating to the derivatives firm's derivatives, transactions in derivatives, and all of its business activities relating to derivatives, trading in derivatives or advising in derivatives. This list of records is not intended to be exhaustive but rather includes the records that must be kept, at a minimum. We would expect a derivatives firm to consider the nature of its derivatives-related activity when determining the records that it must keep and the form of those records.

The general principle underlying section 36 is that a derivatives firm must document, through its records,

- compliance with all applicable securities legislation (including the Instrument),
- the details and evidence of the derivatives to which it has been a party or in respect of which it has been an agent,
- the circumstances surrounding the entry into and termination of those derivatives, and
- related post-trade matters.

We would, for example, expect a derivatives firm to be able to demonstrate, for each derivatives party, the details of compliance with the obligations in section 10 [*Know your derivatives party*] and, if applicable, the obligations in section 11 [*Derivatives-party-specific needs and objectives*] and section 12 [*Suitability*] (and if sections 11 and 12 are not applicable, the reason as to why it is not).

If a derivatives firm wishes to rely on any exemption or exclusion in the Instrument or other related securities laws, it should be able to demonstrate that it is entitled to rely on the exemption or exclusion.

With respect to records demonstrating the existence and nature of the derivatives firm's derivatives that are required to be kept pursuant to paragraph 36(b) and records documenting the transactions relating to the derivatives required to be kept pursuant to paragraph 36(c), we expect a derivatives firm to accurately and fully document every transaction it enters into. We expect a derivatives firm to maintain notes of communications that could have an impact on a derivatives party's account or its relationship with the derivatives firm. These communications may include oral communications and all e-mail, regular mail, fax and other written communications.

While a derivatives firm may not need to save every voicemail or e-mail, or to record all telephone conversations with every derivatives party, we do expect a derivatives firm to maintain records of all communications with a derivatives party relating to derivatives transacted with, for or on behalf of the derivatives party.

Section 37 – Form, accessibility and retention of records

Paragraph 37(1)(b) requires derivatives firms to keep their records in a safe location. This includes ensuring that no one has unauthorized access to information, particularly confidential derivatives party and counterparty information. We would expect a derivatives firm to be particularly vigilant if it maintains books and records in a location that may be accessible by a third party. In this case, we would expect the derivatives firm to have a confidentiality agreement with the third party.

PART 6 EXEMPTIONS

The Instrument provides several exemptions from the requirements in the Instrument. If a person or company is exempt from a requirement in the Instrument, the individuals acting on its behalf are also exempt from the requirement on the same terms.

DIVISION 1 – EXEMPTIONS FROM THIS INSTRUMENT

Section 39 – Exemption for certain derivatives end-users

Section 39 provides an exemption from the requirements of the Instrument for a person or company that transacts in derivatives but does not engage in the activities set out in paragraphs

(a) – (e). The intention of this exemption is to exclude from the application of the Instrument a person or company that uses derivatives in the course of their business but does not deal with or advise other derivatives parties. For example, a person or company that frequently and regularly transacts in derivatives to hedge business risk may qualify for this exemption. Typically, such a person or company would transact with a derivatives dealer who would be subject to the requirements of the Instrument. It would not be reasonable for a person or company who regularly quotes prices on derivatives to other derivatives parties to claim that they are an end-user hedging business activities.

Under paragraph 39(c), a person or company who regularly quotes prices at which they would be willing to transact in a derivative would not qualify for this exemption. This ineligibility applies even if the person or company does not make a two-way market in a derivative by publishing quotes to buy and quotes to sell a derivatives position at the same time. For example, a person or company who is only willing to take a long position in a derivative but regularly quotes prices to prospective counterparties would not qualify for this exemption.

DIVISION 2 – EXEMPTIONS FROM SPECIFIC REQUIREMENTS IN THIS INSTRUMENT

Section 40 – Foreign derivatives dealers

General principle

Section 40 contemplates an exemption from the Instrument for foreign derivatives dealers that are regulated under the laws of a foreign jurisdiction that achieve substantially the same objectives, on an outcomes basis, as the Instrument. This exemption applies to the provisions of the Instrument where the derivatives dealer is subject to and in compliance with the laws of a foreign jurisdiction set out in Appendix A opposite the name of the foreign jurisdiction. The foreign jurisdictions specified in Appendix A are determined on a jurisdiction-by-jurisdiction basis, and depend on a review of the laws and regulatory framework of the jurisdiction.

This exemption is only available where a foreign derivatives dealer is in compliance with the requirements of the laws of the applicable foreign jurisdiction specified in Appendix A and does not incorporate any exemption or discretionary relief granted to a foreign derivatives dealer in connection with the laws of the foreign jurisdiction. Where a foreign derivatives dealer relies on an exemption or discretionary relief from the laws of a foreign jurisdiction set out in Appendix A, it will need to apply to the relevant securities regulatory authorities for consideration of similar exemptive or discretionary relief from the Instrument.

Conditions

This exemption is only available where the foreign derivative dealer is dealing with persons or companies that are eligible derivatives parties. The foreign derivatives dealer must also comply with each of the requirements under section 40. Furthermore, there may be “residual” provisions of the Instrument listed in Appendix A which must be complied with even if a foreign derivatives dealer is in compliance with the laws of a foreign jurisdiction set out in Appendix A.

DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS

Section 44 – Foreign derivatives advisers

General principle

Section 44 contemplates an exemption from the Instrument for foreign derivatives advisers that are regulated under the laws of a foreign jurisdiction that achieve substantially the same objectives, on an outcomes basis, as the Instrument. This exemption applies to the provisions of the Instrument where the derivatives adviser is subject to and in compliance with the laws of a foreign jurisdiction set out in Appendix D opposite the name of the foreign jurisdiction. The foreign jurisdictions specified in Appendix D are determined on a jurisdiction-by-jurisdiction basis, and depend on a review of the laws and regulatory framework of the jurisdiction.

This exemption is only available where a foreign derivatives adviser is in compliance with the requirements of the laws of the applicable foreign jurisdiction specified in Appendix D and does not incorporate any exemption or discretionary relief granted to a foreign derivatives adviser in connection with the laws of the foreign jurisdiction. Where a foreign derivatives adviser relies on an exemption or discretionary relief from the laws of a foreign jurisdiction set out in Appendix D, it will need to apply to the relevant securities regulatory authorities for consideration of similar exemptive or discretionary relief from the Instrument.

Conditions

This exemption is only available where the foreign derivative adviser is dealing with persons or companies that are eligible derivatives parties. The foreign derivatives adviser must also comply with each of the requirements under section 44. Furthermore, there may be “residual” provisions of the Instrument listed in Appendix D which must be complied with even if a foreign derivatives adviser is in compliance with the laws of a foreign jurisdiction set out in Appendix D.