

**CSA Notice and Second Request for Comment****Proposed National Instrument 93-101**  
*Derivatives: Business Conduct***Proposed Companion Policy 93-101CP**  
*Derivatives: Business Conduct***June 14, 2018****Introduction**

We, the Canadian Securities Administrators (the **CSA** or **we**), are publishing the following for a second comment period of 95 days, expiring on September 17, 2018:

- 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.

In developing the Proposed Instrument, the CSA has consulted with the Bank of Canada, the Office of the Superintendent of Financial Institutions (**OSFI**) and the Department of Finance (Canada). We intend to continue to consult with these entities throughout the development of the Proposed Instrument.

On April 19, 2018, we published for comment Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration* (collectively, the **Proposed Registration Instrument**). The Proposed Instrument, together with the Proposed Registration Instrument, are intended to implement a comprehensive regime for the regulation of persons or companies that are in the business of trading or advising on derivatives. Accordingly, we are overlapping the comment period for the Proposed Instrument with that of the Proposed Registration Instrument, which will also close on September 17, 2018. This will allow commenters to consider the Proposed Instrument and the Proposed Registration Instrument together when making their comments.

**Background**

In April 2013, the CSA published for comment CSA Consultation Paper 91-407 *Derivatives: Registration* which outlined a proposed registration and business conduct regime for derivatives markets participants.

On April 4, 2017, we published for comment Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101 *Derivatives: Business Conduct* (the **first consultation**). The comment period for the first consultation closed on September 1, 2017. During the comment period, we received submissions from 21 commenters. We thank all commenters for their input. We have carefully reviewed the comments received and have revised the Proposed Instrument. The names of the commenters and a summary of their comments, together with our responses, are contained in Annex A of this Notice. Copies of the submissions on the Proposed Instrument can be found on the websites of the Alberta Securities Commission,<sup>1</sup> Ontario Securities Commission<sup>2</sup> and Autorité des marchés financiers.<sup>3</sup>

As we indicated in the CSA Notice that accompanied the first consultation, we have chosen to split the proposed derivatives registration and business conduct regime into two separate rules. This approach simplifies each rule and is intended to ensure that all derivatives firms (i.e., all derivatives advisers and all derivatives dealers) remain subject to certain minimum standards in all Canadian jurisdictions.

<sup>1</sup> Available at [http://www.albertasecurities.com/Regulatory%20Instruments/5341884-v1-CSA\\_Note\\_and\\_Request\\_for\\_Comment\\_NI\\_93-101.PDF](http://www.albertasecurities.com/Regulatory%20Instruments/5341884-v1-CSA_Note_and_Request_for_Comment_NI_93-101.PDF)

<sup>2</sup> Available at <http://www.osc.gov.on.ca/en/55181.htm>

<sup>3</sup> Available at <https://lautorite.qc.ca/en/professionals/regulations-and-obligations/public-consultations/topic/derivatives/finished/>

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, increase accountability and promote responsible business conduct in the over-the-counter (OTC) derivatives<sup>4</sup> 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.”<sup>5</sup> Moreover, 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 front-running of customer orders.

To address these issues, the Proposed Instrument, together with the Proposed Registration 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.<sup>6</sup> As a result, the Proposed Instrument will help protect participants in the OTC derivatives markets from unfair, improper or fraudulent practices and foster confidence in the Canadian derivatives markets.

The Proposed Instrument is intended to create a uniform approach to derivatives markets conduct regulation in Canada and promote consistent protections for market participants regardless of the type of firms they deal with, while also providing that derivatives dealers and advisers operating in Canada are subject to consistent regulation that does not result in any competitive disadvantage.

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, a test is used to determine if the person or company is in the business of trading or advising in OTC derivatives. Nevertheless, a person or company that may be in the business of trading in OTC derivatives may be exempt from the requirements of the Proposed Instrument if they qualify for the end-user exemption. 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 derivatives dealer’s or derivatives adviser’s derivatives party.

The Proposed Instrument sets out a comprehensive approach regulating the conduct of derivatives markets 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 derivatives 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.

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 is neither an individual nor a specified commercial hedger, and
  - apply but may be waived if the derivatives firm is dealing with or advising a derivatives party who is an “eligible derivatives party” that is an individual or a specified commercial hedger.

The definition of “eligible derivatives party” and the extent to which obligations do not apply, or apply unless waived, when

<sup>4</sup> The Proposed Instrument applies to derivatives as determined in accordance with the product determination rule applicable in the relevant jurisdiction. 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. Only those OTC derivatives set out in the applicable product determination rule are relevant.

<sup>5</sup> <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD381.pdf> (DMI Report) at p 1.

<sup>6</sup> <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD497.pdf> (DMI Implementation Review) at p. 13.

dealing with or advising an eligible derivatives party are explained below in Part 1 of the Summary of the Instrument.

As explained in CSA Staff Notice 33-319 *Status Report on CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients*, the CSA are presently considering a number of proposals aimed at strengthening the obligations that securities advisers, dealers and representatives owe to their clients. CSA staff responsible for this initiative continue to develop these proposals. We will monitor the work on this project, and may recommend amendments to the Proposed Instrument at a later date based on this work.

## **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 provided below.

#### *Derivatives adviser and derivatives dealer*

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

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 markets 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.

Paragraph (b) in the definitions of each 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 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. It is not necessary that the parties consider a client relationship to exist in order for one party to be a derivatives party to the other.

#### *Eligible derivatives party*

The term “eligible derivatives party” is intended to refer to those sophisticated derivatives parties that do not require the full set of protections afforded to “retail” customers or investors, either because they may reasonably be considered to have sufficient knowledge and experience to assess the risks of transacting in derivatives or because they have sufficient financial resources to obtain professional advice in order to 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.<sup>7</sup> In addition, the definition is similar to the definition of “permitted client” in NI 31-103, with a few modifications intended to reflect differences between derivatives and securities markets.

#### *Specified commercial hedger*

The term “specified commercial hedger” refers to a commercial hedger that meets the conditions under either paragraph (n) or (q) of the definition of eligible derivatives party.

### ***Part 2 – Application***

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

Section 3 is a scope provision intended to allow the Instrument to apply in respect of 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.

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<sup>7</sup> 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 “qualified party” in Saskatchewan General Order 91-908 *Over-the-Counter Derivatives*, the definition of “qualified party” in Manitoba Blanket Order 91-501 *Over-the-Counter Trades in 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* and the definition of “qualified party” in Nova Scotia Blanket Order 91-501 *Over The Counter Trades in Derivatives*.

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 a specified commercial hedger, or
- is an individual or specified commercial hedger that has waived in writing the protections provided by the requirements.

An eligible derivatives party that is neither an individual nor a specified commercial hedger, or is an individual or specified commercial hedger that has waived these protections in writing, is referred to as a **specified eligible derivatives party** in this Notice.

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 23 [*Interaction with other instruments*] and 24 [*Segregating derivatives party assets*] of Part 4 [*Derivatives party accounts*];
- (c) subsection 27(1) [*Content and delivery of transaction information*] of Part 4 [*Derivatives party accounts*]; and
- (d) Part 5 [*Compliance and recordkeeping*].

A derivatives firm and an 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 an eligible derivatives party, these protections should not be required but rather should be a matter of contract for the parties.

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

### ***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 the 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 markets participants’ reasonable expectations. We expect that the fair dealing obligation 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 markets participants’ reasonable expectations. Furthermore, it is expected that in responding to any conflict of interest, the derivatives party will consider the fair dealing obligation 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 are intended to protect non-eligible derivatives parties. They do not apply to the extent that a derivatives firm is dealing with or advising a specified eligible derivatives party.

A description of a number of these obligations is provided below.

##### *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 provide the appropriate pre-transaction disclosure 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. 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.

#### 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. 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 17 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 17 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.

#### **Part 4 – Derivatives Party Accounts**

##### DIVISION 1 – DISCLOSURE TO DERIVATIVES PARTIES

The CSA believe that less sophisticated derivatives parties, or those individuals who may require 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 18 requires a derivatives firm to provide a derivatives party with all information that the derivatives party needs in order 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 18(1) sets out the obligation for a derivatives firm to provide a derivatives party with disclosure 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.

This section also 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. The risk disclosure requires an explanation that borrowing money or using leverage to fund a derivatives transaction carries additional risk.

In addition, subsection 19(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 19(1), and
- if applicable, to set out the price of the derivative to be transacted and the most recent valuation.

Further to these obligations, section 20 requires a derivatives firm to provide a derivatives party with a 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 collateral delivered to a derivatives firm as initial margin, and imposes a requirement on the derivatives firm to obtain the written consent of its derivatives party if the derivatives firm intends to use or invest the collateral that is delivered to it by or for a derivatives party.

The Instrument exempts a derivatives firm from this Division in respect of derivatives party assets if, in respect of those derivatives party assets, any of the following apply:

- 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*,
- the derivatives firm is subject to and complies with securities legislation relating to margin and collateral requirements or National Instrument 81-102 *Investment Funds (NI 81-102)*.

We expect that later this year, securities legislation relating to margin and collateral requirements will be published for comment in *Proposed National Instrument 95-101 Margin and Collateral Requirements for Non-Centrally Cleared Derivatives*.

The obligations in this Division, other than section 23 and section 24, 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 27 provides that a derivatives firm must provide its derivatives party with a confirmation of the key elements of a derivatives transaction. If the derivatives party is not a specified eligible derivatives party, the required contents of this confirmation are set out in subsection 27(2).

Section 28 sets out the obligations of a derivatives firm to provide quarterly statements to derivatives parties. Subsection 28(2) describes the information that must be provided in the quarterly statement.

The obligations in this Division, other than the fundamental transaction confirmation requirement in subsection 27(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 30 provides that a derivatives firm must have policies, procedures and 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.

The CSA are monitoring international regulatory initiatives designed to ensure that senior managers bear responsibility for the effective and efficient management of their business units. Section 31 imposes certain supervisory, management, and reporting obligations on “senior derivatives managers”. These requirements are intended to create accountability at the senior management level. A senior derivatives manager is an individual designated by the derivatives firm as responsible for the derivatives business unit of the derivatives firm. Senior derivatives managers must supervise compliance activities and respond, in a timely manner, to any material non-compliance by an individual working in the derivatives business unit. Furthermore, a senior derivatives manager or a chief compliance officer who has been delegated the responsibility must also report at least annually to the firm’s board of directors, either to specify each incidence of material non-compliance with, or to specify that each derivatives business unit is in material compliance with, the Instrument, applicable securities legislation and the policies and procedures required under section 30.

Section 32 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 – EXEMPTION FROM THE INSTRUMENT

## *End users*

Section 37(1) provides that certain 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 42;
- regularly 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 other than an affiliated entity that is not an investment fund;
- facilitate the clearing of a transaction in a derivative through the facilities of a qualifying clearing agency for another person or company.

## DIVISION 2 AND DIVISION 3 – EXEMPTIONS FROM SPECIFIC REQUIREMENTS OF THE INSTRUMENT

### *Foreign derivatives dealers and foreign derivatives advisers*

Divisions 2 and 3 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 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.

### *Investment dealers*

Division 2 provides an exemption from requirements in the Instrument for a derivatives dealer that is a dealer member of the Investment Industry Regulatory Organization of Canada (**IIROC**) if the derivatives dealer complies with the corresponding conduct and other regulatory requirements of IIROC as set out in Appendix B of the Instrument.

### *Canadian financial institutions*

Division 2 provides an exemption from requirements in the Instrument for a derivatives dealer that is a Canadian financial institution and is subject to and complies with corresponding conduct and other regulatory requirements of its prudential regulator as set out in Appendix C of the Instrument.

Note that, as of the time of this publication for comment, the equivalency analysis required to populate the Appendices of the Instrument has not been completed. The Appendices will be completed and published for public comment prior to the Instrument being finalized.

## 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.

### **Part 8 – Effective Date**

Section 45 provides that the requirements will not apply to unexpired derivatives that were entered into before the effective date of the Instrument other than the following ongoing requirements: fair dealing (Section 8), daily reporting (Section 20) and derivatives party statements (Section 28).

## **Summary of Key Changes to the Proposed Instrument from Previous Publication**

**(a) “eligible derivatives party” new paragraph (o) – commercial hedger**

We received a number of comments relating to the net asset requirement of \$25 million for a person or company to be considered an eligible derivatives party under paragraph (m) of that definition. Commenters expressed the view that this threshold may reduce liquidity for commercial hedgers and is not harmonized with the threshold in other major trading jurisdictions. In response to these comments, we have included a new paragraph of the eligible derivatives party definition for commercial hedgers that have at least \$10 million in net assets and meet other specified conditions. Entities relying on this paragraph must waive their right to be treated as a non-eligible derivative party.

***(b) “eligible derivatives party” new paragraph (p) – fully guaranteed entities***

We received comments that the eligible derivatives party definition should be amended to allow an entity to qualify as an eligible derivatives party if its obligations are guaranteed by an entity that otherwise qualifies as an eligible derivatives party. In response to these comments we have included a new paragraph (p) of the eligible derivatives party definition for companies whose obligations under a derivative are fully guaranteed or otherwise fully supported under an agreement by one or more eligible derivatives parties.

***(c) Managed accounts of eligible derivatives parties***

We received a number of comments recommending that managed accounts for eligible derivatives parties should not be treated like those of non-eligible derivatives parties. They asserted that eligible derivatives parties are sophisticated investors and the fact that they have granted discretionary authority to an adviser to execute derivative transactions on their behalf should not change that classification. In response to these comments, we have removed subsection 7(3) which required managed accounts of eligible derivatives parties to be treated as those of non-eligible derivatives parties.

***(d) Former section 19 – Fair terms and pricing***

We received comments that the former section 19 fair terms and pricing provision was not appropriately tailored for the OTC derivatives market. The commenters pointed out the negotiated, bilateral and bespoke nature of OTC derivatives transactions. We received another comment that this provision would be better suited as part of the fair dealing obligation in section 8 of the Instrument. In response to these comments, we have deleted this provision and included companion policy guidance in section 8 relating to the pricing of derivatives.

***(e) Part 4, Division 2 – Derivatives Party Assets***

We received a number of suggestions to revise this Division, relating to the scope of its application generally and to the re-use and investment of derivatives party assets. Part 4 Division 2 now clarifies that this requirement does not apply to a derivatives firm's transactions with a derivatives party that are already subject to rules that apply to a specific type of derivatives party, such as securities legislation relating to margin and collateral requirements or NI 81-102. Furthermore, this Division imposes a requirement on the derivatives firm to obtain the written consent of its derivatives party if the derivatives firm intends to use or invest initial margin.

***(f) Part 5, Division 1 – Compliance***

We received comments that certain of the senior derivatives manager obligations, such as compliance reporting to a derivatives firm's board of directors, should be undertaken by a firm's chief compliance officer and not its senior derivatives manager. We have amended sections 31 and 32 to permit the senior derivatives manager or a chief compliance officer to fulfil the internal reporting requirements.

***(g) Sections 38 and 43 – Foreign derivatives dealer exemption and foreign derivatives adviser exemption – trading on an exchange or derivatives trading facility***

We received comments that the exemption for foreign derivatives dealers and foreign derivatives advisers should be available to foreign dealers and foreign advisers in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in a Canadian jurisdiction. In response to these comments, we have amended subsections 38(3) and 43(3) so that these foreign derivatives dealers and foreign derivatives advisers are no longer prohibited from qualifying for the exemptions under sections 38 and 43.

***(h) Section 41 – Derivatives traded on a derivatives trading facility that are cleared***

We received comments that a derivatives firm may not know the identity of its derivatives party prior to execution of a transaction anonymously on a derivatives trading facility. We have included an exemption from sections 10 and 27 of the Instrument for derivatives traded on a derivatives trading facility that, as soon as technologically practicable, are submitted for clearing to a qualifying clearing agency. This exemption is only available if the derivatives firm's derivatives party is an eligible derivatives party.

***(i) Section 45 – Effective date***

We received a number of comments that market participants should be permitted to leverage existing disclosures and



representations to determine eligible derivatives party status. In response to these comments, we have included a transition provision that permits derivatives firms to rely on a derivatives party's "permitted client" status under National Instrument 31-103, "accredited counterparty" status under the *Derivatives Act* (Quebec) or "qualified party" status under the relevant blanket orders in the provinces of Alberta, British Columbia, Manitoba, New Brunswick or Nova Scotia for transactions entered into prior to the coming into force of the Instrument. However, the fair dealing obligation, daily reporting and derivatives party statement requirements will apply to these pre-existing transactions.

#### ***(j) International harmonization and miscellaneous drafting clarifications***

There are a number of drafting changes throughout the Instrument to respond to comments that clarify the Instrument and further harmonize the Instrument with international regulatory regimes.

#### **Anticipated Costs and Benefits**

As mentioned above, we have developed the Proposed Instrument to help protect investors and counterparties, reduce risk, improve transparency, increase accountability and promote responsible business conduct in the OTC derivatives markets. Moreover, the business conduct requirements under the Instrument will help to protect participants in the OTC derivatives markets from unfair, improper or fraudulent practices and foster confidence in the Canadian derivatives market.

The Proposed Instrument aims to provide participants in the Canadian OTC derivatives markets with protections that are equivalent to protections offered to participants in other major international markets.

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 markets 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 markets for certain derivatives firms that are not subject to business conduct regulation and oversight. It is intended to foster confidence in the Canadian derivatives markets by creating a regime that meets international standards and is, where appropriate, 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 to the degree possible, by harmonizing the rules across Canadian jurisdictions and establishing a regime that is tailored for the derivatives market.

#### ***(b) Costs***

Generally, firms will incur costs from analysing the requirements 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 Instrument contemplates a number of exemptions, including an exemption for derivatives firms located in foreign jurisdictions, which are subject to and in compliance with equivalent requirements under foreign laws. These exemptions 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***

The CSA are of the view that the impact of the Proposed Instrument, including anticipated compliance costs for derivatives firms, is proportional to the benefits sought.

Protection of derivatives parties and the integrity of the Canadian derivatives markets are the fundamental principles of the Proposed Instrument. 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, while being tailored to the nature of the Canadian market. To achieve a balance of interests, the Proposed Instrument is designed to promote a safer environment in the Canadian derivatives markets while offering exemptions to derivatives firms that only deal with eligible derivatives parties or that are already subject to and compliant with equivalent requirements.

#### **Contents of Annexes**

The following annexes form part of this CSA Notice:

- Annex I – Summary of comments and CSA responses and list of commenters
- Annex II – Proposed National Instrument 93-101 *Derivatives: Business Conduct*
- Annex III – Proposed Companion Policy 93-101 *Derivatives: Business Conduct*
- Annex IV – Alternative version of the definition of “affiliated entity”
- Annex V – 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 “affiliated entity”

The Instrument defines “affiliated entity” on the basis of “control”, and sets out certain tests for “control”. In the context of other rules relating to OTC derivatives, we are also considering a definition of “affiliated entity” that is based on accounting concepts of “consolidation” (a proposed version of the definition is included in Annex IV). Please provide any comments you may have on (i) the definition in the Instrument, (ii) the definition in Annex IV, and (iii) the appropriate balance between harmonization across related rules and using different definitions to more precisely target specific entities under different rules.

2) Definition of “eligible derivatives party”

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please explain your response.

3) Anonymous transactions executed on a derivatives trading facility

We are considering whether the exemption in section 41 should be expanded in respect of other requirements in this Instrument. Is it appropriate to expand this exemption?

We are also considering whether a similar exemption should be available in other scenarios, including, for example:

- (a) derivatives traded anonymously on a derivatives trading facility that are not cleared; and
- (b) derivatives that are not traded on a derivatives trading facility but are submitted for clearing to a regulated clearing agency.

Is it appropriate to provide a similar exemption in other scenarios? Please explain your response.

4) Handling complaints

The obligations in section 16, as proposed, do not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is not an individual or a specified commercial hedger, or (ii) an eligible derivatives party who is an individual or a specified commercial hedger that has waived these protections. Should the obligations in section 16 be expanded towards all derivatives parties? Please explain your response.

5) Derivatives Party Assets

We note that the requirements with respect to initial margin in sections 25 and 26 only apply to transactions with non-EDPs. Please provide any comments you may have, including whether it would be appropriate to include, for all derivatives parties, restrictions with respect to collateral delivered to a derivatives firm (as initial margin) or adopt a model of requiring informed consent with respect to its use and investment, or some combination of the two approaches.

6) Policies, procedures and controls

Subparagraph 30(1)(c)(iii) requires a derivatives firm to have policies, procedures and controls that are sufficient to assure that an individual who transacts or advises on derivatives for a derivatives firm, conducts themselves with integrity. Please provide any comments you may have relating to this requirement, specifically about any issues relating to the implementation of the requirement in its current form. We will consider these comments in assessing the impact of this requirement on derivatives firms.<sup>8</sup>

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<sup>8</sup> Staff in British Columbia are particularly concerned about the scope of this requirement, in its current form.

Please provide your comments in writing by **September 17, 2018**.

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](http://www.albertasecurities.com), the *Autorité des marchés financiers* at [www.lautorite.qc.ca](http://www.lautorite.qc.ca) and the Ontario Securities Commission at [www.osc.gov.on.ca](http://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:

M<sup>e</sup> Anne-Marie Beaudoin  
Corporate Secretary  
Autorité des marchés financiers  
800, rue du Square-Victoria, 22<sup>e</sup> étage  
C.P. 246, tour de la Bourse  
Montréal (Québec) H4Z 1G3  
Fax: 514-864-6381  
[consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

Grace Knakowski  
Secretary  
Ontario Securities Commission  
20 Queen Street West  
22<sup>nd</sup> Floor  
Toronto, Ontario M5H 3S8  
Fax: 416-593-2318  
[comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)

## Questions

Please refer your questions to any of:

Lise Estelle Brault  
Co-Chair, CSA Derivatives Committee  
Senior Director, Derivatives Oversight  
Autorité des marchés financiers  
514-395-0337, ext. 4481  
[lise-estelle.brault@lautorite.qc.ca](mailto:lise-estelle.brault@lautorite.qc.ca)

Kevin Fine  
Co-Chair, CSA Derivatives Committee  
Director, Derivatives Branch  
Ontario Securities Commission  
416-593-8109  
[kfine@osc.gov.on.ca](mailto:kfine@osc.gov.on.ca)

Paula White  
Deputy Director, Compliance and Oversight  
Manitoba Securities Commission  
204-945-5195  
[paula.white@gov.mb.ca](mailto:paula.white@gov.mb.ca)

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Legal Counsel, Corporate Finance  
Alberta Securities Commission  
403-297-4295  
[Chad.Conrad@asc.ca](mailto:Chad.Conrad@asc.ca)

Michael Brady  
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British Columbia Securities Commission  
604-899-6561  
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Abel Lazarus  
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Nova Scotia Securities Commission  
902-424-6859  
[abel.lazarus@novascotia.ca](mailto:abel.lazarus@novascotia.ca)

Wendy Morgan  
Senior Legal Counsel, Securities  
Financial and Consumer Services Commission, New Brunswick  
506-643-7202  
[wendy.morgan@fcnb.ca](mailto:wendy.morgan@fcnb.ca)

Liz Kutarna  
Deputy Director, Capital Markets,  
Securities Division  
Financial and Consumer Affairs Authority  
of Saskatchewan  
306-787-5871  
[liz.kutarna@gov.sk.ca](mailto:liz.kutarna@gov.sk.ca)



## 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 <sup>9</sup>	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"> <li>• an EDP that is not an individual</li> <li>• an EDP that is an individual that has waived this disclosure</li> <li>• an EDP that is a specified commercial hedger that has waived this disclosure</li> </ul>
Gatekeeper KYC (AML, etc.)	Applies in respect of all clients (s. 13.2)  However, this does not apply if the client is a registered firm, Canadian financial institution or Schedule III bank (s. 13.2(5))	Applies in respect of all derivatives parties (s. 10)  However, this does not apply if the derivatives party is a registered firm or a Canadian financial institution (including a Schedule III bank). Additionally, this does not apply to an anonymous transaction executed on a derivatives trading facility that is cleared.
Client-specific KYC (investment needs and objectives, etc.) Suitability	Applies in respect of all clients (ss. 13.2(2)(c) and 13.3) 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  (ss. 13.2(6) and 13.3(4))	Applies in respect of all derivatives parties other than <ul style="list-style-type: none"> <li>• an EDP that is not an individual</li> <li>• an EDP that is an individual that has waived in writing this obligation</li> <li>• an EDP that is a specified commercial hedger that has waived this obligation</li> </ul> (ss. 7, 11 and 12)
Miscellaneous other obligations	Do not apply to a permitted client <ul style="list-style-type: none"> <li>• Disclosure when recommending the use of borrowed money – s. 13.13(2)</li> <li>• When the firm has a relationship with a financial institution – s. 14.4(3)</li> </ul>	Apply in respect of all derivatives parties other than <ul style="list-style-type: none"> <li>• an EDP that is not an individual</li> <li>• an EDP that is an individual that has waived in writing this obligation</li> <li>• an EDP that is a specified commercial hedger that has waived this obligation</li> </ul> (ss. 7 and 19)

<sup>9</sup> 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]; 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]; section 39A of the *Securities Act* (Nova Scotia), R.S.N.S. 1989, c. 418 [N.S. 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].

Obligation	Approach under NI 31-103	Approach under NI 93-101
Miscellaneous other obligations	<p>Do not apply to a permitted client that is not an individual</p> <ul style="list-style-type: none"> <li>• Dispute resolution service – s. 13.16(8)</li> <li>• Relationship disclosure information – s. 14.2(6)</li> <li>• Pre-trade disclosure of charges – s. 14.2.1(2),</li> <li>• Restriction on self-custody and qualified custodian requirement – s. 14.5.2</li> <li>• Additional statements – s. 14.14.1</li> <li>• Security position cost information – s. 14.14.2</li> <li>• Report on charges and other compensation – s. 14.17</li> <li>• Investment performance report – s. 14.18</li> </ul>	<p>Apply in respect of all derivatives parties other than</p> <ul style="list-style-type: none"> <li>• an EDP that is not an individual</li> <li>• an EDP that is an individual that has waived in writing this obligation</li> <li>• an EDP that is a specified commercial hedger that has waived this obligation</li> </ul> <p>(See ss. 7 and Part 4)</p>

## Appendix B

### Application of business conduct requirements

Regulatory Requirement	Derivatives firms dealing with EDPs	Derivatives firms dealing with non-EDPs
General obligations toward all (Part 3 Div 1) <ul style="list-style-type: none"> <li>• Fair dealing</li> <li>• Conflict of interest management</li> <li>• General/gatekeeper know-your-derivatives party</li> </ul>	•	•
Additional obligations and restrictions (Part 3 Div 2–3) <ul style="list-style-type: none"> <li>• Derivatives-party-specific know-your-derivatives party</li> <li>• Product suitability</li> <li>• Permitted referral arrangements</li> <li>• Complaint handling</li> <li>• Prohibition on tied selling</li> </ul>		•
Client and counterparty accounts (Part 4) <ul style="list-style-type: none"> <li>• Relationship disclosure</li> <li>• Pre-trade disclosures re. leverage/borrowing, risk, product, price, and compensation</li> <li>• Report daily valuations</li> <li>• Notice by non-resident registrants</li> <li>• Holding of assets<sup>10</sup></li> <li>• Use and investment of assets</li> <li>• Transaction confirmations<sup>11</sup></li> <li>• Quarterly statements</li> </ul>		•
Compliance and recordkeeping (Part 5) <ul style="list-style-type: none"> <li>• Compliance and risk management systems</li> <li>• Senior manager report</li> <li>• Client/counterparty agreement</li> <li>• Recordkeeping</li> </ul>	•	•

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

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

ANNEX I

COMMENT SUMMARY AND CSA RESPONSES

Section Reference	Summary of Issues/Comments	Response
Part 1 – Definitions and Interpretation		
s. 1 – Definition of “derivatives adviser”	Two commenters noted the compliance requirements of National Instrument 31-103 <i>Registration Requirements and Exemptions</i> (“NI 31-103”) and suggested the Instrument would be duplicative.	<p>Many of the requirements in the Proposed Instrument are similar to existing business conduct requirements applicable to registered dealers and advisers under NI 31-103 but have been tailored to reflect the different nature of derivatives markets.</p> <p>In the case of firms that are registered under NI 31-103, we would expect these firms to have policies and procedures in place aimed at complying with these obligations.</p> <p>To the extent compliance requirements under the Instrument are similar to compliance requirements under NI 31-103, a registered firm will be able to satisfy the requirements through its existing policies and procedures. However, to the extent compliance requirements are dissimilar, these firms will need to adopt additional policies and procedures that reflect the different nature of derivatives markets.</p>
	One commenter suggested that the list of factors for determining whether a party is in the business of advising in respect of derivatives should not be the same as that for trading.	Change made. The CP has been revised to include additional guidance on the business trigger for advising. See revised CP guidance on factors in determining a business purpose – derivatives advisers.
s. 1 – Definition of “derivatives dealer”	One commenter requested clarification on which agency roles fall within the scope of the definition.	Change made. The revised CP provides additional guidance on when a person or company will be considered to be a derivatives dealer. See revised CP guidance on factors in determining a business purpose – derivatives dealer.
	One commenter suggested the definition of derivatives dealer be harmonized across Canada into a national instrument.	<p>No change. The definition of derivatives dealer and the criteria used to assess if a firm is a derivatives dealer found in the CP to this Instrument will be applied consistently across Canada and in Proposed National Instrument 93-102 <i>Derivatives: Registration</i> (“<b>Proposed NI 93-102</b>”).</p> <p>To the extent necessary, any further consequential amendments to other rules, such as rules relating to trade reporting, will be made at a later date.</p>
s. 1 – Business trigger to “derivatives adviser” and “derivatives dealer”, General	Two commenters requested clarification of the definition of “derivatives adviser” and “derivatives dealer” to enable derivatives parties to receive definitive legal advice on whether their activities bring them into scope.	Change made. The revised CP provides additional guidance on when a person or company will be considered to be a derivatives dealer or a derivatives adviser.
	Two commenters suggested replacing the word “trading” with “dealing” in the definition and CP guidance on “derivatives dealer”.	No change. The registration requirement in Canadian securities legislation is generally based on the concept of a “business trigger” for registration, namely whether a person or company is in the business of “trading” securities or derivatives or advising others in relation to



		securities or derivatives.
	Two commenters requested clarification of the jurisdictional scope of the Instrument and CP.	Changes made. The CP has been revised to include guidance on the jurisdictional scope of the Instrument under factors in determining a business purpose –general.
	One commenter requested a specific exemption or guidance that investment-related services provided by pension plan sponsors to their sponsored plans, such as hiring third party investment managers, is not captured. The commenter submitted that the inclusion of “directly or indirectly carrying on the activity with repetition, regularity or continuity” and “transacting with the intention of being compensated” may capture pension plans or their sponsors.	<p>No change. The revised CP provides additional guidance on when a person or company will be considered to be a derivatives dealer or a derivatives adviser.</p> <p>The registration requirement in Canadian securities legislation is generally based on the concept of a “business trigger” for registration, namely whether a person or company is in the business of trading securities or derivatives or advising others in relation to securities or derivatives.</p> <p>Accordingly, the Instrument does not fundamentally alter the nature of the existing registration requirement for market participants, but merely extends the requirement to OTC derivatives.</p> <p>If a firm, after considering the guidance in the CP, remains uncertain as to whether or not it has tripped the business trigger for registration, the firm should consider the exemptions in Part 6 of the Instrument, including the exemption in s. 37 for certain derivatives end-users.</p>
	One commenter requested guidance that a person acting as a manager of investment managers providing derivatives advisory services will not be considered a “derivatives adviser” solely on the basis of engaging in hiring, and providing investment guidelines to, third-party investment managers.	<p>No change. The revised CP provides additional guidance on when a person or company will be considered to be a derivatives dealer or a derivatives adviser.</p> <p>The Instrument and Proposed NI 93-102 do not contemplate a separate category of registration for fund managers of funds that invest in derivatives. However, the existing registration category of investment fund manager in NI 31-103 would likely cover these activities.</p>
s. 1 – Business trigger to “derivatives adviser” and “derivatives dealer”, Routinely quotes prices	Several commenters suggested that routinely providing quotes should not be treated as indicia of dealing or advising. The commenters suggested that “derivatives dealer” be limited to market making activity, which absent other factors, should not be determined solely by quoting prices, routinely or not. The commenters requested clarification of the end-user exemption.	Partial change. Further revisions have been made to the indicia described in the CP to determine whether a derivatives dealer or derivatives advisor is in the business of trading derivatives. The CP explains that the end-user exemption may be available to a party that trades derivatives with regularity but does not engage in specified dealer-like activities.
s. 1 – Business trigger to “derivatives adviser” and “derivatives dealer”, Derivatives clearing services	One commenter requested clarification of clearing services that would result in a clearing broker being considered a “derivatives dealer”.	No change. Providing clearing services is one of the indicia of being in the business of trading derivatives.
s. 1 – Business trigger to “derivatives adviser” and	Several commenters submitted that a notional value-based <i>de minimis</i> exception to “derivatives dealer” requirements be provided to alleviate risk concentration and decreased liquidity.	No change. The Instrument creates a uniform approach to regulating conduct in derivatives markets and promotes consistent protections for market participants. However, a <i>de minimis</i>

<p>“derivatives dealer”, <i>De minimis</i></p>		<p>exemption from certain requirements imposed on derivatives dealers is contemplated in Proposed NI 93-102. This is intended to strike a balance between addressing liquidity/market access concerns without significantly impacting protections for market participants.</p>
<p>s. 1 – Business trigger to “derivatives adviser” and “derivatives dealer”, Incidental advisory activities</p>	<p>Several commenters suggested express exclusions of professionals whose advisory services are solely incidental to their business or profession.</p>	<p>Change made. Clarifying language has been added to the CP. Appropriately licensed professionals would generally not be considered to be advising on derivatives if their activities are incidental to their <i>bona fide</i> professional activities.</p>
	<p>Commenters suggested express exclusion of otherwise-regulated persons including banks, trust companies and insurance companies. Pension plan sponsors and affiliates providing investment-related services to a Canadian regulated pension fund or subsidiary were requested to be expressly excluded.</p>	<p>No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.</p>
<p>s. 1 – Definition of “eligible derivatives party”, General</p>	<p>Several commenters supported the concept of an eligible derivatives party (“EDP”) to classify sophisticated market participants.</p> <p>One commenter recommended reconsideration of EDP status for advisers that only advise on an incidental basis (and accordingly do not require registration as derivatives advisers).</p> <p>One commenter suggested that managed account clients be subject to the same carve-outs applicable to EDPs.</p>	<p>We thank the commenters for their comments.</p> <p>We have specifically requested comment in the Notice and Request for Comment in relation to Proposed NI 93-102 as to whether and in what circumstances registered advisers (portfolio managers) under NI 31-103 should be considered derivatives advisers. We will consider these responses in determining whether registered advisers (portfolio managers) should remain included within the EDP definition.</p> <p>We have deleted proposed subsection 7(3) of the version of the Instrument published for comment in April 2017. Accordingly, a derivatives firm acting as an adviser in respect of a managed account of an EDP will be subject to the reduced set of obligations contemplated by s. 7 of the Instrument unless otherwise agreed by the firm and the EDP.</p>
<p>s. 1 – Definition of “eligible derivatives party”, Consistency with other regulatory definitions</p>	<p>Several commenters suggested that the definition of EDP be expanded to include all “permitted clients” under NI 31-103, including mutual fund dealers, exempt market dealers and charities. The commenters noted the compliance burdens on the derivatives industry if the “permitted client” status cannot be leveraged to determine EDP status under the Instrument.</p>	<p>We have amended the definition of EDP to include certain new categories; however, the definition of EDP has not been extended to expressly include mutual fund dealers, exempt market dealers and registered charities.</p> <p>In terms of the compliance burden, we point out that the financial asset test for companies found in the definition of “permitted client” may be higher than the threshold contemplated in this Instrument. For example, the net asset test that applies to a company that qualifies as a specified commercial hedger in this Instrument is \$10,000,000.</p> <p>Furthermore, we are permitting a derivatives firm to leverage a pre-existing “permitted client”, “accredited counterparty” or “qualified party” representation from its client as set out in s. 45 of the Instrument for pre-existing transactions. If the conditions in that section are satisfied, then those transactions are only subject to s. 8 [<i>Fair dealing</i>], s. 20 [<i>Daily reporting</i>] and s. 30 [<i>Derivatives party</i>]</p>

		<p>statements].</p> <p>The definition of EDP is built on the knowledge and experience test found in the <i>Derivatives Act</i> (Quebec). Unless a person or company qualifies as an EDP under any of the prescribed categories, we are not persuaded that they otherwise have sufficient sophistication, derivatives-related expertise, or financial resources so as to not require the additional protections afforded to non-EDP customers.</p>
	<p>Several commenters suggested harmonization of the definition of EDP with existing definitions, noting liquidity and equivalence concerns. These definitions included “eligible contract participant” used by the U.S. Commodity Futures Trading Commission (“CFTC”)<sup>1</sup>, “qualified party” in Blanket Order 91-507 <i>Over-the-Counter Trades in Derivatives</i> (“BO 91-507”),<sup>2</sup> “accredited investor” in National Instrument 45-106 <i>Prospectus Exemptions</i> (“NI 45-106”), and “permitted client” under NI 31-103.</p>	<p>Change made. We have amended the definition of EDP to include certain new categories, including:</p> <ul style="list-style-type: none"> <li>• (n) non-individual commercial hedger that has net assets of \$10,000,000,</li> <li>• (p) non-individual entity whose obligations under derivatives are fully guaranteed by another EDP, other than an individual or commercial hedger, and</li> <li>• (q) non-individual entity that is a commercial hedger and whose obligations under derivatives are fully guaranteed by another EDP, other than an individual.</li> </ul> <p>We believe that, with these changes, the definition of EDP is sufficiently harmonized with the definitions cited by the commenter, recognizing that there are differences in the overall regulatory approach that warrant certain distinctions.</p>
<p>s. 1 – Definition of “eligible derivatives party”, para (m)</p>	<p>Several commenters requested a lower asset threshold necessary to qualify as an EDP and specifically requested harmonization with the \$10 million threshold applicable to an “eligible contract participant” under the U.S. <i>Commodity Exchange Act</i><sup>3</sup> (“CEA”) and an “accredited counterparty” under the Quebec <i>Derivatives Act</i>.<sup>4</sup></p> <p>One commenter suggested a threshold of \$25 million of total assets instead of net assets.</p> <p>Another commenter suggested that individuals with net assets reaching an aggregate realizable value of \$25 million should be treated as EDPs that are not individuals.</p>	<p>Change made. See new paragraph (n) of the EDP definition.</p>
<p>s. 1 – Definition of “Eligible Derivatives Party”, para (n)</p>	<p>Two commenters suggested that individuals with minimum net assets of \$5 million should be treated as EDPs. One of these commenters suggested harmonization with the definition of</p>	<p>No change. Based on our analysis, the threshold aggregate realizable value before tax but net of any related liabilities of at least \$5 million of <i>financial assets</i> is appropriate for the</p>

<sup>1</sup> See s. 1a(18)(a)(v) of the U.S. *Commodity Exchange Act*.

<sup>2</sup> In Quebec, “accredited counterparty” under the Quebec *Derivatives Act*.

<sup>3</sup> The U.S. Commodity Exchange Act sets out a \$10 million total assets test in the definition of “eligible contract participant” (calculated as \$10 million in total assets, or, if hedging, a minimum net worth exceeding \$1 million).

<sup>4</sup> “Accredited counterparty” under the Quebec *Derivatives Act* is calculated as “cash, securities, insurance contracts or deposits having an aggregate realizable value, before taxes, but after deduction of the corresponding liabilities, of more than \$10,000,000” (*Derivatives Regulation*, c. I-14.01, r.1, s. 1).

	“accredited counterparty” under the Quebec <i>Derivatives Act</i> . <sup>5</sup>	determination of eligible derivatives party status for an individual.  This is consistent with the current financial threshold for individuals in the definition of “permitted client” in NI 31-103.
s. 1 – Definition of “eligible derivatives party”, Knowledge and experience requirements of paras (m)-(n)	Several commenters suggested a “bright line” financial resources test eliminating the knowledge and experience requirements, consistent with the approach in NI 31-103 and NI 45-106. Alternatively, the knowledge and experience requirements should apply generally with no transaction-specific determination.  One commenter submitted that investable assets do not necessary imply financial sophistication, such that tests based on financial assets may not be indicative of better access to information and less need for protection.	No change. Appropriate knowledge and experience is necessary for a derivatives party to transact in derivatives without the additional protections provided to non-EDPs.  This is also consistent with requirements that currently apply in Quebec under the Quebec <i>Derivatives Act</i> .
	Several commenters suggested that the Instrument allow representations as to the knowledge and experience requirements to be given in ISDA Master Agreements or protocols amending them.	Change made. Representations are required to be made in writing and can be included as an element of a broader written agreement.
	One commenter noted that to the extent previously given representations are no longer true or reliable about a party’s knowledge and experience with particular types of derivatives, the knowledge and experience requirements may potentially trigger default events, followed by transaction terminations, under derivatives trading agreements. As the OTC derivatives market is characterized by inter-related transactions, such default and subsequent termination may spread to other derivatives transactions among different parties.	No change. The CP provides guidance on when a derivatives firm may rely on a representation. See CP guidance on subsection 1(7).
	One commenter submitted that it is practically remote to receive written representations from each counterparty and requested that derivatives firm be allowed to otherwise confirm, acting reasonably, that the counterparty satisfies the requirements.	No change. Representations form part of the written agreements that document derivatives transactions.
s. 1 – Definition of “eligible derivatives party”, Waiver and representations  <i>See also s. 7 below.</i>	Several commenters suggested that market participants who would not otherwise qualify for EDP status be allowed to affirmatively represent their qualification to evaluate risks associated with derivatives transactions and waive the applicability of certain provisions.	No change. However, new paragraphs have been added under the definition of eligible derivatives party. A person or company, other than an individual, may qualify for EDP status under these new paragraphs.
	One commenter submitted that allowing an investor to waive protections may result in abuse.	No change. Derivatives firms have an obligation to act in good faith. Applying undue pressure on a derivatives party to waive protections would be a breach of that obligation.
	Several commenters requested clarification that there is no affirmative duty to perform an investigation of a party’s representation or warranty, unless a reasonable person would have grounds to believe that such statements are false	Change made. We have further clarified that a derivatives firm may rely on written representations unless it would be unreasonable to do so. See CP guidance on subsection 1(7).

<sup>5</sup> Calculated as “cash, securities, insurance contracts or deposits having an aggregate realizable value, before taxes, but after deduction of the corresponding liabilities, of more than” \$5,000,000 (Derivatives Regulation, c. I-14.01, r.1, s. 1).

	or otherwise unreasonable to rely on.	
s. 1 – Definition of “eligible derivatives party”, Commercial hedger	Several commenters requested that the definition of EDP include an exemption for hedgers. The commenters suggested a definition similar to the existing exemptions in BO 91-507 for “qualified parties” or “eligible contract participants” in the U.S., and broad enough to include all end-users who currently transact in OTC derivatives transactions for hedging purposes. One commenter submitted that regardless of size, many commercial operations need to hedge their foreign currency or interest rate risks and no market other than the OTC derivatives market can provide an equivalent tailored risk management solution.	Change made. Please see new paragraphs (n) and (q) under the definition of EDP. A person or company, other than an individual, will qualify for EDP status subject to certain requirements when it meets the definition of commercial hedger.
s. 1 – Definition of “eligible derivatives party”, Guarantees	Several commenters suggested that the definition of EDP also include an entity whose obligations are guaranteed by an entity that otherwise qualifies as an EDP. One of these commenters suggested that the definition of EDP also include an entity that wholly, directly or indirectly, owns, is owned by, or is under common ownership with, one or more EDPs.	Change made. Please see new paragraph (p) under the definition of EDP. A person or company, other than an individual, whose obligations under a derivative are fully guaranteed or fully supported (under a letter of credit or credit support agreement) by one or more eligible derivatives parties will qualify for EDP status subject to certain conditions.
<b>Part 2 – Application</b>		
s. 3 – Application - scope of instrument	One commenter submitted that the imposition of the same requirements on derivatives advisers as those on derivatives dealers creates a duplicative and unnecessary compliance burden.	Change made. The CP has been revised to include additional guidance on the business trigger for advising.  The requirements in the Instrument are generally similar to existing business conduct requirements applicable to registered advisers under NI 31-103 but have been tailored to reflect the different nature of derivatives markets. Accordingly, we do not believe that the proposed regulatory regime for derivatives advisers unnecessarily duplicates the regime for derivatives dealers.
	One commenter suggested that members of the Investment Industry Regulatory Organization of Canada (“IIROC”) not be required to comply with the Instrument.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
	One commenter suggested exempting derivatives firms that adhere to the FX Global Code of Conduct, whether or not their counterparty is an EDP. Alternatively, that such exemption applies in respect of physically-settled FX swaps and FX forwards.	No change. The FX Global Code of Conduct does not impose legal or regulatory obligations on market participants.  Many of the requirements in the Instrument are principles-based and may be satisfied in different ways. We encourage derivatives firms that trade or advise others in relation to FX-related derivatives to consider the contents of the FX Global Code of Conduct in developing their policies and procedures aimed at complying with the requirements of the Instrument.
s. 4 – Application – affiliated entities	One commenter supported the inclusion of s. 4, which exempts a person providing derivatives advisory services to an affiliated entity from the Instrument. The commenter requested an exemption for the person providing investment	We thank the commenter for their comment.  A person or company that deals with or advises an entity that meets the definition of “affiliated entity” may qualify for the exemption. However,

	<p>advisory services for no compensation to an associated or related person that does not otherwise fall within the definition of an affiliated entity. Alternatively, that guidance clarify that such person does not trip any business trigger as a “derivatives adviser”.</p>	<p>the exemption is not available if the affiliated entity is an investment fund.</p> <p>We have specifically requested comment in the Notice and Second Request for Comment in relation to this Instrument and in the Notice and Request for Comment in relation to Proposed NI 93-102 as to how we should define the concept of affiliated entity for the purposes of these rules.</p>
<p>s. 5 – Application - qualifying clearing agencies</p>	<p>One commenter requested clarification on whether derivatives firms are exempt from the Instrument when facing regulated clearing agencies.</p> <p>The commenter also requested that EDP status be granted for clearing agencies that enter into proprietary trades that are not cleared transactions.</p>	<p>Change made. Qualifying clearing agencies have been added to the definition of EDP. See new paragraph (r) under the definition of EDP.</p> <p>A clearing agency will be an EDP for all trades, including proprietary trades.</p>
<p>s. 6 – Application - governments, central banks and international organizations</p>	<p>Two commenters requested clarification on whether derivatives firms are exempt from the Instrument when facing entities listed under s. 6.</p>	<p>Clarifying language has been added to the CP to make it clear that derivatives firms are not exempt from their obligations when facing government entities, central banks and international organizations. However, these entities will generally be EDPs.</p>
	<p>One commenter suggested expanding the list of excluded entities to include (1) crown corporations, government agencies and any other entity wholly owned or controlled by, or all of whose liabilities are guaranteed by, one or more governments, central banks and international organizations, and (2) state, regional and local governments in foreign jurisdictions.</p>	<p>No change. To ensure a level playing field, all derivatives dealers and derivatives advisors are subject to a minimum set of standards in their dealings with derivatives parties.</p>
<p>s. 7 – Exemptions from the requirements of this Instrument when dealing with or advising an eligible derivatives party, General</p>	<p>Several commenters supported the two-tiered approach of the Instrument with the effect that a substantial portion of the Instrument will not apply to transactions with an EDP and submitted that no additional requirements are necessary when a derivatives firm deals with an EDP. Two commenters suggested a three-tier approach with the effect of an outright exemption for the inter-dealer market.</p>	<p>No change. The Instrument sets out a two-tiered regime with the effect that a derivatives firm is not required to comply with certain requirements in the Instrument when dealing with eligible derivatives parties. The obligations of a derivatives firm differ depending on the nature of the derivatives party. Please see s. 7 of the Instrument and related guidance in the CP. The inter-dealer market will typically involve transactions between two EDPs and since those parties can bargain for appropriate protections, they are subject to a limited set of provisions in this Instrument. It is inappropriate and inconsistent with the rule to provide an outright exemption for the inter-dealer market and also inconsistent with the approach taken internationally.</p>
<p>s. 7 – Exemptions from the requirements of this Instrument when dealing with or advising an eligible derivatives party, subsection (2)</p>	<p>Three commenters submitted that the Instrument requires individual EDPs to waive in writing the second tier of requirements. The commenters suggested that individual EDPs be exempt from the second-tier requirements similar to other categories of EDPs. In the alternative, the commenters requested that no new waiver be required from the individual every 365 days and instead the onus for revocation be placed on the individual.</p>	<p>Change made. An individual eligible derivatives party may waive, in writing, any or all of the requirements of the Instrument, other than as set out in s. 7(1). Waiver may be included in account-opening documentation or other relationship disclosure, and there is no obligation to update the waiver once a derivatives party has begun trading. A derivatives party may withdraw their waiver at any time.</p>
<p>s. 7 – Exemptions from the requirements of</p>	<p>Several commenters suggested that s. 7(3) be deleted on the basis that disclosures and protections are not affected by whether the</p>	<p>Change made. The requirements of the Instrument are not dependent on whether a derivatives firm is acting as an adviser to an EDP</p>

<p>this Instrument when dealing with or advising an eligible derivatives party, subsection (3)</p>	<p>trading decision is client-directed or at the discretion of the adviser. Managed account clients benefit from both the fiduciary obligation owed to them by their adviser and the contractual terms of the investment management agreement. In the alternative, the commenters requested that managed account clients be permitted to waive sections of the Instrument that but for s. 7(3) would not apply.</p>	<p>or an adviser in respect of a managed account of an eligible derivatives party.</p> <p>We have deleted proposed subsection 7(3) of the version of the Instrument published for comment in April 2017. Accordingly, a derivatives firm acting as an adviser in respect of a managed account of an EDP will be subject to the reduced set of obligations contemplated by s. 7 of the Instrument unless otherwise agreed by the firm and the EDP.</p>
<p>Part 3 – Dealing with or Advising Derivatives Parties</p>		
<p>Division 1 – General Obligations Towards All Derivatives Parties</p>		
<p>s. 8 – Fair dealing</p>	<p>Several commenters supported the fair dealing requirements, noting the importance of regulatory tools necessary to enforce against deceptive and manipulative trading practices or fraudulent activity.</p> <p>One commenter requested clarification on s. 8 as compared with s. 19.</p> <p>Two commenters suggested higher requirements for derivatives advisers, while other commenters noted that fiduciary standards apply, NI 31-103 regulates derivatives advisers, and that transactions are often of a bespoke nature.</p> <p>One commenter requested an exemption for derivatives firms dealing with other derivatives firms or financial institutions.</p> <p>One commenter submitted that the need for regulation has not been identified, as no appreciable or material examples of banks or other derivatives firms have been identified in Canada as violating existing fair dealing rules.</p> <p>One commenter submitted that fair dealing should not change depending on the sophistication of counterparties and s. 8 should be deleted. The commenter submitted that the derivatives dealer relationship is not a fiduciary one, nor does good faith generally apply to the negotiation of transactions at common law. In the alternative, s. 8 should be harmonized with other regulatory regimes, which do not impose requirements on individuals acting on behalf of a derivatives firm.</p>	<p>We thank the commenters for their comments.</p> <p>Change made. Former stand-alone provision in s. 19 on fair terms and pricing has been removed and clarifying language in the CP has been added that fair terms and pricing may, in certain circumstances, be viewed to fall within the overall fair dealing principle in s. 8.</p> <p>We have deleted proposed subsection 7(3) of the version of the Instrument published for comment in April 2017. Accordingly, a derivatives firm acting as an adviser/investment counsel to an EDP will be subject to the same set of obligations under the Instrument as a derivatives firm acting as an adviser/portfolio manager for an EDP.</p> <p>However, where a derivatives firm is acting as an adviser to a fully managed account for a derivatives party, including an EDP, the derivatives firm may be subject to a fiduciary duty under certain statutes and under common law.</p> <p>No change. However, clarifying language has been added to the CP. Fair dealing obligations will be interpreted flexibly and in a manner sensitive to context.</p> <p>No change. Canadian jurisdictions are committed to implementing harmonized business conduct rules that will protect derivatives parties in the Canadian market.</p> <p>No change. Fair dealing obligations will be interpreted flexibly and in a manner sensitive to context.</p>
<p>s. 9 – Conflicts of interest</p>	<p>Two commenters requested clarification of the Instrument and CP, particularly with respect to the divergent nature of two parties' interests. For conflicts of interest not prohibited by law, the only regulatory requirement should be to identify and disclose material conflicts. One of the commenters suggested limiting the requirement to</p>	<p>No change. Requirements relating to conflicts of interest are a central pillar of business conduct regulation.</p>

	<p>conflicts of interest relating to research and clearing activities.</p> <p>One commenter suggested eliminating specific conflict of interest requirements with respect to derivatives advisers, as they face fiduciary obligations.</p>	<p>The requirements in the Instrument are generally similar to existing business conduct requirements applicable to registered advisers under NI 31-103 but have been tailored to reflect the different nature of derivatives markets.</p> <p>These requirements include requirements in relation to identifying and responding to conflicts of interest.</p> <p>We acknowledge that, where a derivatives firm is acting as an adviser to a fully managed account for a derivatives party, including an EDP, the derivatives firm may be subject to a fiduciary duty under certain statutes and under common law. However, this may not be the case where the derivatives adviser is merely providing advice in relation to derivatives or strategies but does not exercise discretion over the EDP's account.</p>
	<p>One commenter submitted that the Instrument overlaps with conflicts of interest requirements under existing Canadian laws<sup>6</sup> and that overlapping requirements should be removed from the Instrument.</p>	<p>No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.</p>
	<p>Two commenters submitted that disclosure must be specific and provided before a transaction takes place, recognizing that in certain situations disclosure may be more appropriate after the transaction. Another commenter requested that the use of standardized disclosures be permitted, provided that additional or particularized disclosures are made available as appropriate.</p>	<p>Change made. Please see revised CP guidance related to s. 9. We expect derivatives firms to provide general and specific disclosures.</p>
<p>s. 10 – Know your derivatives party, General</p>	<p>Several commenters suggested harmonization of s. 10 with similar regulatory requirements in other jurisdictions.<sup>7</sup> Several commenters submitted that an exemption is needed for derivatives dealers that do not know the identity of their counterparties prior to execution of the transaction.</p>	<p>Change made. New s. 41 exempts a derivatives firm in certain circumstances where it does not know the identity of its derivatives party prior to the execution of the transaction. The exemption in s. 41 is applicable to transactions executed on a derivatives trading facility (or analogous platform) where at the time of the transaction, the derivatives party to the derivative that is submitted for clearing is an eligible derivatives party. We have specifically requested further comment in the Notice and Second Request for Comment in relation to this Instrument about the availability of a similar exemption in respect of derivatives traded anonymously on a derivatives trading facility that are not cleared, derivatives that are not traded on a derivatives trading facility but are submitted for clearing to a regulated clearing agency, and otherwise if it is appropriate to extend the scope of the exemption to other sections of this Instrument.</p>

<sup>6</sup> The *Bank Act* requires Canadian banks to establish procedures to identify and address conflicts of interest. OSFI Guideline B-7 requires federally regulated financial institutions that are dealing in derivatives to take reasonable steps to identify and address potential material conflicts of interest.

<sup>7</sup> See CFTC's relief in No Action Letter 13-70 in respect of swaps that are intended to be cleared.



		We understand that a trading platform would perform know-your-derivatives-party diligence prior to accepting a derivatives party for trading on the platform. We consider this to be a reasonable steps obligation and we would accept that if it is not possible to know the identity of the counterparty, that information is not required.
s. 10 – Know your derivatives party, subsection (2)	Several commenters requested that s. 10(2)(c) be removed, submitting that it is disproportionately impracticable to require derivatives advisers, in connection with securities-based derivatives, to establish if the party they are advising (i) is an insider of a reporting issuer or any other issuer whose securities are publicly traded, or (ii) would be reasonably expected to have access to material non-public information relating to any interest underlying the derivative.	No change. These obligations already exist for registered firms under securities legislation.  In the case of derivatives firms that are not currently registered under securities legislation but nevertheless provide products or services in relation to equity derivatives, we would expect these firms today to have policies and procedures in place aimed at preventing illegal insider trading and tipping. This information is necessary to ensure that securities law is being complied with.
s. 10 – Know your derivatives party, subsection (4)	Two commenters requested that information be deemed current, unless a client informs a derivatives firm otherwise.	No change. The requirements in relation to “gatekeeper” KYDP in s. 10 of the Instrument and “derivatives-party-specific” KYDP in s. 11 of the Instrument are generally consistent with existing “know-your-client” obligations under Canadian securities legislation and comparable requirements in foreign jurisdictions.  This information is necessary to ensure that securities law is being complied with.
s. 10 – Know your derivatives party, subsection (5)	Two commenters requested an expansion of s. 10(5) to cover EDPs, registration-exempt entities, and foreign financial institutions.	No change. Know-your-derivatives party requirements do not apply to a registered securities firm, registered derivatives firm, or a Canadian financial institution.
<b>Division 2 – Additional Obligations when Dealing with or Advising Certain Derivatives Parties</b>		
s. 12 – Suitability	Two commenters requested clarification on what constitutes a recommendation by a derivatives dealer. The commenters suggested that suitability be limited to recommendations, and not instructions.	No change. Reasonable steps must be taken 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.
	One commenter requested that s. 12 clarify that a determination of suitability need not be made on a trade-by-trade basis if a discrete trade fits into a larger trading strategy or series of trades, for which suitability can be assessed.	No change. Reasonable steps must be taken 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.  If a discrete transaction fits into a larger trading strategy or series of transactions, and the derivatives firm has determined that the larger trading strategy or series of transactions is suitable for the derivatives party, it is unclear why there should be a concern over the discrete transaction.
	One commenter submitted that specific suitability obligations are not necessary in the case of a derivatives adviser, as they have broader fiduciary obligations.	We acknowledge that, where a derivatives firm is acting as an adviser to a fully managed account for a derivatives party, including an EDP, the derivatives firm may be subject to a fiduciary duty under certain statutes and under common law. However, this may not be the case where the derivatives adviser is merely providing advice in relation to derivatives or strategies but does not exercise discretion over the EDP’s account.

	Two commenters requested safe harbours from the suitability requirements, including for derivatives dealers and intended to be cleared derivatives.	No change. Suitability requirements are crucial to the protection of non-EDPs.  Suitability requirements do not apply when trading with or advising non-individual EDPs and apply, but may be waived, when trading with or advising individual EDPs.  As explained in the Notice and Request for Comment for the Instrument published in April 2017, this is generally similar to the regime that applies to registered securities firms under NI 31-103.
s. 13 – Permitted referral arrangements	Three commenters submitted that s. 13 imposes broad obligations. One commenter requested clarification that establishing a relationship with a dealer on behalf of an advisory client does not constitute a referral arrangement. Other commenters requested that s. 13 be removed to better align with the absence of comparable obligations in CFTC rules. Alternatively, that s. 13 apply only to referral arrangements that specifically involve derivatives and that exemptions be provided for inter-group referrals.	No change. The requirements in relation to permitted referral arrangements do not apply if the firm is trading with or advising non-individual EDPs and apply but may be waived if the firm is trading with or advising individual EDPs.  In the case of firms trading with or advising non-EDPs, these requirements are generally consistent with requirements in NI 31-103 applicable to IIROC CfD/forex firms.
Former s. 16 – Disclosure regarding the use of borrowed money or leverage	One commenter requested that to avoid duplication, the disclosure statement apply only to derivatives dealers. The commenter requested clarification that posting of the disclosure statement on a website in a readily accessible location will be sufficient.	Change made. Disclosure regarding the use of borrowed money or leverage has been incorporated into new s. 19. Disclosure must be delivered to a derivatives party.
Former s. 17 – Handling complaints	One commenter suggested harmonization with CFTC rules by eliminating complaint handling obligations.	No change. The requirements in relation to complaint handling do not apply if the firm is trading with or advising non-individual EDPs and apply, but may be waived, if the firm is trading with or advising individual or specified commercial hedger EDPs.  In the case of firms trading with or advising non-EDPs, these requirements are generally consistent with requirements in NI 31-103 applicable to IIROC CfD/forex firms.  Please see the Instrument and related guidance in the CP.
<b>Division 3 – Restrictions on Certain Business Practices when Dealing with Certain Derivatives Parties</b>		
Former s. 18 – Tied selling	One commenter suggested that tied selling obligations are duplicative of existing Canadian legislation and should be eliminated to better align with other regulatory regimes.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
Former s. 19 – Fair terms and pricing	Two commenters supported the requirement. One commenter submitted that the terms are better suited to CP guidance on s. 8. Another submitted that the inclusion of an express best execution requirement would be beneficial to avoiding conflicts.  Two other commenters suggested that the	Change made. Former s. 19 on fair terms and pricing has been merged with s. 8. Clarifying language has been added to the CP in relation to guidance on s. 8. Both the compensation and market value or price components of a derivative are relevant to a derivatives firm's obligation to transact with derivatives parties under terms and pricing that are fair. Derivatives firms are expected

	requirement should be deleted. The commenters suggested that given the negotiated, bilateral and bespoke nature of transactions, there is no fair price beyond what the parties agree, and that legal obligations and remedies already exist.	to set and follow policies and procedures that are reasonably designed to achieve the most advantageous terms for the derivatives firm's derivatives parties.
<b>Part 4 – Derivatives Party Accounts</b>		
<b>Division 1 – Disclosure to Derivatives Parties</b>		
Division 1, General	Several commenters suggested harmonization of the requirements with CFTC rules. Derivatives firms should not be required to provide valuations or related inputs and assumptions and that instead “mid-market marks” <sup>8</sup> should be used. Several other commenters supported the requirement to provide valuations that are accompanied by inputs and assumptions in order to make the estimates/prices more meaningful. Commenters suggested that daily marks should only be required for uncleared transactions. One commenter suggested limiting “inputs and assumptions” to “methodology and assumptions”.	Change made. Please see revised CP guidance on the definition of valuation.
Former s. 20 – Relationship disclosure information	One commenter submitted that certain relationship documentation listed in former s. 20(2) is not applicable for a derivatives relationship.	No change made. The requirements in relation to client relationship disclosure do not apply if the firm is trading with or advising non-individual EDPs and apply, but may be waived, if the firm is trading with or advising individual or specified commercial hedger EDPs.  In the case of firms trading with or advising non-EDPs, these requirements are generally consistent with requirements in NI 31-103 applicable to IIROC CfD/forex firms.  The required disclosure is important for non-EDPs to understand the risks associated with derivatives.
Former s. 21 – Pre-transaction disclosure	One commenter requested that the use of standardized disclosures be permitted provided additional or particularized disclosures are made available as appropriate.	No change. Where standardized disclosure meets all requirements, it is acceptable.
	Two commenters requested clarification that pre-transaction disclosures do not apply where the transaction is an intended to be cleared derivative or executed on an exchange.	No change. Pre-transaction disclosures are required for all transactions with non-EDPs.
	One commenter requested clarification on when disclosure would not be required as result of the application of subsection (2)(b) and what additional information is intended by subsection (2)(c).	Change made. The phrase “if applicable” has been removed from new s. 19(2)(b). Compensation not reflected in the price would be required to be disclosed pursuant to s. 19(2)(c).
Former s. 22 – Daily reporting	Only derivatives dealers should have a daily reporting obligation, and it is sufficient for derivatives advisers to provide reporting on a monthly basis, unless otherwise agreed.	Change made. See new s. 20(2).
Former s. 23 – Notice to derivatives parties by non-resident	One commenter submitted that the notice requirement for non-resident derivatives firms is duplicative of former s. 20 and standard information that is provided in relationship	No change. However, clarifying language has been added to the CP. A separate statement is not required when information required is already provided to counterparties under standard form

<sup>8</sup> CFTC rules do not include amounts for profit, credit reserve, hedging, funding, liquidity or other costs or adjustments in the mid-market mark.

derivative firms	documentation.	industry documentation.
<b>Division 2 – Derivatives Party Assets</b>		
Division 2, General	<p>Several commenters requested a revision of Division 2 of Part 4 to recognize that re-hypothecation is a private commercial matter, unless otherwise subject to existing regulatory restrictions, such as segregation, margin, and specific types of counterparty requirements.</p> <p>Two commenters submitted that only former s. 24 should apply to EDPs.</p> <p>Two commenters requested clarification of the application of the requirements to derivatives advisers fulfilling discretionary mandates, for which they are generally given authority by their clients with respect to the use and investment of assets.</p>	<p>Change made. A derivatives firm is exempted from the requirements of the division if it is subject to and complies with or is otherwise exempt from National Instrument 94-102 <i>Derivatives: Customer Clearing and Protection of Customer Collateral and Positions</i> (“<b>NI 94-102</b>”), securities legislation relating to margin and collateral requirements or National Instrument 81-102 <i>Investment Funds</i>.</p> <p>We note that ss. 25 and 26 only apply to transactions with non-EDPs. We have specifically requested further comment in the Notice and Second Request for Comment in relation to this Instrument about the appropriate model for protecting customer assets of derivatives parties.</p>
Former s. 24 – Interaction with NI 94-102	<p>Several commenters submitted that the Instrument was more onerous than securities instruments such as NI 94-102.</p> <p>One commenter requested clarification regarding the application of provisions relating to the segregation, use, holding and investment of derivatives party assets as applied to a portfolio manager acting on behalf of a managed account client, where the adviser has been granted authority with respect to portfolio assets that include but are not limited to derivatives.</p> <p>Another commenter requested clarification of the exemption from Division 2 for parties relying on the substituted compliance provisions in NI 94-102.</p>	<p>Change made. In circumstances where initial margin has been delivered by a non-EDP to a derivatives firm, the requirement is that this collateral will be (i) segregated and held at a permitted depository and (ii) the derivatives firm has obtained written consent from its counterparty to the use or investment of the collateral.</p> <p>Division 2 does not apply to a derivatives firm for transactions that are subject to NI 94-102, including firms relying on exemptions in that instrument.</p>
<b>Division 3 – Reporting to Derivatives Parties</b>		
Former s. 29 – Content and delivery of transaction information	<p>Two commenters supported the requirement that transactions be confirmed in writing but submitted the prescriptive contents of those confirmations are not appropriate. The commenters requested harmonization with CFTC requirements.</p> <p>The commenters requested clarification of the application of the requirement to uncleared derivatives and that electronic confirmations satisfy the “in writing” requirement.</p>	<p>No change. However, clarifying language has been added to the CP.</p> <p>New s. 41 exempts a derivatives firm from the requirement in subsection 27(1) to deliver a written confirmation of the transaction in certain circumstances. The exemption in s. 41 is applicable to transactions executed on a derivatives trading facility (or analogous platform) where at the time of the transaction, the derivatives party to the derivative that is submitted for clearing is an eligible derivatives party. We have specifically requested further comment in the Notice and Second Request for Comment in relation to this Instrument about the availability of a similar exemption in respect of derivatives traded anonymously on a derivatives trading facility that are not cleared, derivatives that are not traded on a derivatives trading facility but are submitted for clearing to a regulated clearing agency, and otherwise if it is appropriate to extend the scope of the exemption to other sections of this Instrument.</p> <p>The requirements in relation to client relationship disclosure do not apply if the firm is trading with or</p>

		advising non-individual EDPs and apply, but may be waived, if the firm is trading with or advising individual or specified commercial hedger EDPs.
Former s. 30 – Derivatives party statements	One commenter noted that there are no requirements to prepare monthly statements under either the CFTC rules or MiFID II. <sup>9</sup> As it would require derivatives dealers to implement new reporting technology, the commenter requested that the requirement to deliver monthly statements be removed.	No change. Monthly statements contain important information for non-EDPs to monitor their derivatives transactions.  The requirements in relation to client relationship disclosure do not apply if the firm is trading with or advising non-individual EDPs and apply but may be waived if the firm is trading with or advising individual or specified commercial hedger EDPs.
<b>Part 5 – Compliance and Recordkeeping</b>		
<b>Division 1 – Compliance</b>		
Former s. 33 – Responsibilities of senior derivatives managers	Several commenters requested that former s. 33 be eliminated or the responsibilities reassigned to a chief compliance officer to reflect current industry best practices. A derivatives manager's oversight of activities within the derivatives manager's functional business unit is a conflict of interest. Any reporting to the regulators should be the obligation of the chief compliance officer. One commenter, noting the Office of the Superintendent of Financial Institutions ("OSFI") Guidelines, <sup>10</sup> submitted that the proposed requirements are at odds with the existing compliance structure.  Two commenters submitted that the context where a specific duty has been introduced for senior managers in other jurisdictions is distinguishable from that in Canada. There has not been any crisis of confidence in Canada. Where specific duty has been imposed, it has been part of a comprehensive framework across business lines and the responsibility is shared across multiple functions.  Several commenters noted that personal liability for a senior derivatives manager is unwarranted and inconsistent with best practices.	Change made. Revisions have been made to the Instrument and CP to better reflect existing compliance structures at derivatives firms.
	One commenter requested clarification of CP guidance on "serious misconduct" and "material non-compliance".	No change. The CP provides guidance on these terms. See CP guidance under new s. 31 – responsibilities of senior derivatives managers
	One commenter requested an optional carve-out for firms registered under NI 31-103 from the senior derivatives manager requirements to allow the senior derivatives manager to be the chief compliance officer. A separate senior derivatives manager regime should not be mandated for firms registered as portfolio managers under NI 31-103.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
	One commenter submitted that there should be flexibility to former s. 33(2) to submit reports to senior management in lieu of reporting to the board. Another commenter submitted that all	Change made. The instrument has been revised in new s. 31 to permit a senior derivative manager to delegate its responsibility for submitting the report to the board to the firm's chief compliance

<sup>9</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ("**MiFID II**").

<sup>10</sup> For example, OSFI Guideline E-13 *Regulatory Compliance Management* and OSFI Guideline E-21 *Operational Risk Management*.

	instances of material non-compliance should be reported no less frequently than on an annual basis and following the review of the annual report by the board.	officer.
Former s. 34 – Responsibility of derivatives firm to respond to material non-compliance	<p>One commenter submitted that former s. 34(b) places a broad and onerous self-reporting burden on derivatives firms without precedent in Canadian securities legislation and should be removed from the Instrument.</p> <p>One commenter requested clarification of the CP guidance related to former s. 34 to expressly provide an opportunity for derivatives firms to raise issues with their board before being required to report to regulators.</p>	No change. Self-reporting is a key element of the Instrument. The Instrument does not prohibit issues of material non-compliance with the Instrument from being raised with a board as long as the report is submitted to the regulator in a timely manner.
<b>Division 2 – Recordkeeping</b>		
Division 2 – General	One commenter submitted that recordkeeping obligations already exist under OSC Rule 91-507 <i>Trade Repositories and Derivatives Data Reporting</i> and OSFI Guidelines for federally regulated financial institutions. One commenter submitted that federally regulated financial institutions should be exempt from compliance and in the alternative, should be granted substituted compliance.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
Former s. 35 – Derivatives party agreement	Two commenters requested an exemption for transactions that are executed on an exchange and for transactions that are cleared.	No change. However, clarifying language has been added to the CP.
	Two commenters submitted that firms regularly enter into foreign exchange transactions prior to completing an ISDA Master Agreement and should be exempt from such requirement.	No change. A written agreement should be entered into prior to completing a transaction.
Former s. 36 – Records	Several commenters note that the recordkeeping requirements are too broad and the added costs on derivatives firms will be passed on to other market participants. Commenters suggested that the recordkeeping obligations be limited to keeping records of communications related to the negotiation, execution and amendment or termination of derivatives. All records of communications should not be kept where a record of those communications otherwise exists.	No change. Please see the Instrument and related guidance in the CP.
Former s. 37 – Form, accessibility and retention of records	Two commenters submitted that the length of the record retention requirement exceeds that of the CFTC.	No change. This retention period is consistent with other Canadian requirements.
<b>Part 6 – Exemptions</b>		
<b>Division 1 – Exemption from this Instrument</b>		
Former s. 39 – Exemption for certain derivatives end-users, General	<p>Two commenters requested clarification of the scope of the end-user exemption and suggested reference to particular categories of persons.</p> <p>Several commenters submitted that the availability of the end-user exemption should not be restricted to parties that interact solely with EDPs.</p>	<p>Change made. The end-user exemption in new s. 37 of the Instrument has been amended to clarify the scope of the exemption.</p> <p>The end-user exemption includes the following conditions:</p> <ul style="list-style-type: none"> <li>• (a) the person or company does not solicit or otherwise transact a derivative with, for or on behalf of, a non-eligible</li> </ul>

		<p>derivatives party;</p> <ul style="list-style-type: none"> <li>• (b) the person or company does not, in respect of any derivative or transaction, advise non-eligible derivatives parties, other than general advice that is provided in accordance with the conditions of s. 42 [<i>Advising generally</i>];</li> <li>• (c) the person or company does not regularly make or offer to make a market in a derivative with a derivatives party;</li> <li>• (d) the person or company does not regularly facilitate or otherwise intermediate transactions for another person or company other than an affiliated entity that is not an investment fund;</li> <li>• (e) the person or company does not facilitate clearing of a derivative through the facilities of a qualifying clearing agency for another person or company.</li> </ul> <p>Although the end-user exemption includes a condition that the person or company does not solicit or transact with a non-EDP, we have also amended the definition of EDP to include a specified commercial hedger category. We believe this should partially address the commenter's concerns.</p>
Former s. 39 – Exemption for certain derivatives end-users, para (c)	<p>Several commenters submitted that entities that are market-makers and that do not otherwise act as derivatives dealers or advisers, but regularly quote prices due to a need to regularly hedge positions, should not be excluded from the end-user exemption.</p> <p>One commenter requested clarification on whether former s. 39(c) is intended to capture commodity firms trading amongst themselves in the over the counter market.</p>	<p>No change. However, clarifying changes have been made to the CP. A person or company that frequently and regularly transacts in derivatives to hedge business risk but that does not undertake any of the activities listed in new s. 37 may qualify for this exemption.</p>
<b>Division 2 – Exemptions from Specific Requirements in this Instrument</b>		
Former s. 40 – Foreign derivatives dealers, General	<p>One commenter submitted that substituted compliance from substantially the entire Instrument should be granted either to both foreign derivatives dealers and Canadian financial institutions or to neither of them in order to maintain a level playing field.</p>	<p>No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.</p>
	<p>One commenter requested that corresponding domestic and foreign laws that can be complied with in lieu of the Instrument and the residual provisions of the Instrument be published for consultation before the Instrument is finalized.</p>	<p>Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.</p>
Former s. 40 – Foreign derivatives dealers, subsection (1)	<p>One commenter submitted that the foreign dealer exemption should not be conditional on dealings with EDPs when the business conduct rules of a foreign jurisdiction are deemed equivalent.</p>	<p>No change. The foreign dealer exemption is not available to derivatives firms that transact with non-EDPs. This approach is similar to the approach taken towards foreign dealers in NI 31-103.</p>

Former s. 40 – Foreign derivatives dealers, subsection (3)	Two commenters submitted that the requirement to deliver a statement pursuant to former s. 40(3)(c) in order to qualify for the exemption does not provide any additional protection and the disclosures are generally addressed in the Master Agreement. This type of statement is not required by the CFTC as a condition of substituted compliance. This requirement should be removed, and disclosure in a Master Agreement should be sufficient. In the alternative, the statement should only be required delivered to non-EDPs.	No change. However, clarifying language has been added to the CP. Disclosures contemplated in s. 38(3)(b) can be made by a derivatives firm in a master trading agreement with its counterparty.
	Several commenters requested clarification on the policy rationale behind former s. 40(3)(e) on which the exemption for foreign dealers based on substituted compliance is not available if the dealer is in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in a Canadian jurisdiction, particularly if only dealing with EDPs.	Change made. The subsection was removed. A person or company in the business of trading in derivatives on an exchange or a derivatives trading facility is no longer prohibited from qualifying for the exemption under new s. 38(1).
<b>Division 3 – Exemptions for Derivatives Advisers</b>		
Division 3, General	One commenter submitted that a corresponding exemption to former s. 41 should be added for portfolio managers, as they have limited derivatives activity.	We have specifically requested comment in the Notice and Request for Comment in relation to Proposed NI 93-102 as to whether and in what circumstances registered advisers (portfolio managers) under NI 31-103 should be considered derivatives advisers. We will consider these responses in determining whether registered advisers (portfolio managers) that provide incidental advice in relation to derivatives should be considered in the business of advising in relation to derivatives or whether an express exemption is required.
Former s. 44 – Foreign derivatives advisers, General	Several commenters generally supported exempting foreign derivatives advisers but noted that the exemption is too narrow, as many jurisdictions do not subject derivatives advisers to registration. Derivatives advisers should be exempt from the Instrument when exempt or not required to be registered in their principal jurisdiction, which would better align with the international adviser exemption in NI 31-103.	No change. We have intentionally limited the exemption in s. 43 [ <i>Foreign derivatives advisers</i> ] of the Instrument to foreign derivatives advisers that are “registered, licensed or otherwise authorized under the securities, commodity futures or derivatives legislation of a foreign jurisdiction specified in Appendix D”.
	One commenter requested that corresponding domestic and foreign laws that can be complied with in lieu of the Instrument and the residual provisions of the Instrument be published for consultation before the Instrument is finalized.	Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
Former s. 44 – Foreign derivatives advisers, subsection (1)	One commenter submitted that the foreign adviser exemption should not be conditional on dealings with EDPs when the business conduct rules of a foreign jurisdiction are deemed equivalent.	No change. The foreign adviser exemption is not available to derivatives firms that transact with non-EDPs.
Former s. 44 – Foreign derivatives advisers, subsection (3)	One commenter submitted that the requirement to deliver a statement pursuant to former s. 44(3)(c) in order to qualify for the exemption does not provide any additional protection and is inconsistent with former s. 23, which requires a similar statement only be delivered to non-EDPs.	No change. However, clarifying language has been added to the CP. Disclosures contemplated in s. 43(3)(b) can be made by a derivatives firm in a master trading agreement with its counterparty.
	Several commenters requested clarification on the policy rationale behind former s. 44(3)(e) on which the exemption for foreign advisers based	Change made. A person or company in the business of trading in derivatives on an exchange or a derivatives trading facility is no longer



	on substituted compliance is not available if the adviser is in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in a Canadian jurisdiction, particularly if only dealing with EDPs.	prohibited from qualifying for the exemption under s. 43(1).
<b>Part 7 – Granting an Exemption</b>		
Former s. 45 – Exemption	One commenter submitted that credit unions make available products largely on demand to provide a full suite of services and do not operate platforms, are not market makers, and are not directly offering quotes. Credit unions are the intended beneficiaries of the Instrument and qualify for the end-user exemption. Credit unions should not be defined as derivatives dealers or advisers and should fall outside the scope of the Instrument.	No change. The exemption available for derivatives end-users that satisfy certain requirements is set out in s. 37. Discretionary exemptions are available on an ad-hoc basis.
	One commenter submitted that IIROC-regulated dealers are already regulated and should be exempt from the Instrument.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
<b>Part 8 – Effective Date</b>		
Former s. 46 – Effective date	Two commenters suggested delaying the implementation date to harmonize the Instrument with CFTC and Securities and Exchange Commission rules.	No change. Canadian jurisdictions are committed to implementing harmonized business conduct rules.
	Several commenters suggested extending the implementation period to become compliant to 6 months for previously regulated firms and 12 months for those not previously regulated.	No change. Please see the Instrument and related guidance in the CP.
	One commenter submitted that all pre-effective date transactions regardless of their remaining term should be grandfathered and that grandfathering should apply even if pre-effective date transactions are subsequently amended after the date the Instrument is finalized.	We are permitting a derivatives firm to leverage a pre-existing “permitted client”, “accredited counterparty” or “qualified party” representation from its client as set out in s. 45 of the Instrument for pre-existing transactions. If the conditions in that section are satisfied, then those transactions are only subject to s. 8 [ <i>Fair dealing</i> ], s. 20 [ <i>Daily reporting</i> ] and s. 28 [ <i>Derivatives party statements</i> ].

## List of Commenters

1. Associated Foreign Exchange, ULC
2. Bruce Power L.P.
3. Canadian Bankers Association
4. Canadian Credit Union Association
5. Capital Power Corporation
6. Enbridge Inc.
7. Franklin Templeton Investments Corp.
8. International Energy Credit Association
9. International Swaps and Derivatives Association, Inc.
10. Investment Industry Association of Canada
11. Investor Advisory Panel
12. Just Energy Corp.
13. NorthPoint Energy Solutions, Inc.
14. Osler, Hoskin & Harcourt LLP
15. Pension Investment Association of Canada
16. Portfolio Management Association of Canada
17. SIFMA Asset Management Group
18. The Canadian Advocacy Council for Canadian CFA Institute Societies
19. The Canadian Commercial Energy Working Group
20. The Canadian Market Infrastructure Committee
21. Western Union Business Solutions

## ANNEX II

### 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 any of the following:

- (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;
- (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;

“collateral” means all cash, securities and other property that is

- (a) received or held by the derivatives firm from, for or on behalf of a derivatives party, and
- (b) intended to or does margin, guarantee, secure, settle or adjust one or more derivatives between the derivatives firm and the derivatives party;

“commercial hedger” means a person or company that carries on a business and that transacts a derivative that is intended to hedge risks relating to that business if those risks arise from potential changes in value of any of the following:

- (a) an asset that the person or company owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;
- (b) a liability that the person or company incurs or anticipates incurring;
- (c) a service which the person or company provides, purchases, or anticipates providing or purchasing;

“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 in respect of derivatives, and
- (b) any other person or company required to be registered as a derivatives adviser under securities legislation;

“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 securities legislation;

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

“derivatives party” means

- (a) in relation to a derivatives dealer, any of the following:
  - (i) a person or company for which the derivatives dealer acts or proposes to act as an agent in relation to a transaction;
  - (ii) a person or company that is, or is proposed to be, a party to a derivative if the derivatives dealer is the counterparty, and
- (b) in relation to a derivatives adviser, a person or company to which the adviser provides or proposes to provide advice in relation to a derivative;

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

“derivatives position” means the economic interest of a counterparty in an outstanding derivative at a point in time;

“eligible derivatives party” means, for a derivatives party of a derivatives firm, 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 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 the pension fund;
- (f) an entity organized under the laws of a foreign jurisdiction that is analogous to any of the entities referred to in paragraphs (a) to (e);
- (g) the Government of Canada or the government of a jurisdiction of Canada, or any crown corporation, agency or wholly-owned entity of the Government of Canada or the government of a jurisdiction of Canada;
- (h) the government of a 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 account managed by the trust company or trust corporation, as the case may be;
- (k) a person or company that is acting on behalf of a managed account if the person or company is registered or authorized to carry on business as one of the following:
  - (i) an adviser or a derivatives adviser;
  - (ii) the equivalent of an adviser or a derivatives adviser under the securities legislation of a jurisdiction of Canada or of a foreign jurisdiction;
- (l) an investment fund that is advised by an adviser registered or exempted from registration under securities legislation or under commodity futures legislation in Canada;
- (m) a person or company, other than an individual, that has represented to the derivatives firm in writing, that
  - (i) it has the requisite knowledge and experience to evaluate the information provided to the person or company about derivatives by the derivatives firm, the suitability of the derivatives for the person or company, and the characteristics of the derivatives to be transacted on the person or company's behalf, and
  - (ii) it has net assets of at least \$25 000 000 as shown on its most recently prepared financial statements;
- (n) a person or company, other than an individual, that has represented to the derivatives firm, in writing, that

- (i) it has the requisite knowledge and experience to evaluate the information provided to the person or company about derivatives by the derivatives firm, the suitability of the derivatives for the person or company, and the characteristics of the derivatives to be transacted on the person or company's behalf,
  - (ii) it has net assets of at least \$10 000 000 as shown on its most recently prepared financial statements, and
  - (iii) it is a commercial hedger in relation to the derivatives that it transacts with the derivatives firm;
- (o) an individual that has represented to the derivatives firm, in writing, that
- (i) he or she has the requisite knowledge and experience to evaluate the information provided to the individual about derivatives by the derivatives firm, the suitability of the derivatives for the individual, and the characteristics of the derivatives to be transacted on the individual's behalf, and
  - (ii) he or she 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 \$5 000 000;
- (p) a person or company, other than an individual, that has represented to the derivatives firm, in writing, that its obligations under derivatives that it transacts with the derivatives firm are fully guaranteed or otherwise fully supported, under a written agreement, by one or more eligible derivatives parties, other than a person or company that only qualifies as an eligible derivatives party under paragraph (n) or under paragraph (o);
- (q) a person or company, other than an individual, that has represented to the derivatives firm, in writing, that all of the following apply:
- (i) the person or company is a commercial hedger in relation to the derivatives that it transacts with the derivatives firm;
  - (ii) the obligations of the person or company, under derivatives that it transacts with the derivatives firm, are fully guaranteed or otherwise fully supported, under a written agreement, by one or more eligible derivatives parties that qualifies as an eligible derivatives party under paragraph (n);
- (r) a qualifying clearing agency;

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

“IIROC” means the Investment Industry Regulatory Organization 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 transact derivatives 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 qualifying clearing agency;
- (c) the Bank of Canada or the central bank 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 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;

“qualifying clearing agency” means a person or company if any of the following applies:

- (a) it is recognized or exempted from recognition as a clearing agency or a clearing house, as applicable, in a jurisdiction of Canada;
- (b) it is regulated by an authority in a foreign jurisdiction that applies regulatory requirements that are consistent with the *Principles for market infrastructures* applicable to central counterparties, as amended from time to time, and published by the Bank for International Settlements’ Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions;

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

“referral fee” means any compensation, regardless of its form, whether made directly or indirectly, 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 the securities legislation of a jurisdiction in Canada as a derivatives dealer or a derivatives adviser;

“registered firm” means a registered derivatives firm or a registered securities firm;

“registered securities firm” means a person or company that is registered as a dealer, an adviser or an investment fund manager in a category of registration specified in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;

“Schedule III bank” means an authorized 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 related to derivatives or derivatives party assets;

“specified commercial hedger” means a person or company described in paragraph (n) or (q) of the definition of “eligible derivatives party”;

“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 qualifying clearing agency;

“valuation” means the value of a derivative as at a certain date determined in accordance with applicable accounting standards for fair value measurement using a methodology that is consistent with industry standards.

**(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) all of the following apply:
    - (i) the second party is a limited partnership;
    - (ii) the first party is a general partner of the limited partnership referred to in subparagraph (i);
    - (iii) the first party has the power to direct the management and policies of the second party by virtue of being a general partner of the second party;
  - (d) all of the following apply:
    - (i) the second party is a trust;
    - (ii) the first party is a trustee of the trust referred to in subparagraph (i);
    - (iii) the first party has the power to direct the management and policies of the second party by virtue of being a trustee of the second party.
- (5) In this Instrument, a person or company is a subsidiary of another person or company if one of the following applies:
- (a) it is controlled by
    - (i) the other person or company,
    - (ii) the other person or company and one or more persons or companies each of which is controlled by that person or company, or
    - (iii) 2 or more persons or companies each of which is controlled by the other person or company;
  - (b) it is a subsidiary of a person or company that is that other person or company's subsidiary.
- (6) For the purpose of this Instrument, a person or company described in paragraph (k) of the definition of "eligible derivatives party" is an adviser acting on behalf of a managed account owned by another person or company.
- (7) For the purpose of determining whether a derivatives party is an eligible derivatives party, a derivatives firm must not rely on a written representation if reliance on that representation would be unreasonable.
- (8) 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 persons or companies**

2. This Instrument applies to a person or company whether or not the person or company is a registered derivatives firm or an individual acting on behalf of a registered derivatives firm.

### **Application – 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(8) of this Instrument. The text boxes in this Instrument do not form part of this Instrument and have no official status.*

#### **Application – affiliated entities**

- 4. A person or company is exempt from the requirements of this Instrument in respect of dealing with or advising an affiliated entity of the person or company, other than an affiliated entity that is an investment fund.

#### **Application – qualifying clearing agencies**

- 5. This Instrument does not apply to a qualifying clearing agency.

#### **Application – 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.

#### **Exemptions from the requirements of this Instrument when dealing with or advising an eligible derivatives party**

- 7. (1) A derivatives firm is exempt from the requirements of this Instrument if a derivatives party is an eligible derivatives party and is neither an individual nor a specified commercial hedger, except for the following requirements,
  - (a) Division 1 [*General obligations towards all derivatives parties*] of Part 3 [*Dealing with or advising derivatives parties*];
  - (b) sections 23 [*Interaction with other Instruments*] and 24 [*Segregating derivatives party assets*];
  - (c) subsection 27(1) [*Content and delivery of transaction information*];
  - (d) Part 5 [*Compliance and recordkeeping*].
- (2) A derivatives firm is exempt from the requirements of this Instrument in respect of a derivatives party that is an eligible derivatives party and that is an individual or a specified commercial hedger, if the eligible derivatives party has waived in writing its right to receive some or all of the protections provided under those requirements in relation to all derivatives, a class of derivatives or a specific derivative.
- (3) The exemption in subsection (2) does not apply in respect of the requirements in the provisions identified in paragraphs (1)(a) to (d).

### **PART 3 DEALING WITH OR ADVISING DERIVATIVES PARTIES**

#### **DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES**

##### **Fair dealing**



8. (1) A derivatives firm must act fairly, honestly and in good faith with a derivatives party.
- (2) An individual acting on behalf of a derivatives firm must act fairly, honestly and in good faith with a derivatives party.

#### **Conflicts of interest**

9. (1) A derivatives firm must establish, maintain and apply reasonable policies and procedures 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 a 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 facts necessary to comply with applicable 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 a derivative that has one or more 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, a derivatives firm must establish 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 (i) an eligible derivatives party that is neither an individual nor a specified commercial hedger or (ii) an eligible derivatives party who is either an individual or a specified commercial hedger 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 transacts 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, or an individual acting on behalf of 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 transacts in a derivative for a derivatives party's managed account, both the derivative and the transaction are suitable for the derivatives party.
- (2) If a derivatives party instructs a derivatives firm, or an individual acting on behalf of a derivatives firm, to transact in a derivative and, in the derivatives firm's reasonable opinion, following the instruction would result in a transaction or derivative that is not 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 in respect of a derivative with another person or company unless all of the following apply:
- (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;
  - (c) the derivatives firm, or the 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 the 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 relied upon, 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.

### Handling complaints

16. A derivatives firm must document and, in a manner that a reasonable person would consider fair and effective, promptly 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.

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

*The obligations in Division 3 of Part 3 do not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is neither an individual nor a specified commercial hedger or (ii) an eligible derivatives party who is either an individual or a specified commercial hedger that has waived these protections – see section 7.*

### Tied selling

17. (1) A derivatives firm, or an individual acting on behalf of the derivatives firm, must not impose undue pressure on or coerce a person or company to obtain a derivatives-related product or service from a particular person or company, including the derivatives firm or any of its affiliated entities, as a condition of obtaining another product or service from the derivatives firm.

(2) Before a derivatives firm, or an individual acting on behalf of the derivatives firm, first transacts in a derivative with or on behalf of a derivatives party or first advises a derivatives party in respect of a derivative, the derivatives firm must disclose to the derivatives party the prohibition on tied selling set out in subsection (1) in a statement in writing.

## PART 4 DERIVATIVES PARTY ACCOUNTS

### DIVISION 1 – DISCLOSURE TO DERIVATIVES PARTIES

*The obligations in this Division 1 of Part 4 do not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is neither an individual nor a specified commercial hedger or (ii) an eligible derivatives party who is either an individual or a specified commercial hedger that has waived these protections – see section 7.*

### Relationship disclosure information

18. (1) Before transacting with, for or on behalf of a derivatives party for the first time, or advising a derivatives party for the first time, 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, including all of the following:

- (a) a description of the nature or type of the derivatives party's account;
- (b) a description of the conflicts of interest that the derivatives firm is required to disclose to a derivatives party under securities legislation;
- (c) disclosure of the fees or other charges the derivatives party might be required to pay related to the derivatives party's account;
- (d) a general description of the types of transaction fees or other charges the derivatives party might be required to pay in relation to derivatives;
- (e) a general description of any compensation paid to the derivatives firm by any other party in relation to the different types of derivatives that a derivatives party may transact in through the derivatives firm;
- (f) a description of the content and frequency of reporting for each account or portfolio of a derivatives party;
- (g) disclosure of the derivatives firm's obligations if a derivatives party has a complaint contemplated under

section 16 [*Handling complaints*];

- (h) 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 or at any other time or a statement identifying the exemption the derivatives firm is relying on in respect of this obligation;
  - (i) 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*]
  - (j) 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 available to the derivatives party from the derivatives firm;
  - (k) in the case of a derivatives firm that holds or has access to derivatives party assets, a general description of the manner in which the assets are held, used or are invested by the derivatives firm and a description of the risks and benefits to the counterparty arising from the derivatives firm holding or having access to use or invest the derivatives party assets in that manner.
- (2) A derivatives firm must deliver the information in subsection (1) to the derivatives party in writing before the derivatives firm does either of the following:
- (a) transacts in a derivative with, for or on behalf of the derivatives party;
  - (b) advises the derivatives party in respect of a derivative.
- (3) If there is a significant change in respect of the information delivered to a derivatives party under subsections (1), 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 does either of the following:
- (a) transacts in a derivative with, for or on behalf of the derivatives party;
  - (b) advises the derivatives party in respect of a derivative.
- (4) 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.
- (5) Subsections (1), (2) and (3) do not apply to a derivatives dealer in respect of a derivatives party for whom the derivatives dealer transacts in a derivative only as directed by a derivatives adviser acting for the derivatives party.
- (6) A derivatives dealer referred to in subsection (5) must deliver the information required under paragraphs (1)(a) to (g) to the derivatives party in writing before the derivatives dealer first transacts in a derivative for the derivatives party.

#### **Pre-transaction disclosure**

19. (1) Before transacting in a type of derivative with, for or on behalf of a derivatives party for the first time, a derivatives dealer must deliver each of the following to the derivatives party:
- (a) a general description of the type of derivatives and services related to derivatives that the derivatives firm offers;
  - (b) a document reasonably designed to allow the derivatives party to assess each of the following:
    - (i) the types of risks that a derivatives party should consider when making a decision relating to types of derivatives that the derivatives dealer offers, including the material risks relating to the type of derivatives transacted and the derivatives party's potential exposure under the type of derivatives;
    - (ii) 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;
  - (c) a statement in writing 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. We 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, we 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) Before transacting in a derivative with, for 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.

### **Daily reporting**

20. (1) On each business day, a derivatives dealer must make available to a derivatives party a valuation for each derivative that it has transacted with, for or on behalf of the derivatives party and with respect to which contractual obligations remain outstanding on that day.
- (2) On a monthly basis, a derivatives adviser must make available to a derivatives party a valuation for each derivative that it has transacted for or on behalf of the derivatives party, unless a derivatives adviser and a derivatives party agree otherwise.

### **Notice to derivatives parties by non-resident derivatives firms**

21. A derivatives firm whose head office or principal place of business 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 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 23 and 24, does not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is neither an individual nor a specified commercial hedger or (ii) an eligible derivatives party who is either an individual or a specified commercial hedger that has waived these protections – see section 7.*

#### **Definition – initial margin**

22. In this Division, “initial margin” means any derivatives party assets delivered by a derivatives party to a derivatives firm as collateral to cover potential changes in the value of a derivative over an appropriate close-out period in the event of a default.

#### **Interaction with other instruments**

23. A derivatives firm is exempt from the requirements in this Division in respect of derivatives party assets if any of the following apply:
- (a) the derivatives firm is subject to and complies with or is exempt from sections 3 to 8 of National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* in respect of the derivatives party assets;
  - (b) the derivatives firm is subject to and complies with securities legislation relating to margin and collateral

requirements<sup>1</sup> or National Instrument 81-102 *Investment Funds* in respect of the derivatives party assets.

### **Segregating derivatives party assets**

24. A derivatives firm must segregate derivatives party assets and derivatives positions from the property and derivatives positions of the derivatives firm and other persons or companies.

### **Holding initial margin**

25. A derivatives firm must hold initial margin in an account at a permitted depository.

### **Investment or use of initial margin**

26. (1) A derivatives firm must not use or invest initial margin without receiving written consent from the derivatives party.
- (2) A loss resulting from an investment or use of a derivatives party's initial margin 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 27(1), does not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is neither an individual nor a specified commercial hedger or (ii) an eligible derivatives party who is an individual or a specified commercial hedger that has waived these protections – see section 7.*

### **Content and delivery of transaction information**

27. (1) A derivatives dealer that has transacted with, for or on behalf of a derivatives party must promptly deliver a written confirmation of the transaction to
- (a) the derivatives party, or
  - (b) if the derivatives party consents or has given a direction in writing, a derivatives adviser acting for the derivatives party.
- (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 required under subsection (1) must include all of the following, if and as applicable:
- (a) a description of the derivative;
  - (b) a description of the agreement that governs the transaction;
  - (c) the notional 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 each individual acting on behalf of the derivatives firm, if any, that provided advice relating to the derivative or the transaction;
  - (j) the date of the transaction;
  - (k) the name of the qualifying clearing agency, if any, where the derivative was cleared.

### **Derivatives party statements**

28. (1) A derivatives firm must make available a statement to a derivatives party, at the end of each quarterly period, if either of the following applies:

<sup>1</sup> This reference will be substituted with a reference to National Instrument 95-101 *Margin and Collateral Requirements for Non-Centrally Cleared Derivatives* once it is published.

- (a) within the quarterly period the derivatives firm transacted a derivative with, for or on behalf of the derivatives party;
  - (b) the derivatives party has an outstanding derivatives 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 transaction, including the number of units of the transaction, the per unit price and the total price;
  - (c) information sufficient to identify the agreement that governs the transaction.
- (3) A statement delivered under this section must include all of the following information 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, as at the statement date, of each outstanding derivative referred to in paragraph (a);
  - (c) the final valuation, as at the expiry or termination date, of each derivative that expired or terminated during the period covered by the statement;
  - (d) a description of all derivatives party assets held or received by the derivatives firm as collateral;
  - (e) any cash balance in the derivatives party's account;
  - (f) a description of any other derivatives party asset held or received by the derivatives firm;
  - (g) the total market value of all cash, outstanding derivatives and other derivatives party assets in the derivatives party's account, other than assets held or received as collateral.

## PART 5 COMPLIANCE AND RECORDKEEPING

### DIVISION 1 – COMPLIANCE

#### Definitions

29. In this Division,

“chief compliance officer” means the officer or partner of a derivatives firm that is responsible for establishing, maintaining and applying written policies and procedures to monitor and assess compliance, by the derivatives firm and individuals acting on its behalf, with securities legislation relating to derivatives;

“derivatives business unit” means, in respect of a derivatives firm, a division or 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;

“senior derivatives manager” means, in respect of a derivatives business unit of a derivatives firm, an individual designated by the derivatives firm under section 30(2).

#### Policies, procedures and designation

30. (1) A derivatives firm must establish, maintain and apply policies, procedures, controls and supervision sufficient to provide reasonable assurance that all of the following are satisfied:

- (a) the derivatives firm and each individual acting on its behalf in relation to transacting in, or providing advice in relation to, a derivative, comply with securities legislation relating to trading and advising in derivatives;
- (b) the risks relating to its derivatives activities within the derivatives business unit are managed in accordance with the derivative's firms risk management policies and procedures;
- (c) each individual who performs an activity on behalf of the derivatives firm relating to transacting in, or providing advice in relation to, derivatives, prior to commencing the activity and on an ongoing basis,

- (i) has the experience, education and training that a reasonable person would consider necessary to perform the activity competently,
  - (ii) without limiting subparagraph (i), has the understanding of the structure, features and risks of each derivative that the individual transacts in or advises in relation to, and
  - (iii) has conducted themselves with integrity.
- (2) A derivatives firm must designate a senior derivatives manager in respect of each derivatives business unit;
- (3) A derivatives firm must identify to the regulator or the securities regulatory authority, upon request, each individual designated as the senior derivatives manager in respect of each derivatives business unit.

### **Responsibilities of senior derivatives managers**

31. (1) A senior derivatives manager must do all of the following:

- (a) supervise the derivatives-related activities conducted in the derivatives business unit 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 30 [*Policies, procedures and designation*];
  - (b) respond, in a timely manner, to any material non-compliance by an individual working in the derivatives business unit with this Instrument, applicable securities legislation or the policies and procedures required under section 30 [*Policies, procedures and designation*].
- (2) At least once per calendar year, the senior derivatives manager in respect of each derivatives business unit must,
- (a) prepare a report stating, as applicable, either of the following:
    - (i) each incidence of material non-compliance with this Instrument, securities legislation relating to trading and advising in derivatives and the policies and procedures required under section 30 [*Policies, procedures and designation*] by the derivatives business unit or an individual in the derivatives business unit and the steps taken to respond to each such incidence of material non-compliance;
    - (ii) the derivatives business unit is in material compliance with this Instrument, securities legislation relating to trading and advising in derivatives and the policies and procedures required under section 30 [*Policies, procedures and designation*];
  - (b) submit the report referred to in paragraph (a) to the board of directors of the derivatives firm.
- (3) The senior derivatives manager may not delegate its obligation under paragraph (2)(b) except to the derivatives firm's chief compliance officer.

### **Responsibility of derivatives firm to report material non-compliance**

32. The derivatives firm must report to the regulator or the securities regulatory authority in a timely manner any circumstance in which the derivatives firm is not or was not in material compliance with this Instrument or securities legislation relating to trading and advising in derivatives and one or more of the following applies:
- (a) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to a derivatives party;
  - (b) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to capital markets;
  - (c) the non-compliance is part of a pattern of non-compliance.

## **DIVISION 2 – RECORDKEEPING**

### **Derivatives party agreement**

33. (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, for 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 the rights and obligations of the derivatives firm and the derivatives party.

## Records

- 34.** 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 the derivatives party relating to transacting in the derivative,
    - (ii) documents provided to the derivatives party to confirm the derivative, the terms of the derivative 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 each transaction relating to the derivative, including 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 for each transaction 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,
      - (C) any other information relevant to the transaction, and
      - (D) information used in calculating the derivative's valuation;
  - (d) an itemized record of post-transaction processing and events, including a record in relation to the calculation of margin and exchange of collateral;
  - (e) the price and valuation of the derivative.

## Form, accessibility and retention of records

- 35. (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 the derivatives firm's last outstanding derivative with the derivatives party 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.

## **DIVISION 1 – EXEMPTION FROM THIS INSTRUMENT**

### **Limitation on the availability of the exemption in this Division**

36. The exemption in this Division is not available to a person or company if either of the following applies:
- (a) the person or company is a registered derivatives firm or a registered securities firm in any jurisdiction of Canada or is registered under the commodity futures legislation of any jurisdiction of Canada;
  - (b) the person or company is registered under the securities, commodity futures or derivatives legislation of a foreign jurisdiction in which its head office or principal place of business is located in a category of registration 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**

37. (1) A person or company is exempt from the requirements of this Instrument if all of the following apply:
- (a) the person or company does not solicit or otherwise transact 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 any transaction, advise a person or company that is not an eligible derivatives party, other than general advice that is provided in accordance with the conditions of section 42 [*Advising generally*];
  - (c) the person or company does not regularly 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 for another person or company other than an affiliated entity that is not an investment fund;
  - (e) the person or company does not facilitate clearing of a derivative through the facilities of a qualifying clearing agency for another person or company.
- (2) In determining whether a person or company satisfies the conditions in subsection (1), a person or company is not required to consider activities conducted with an affiliated entity, other than an affiliated entity that is an investment fund.

## **DIVISION 2 – EXEMPTIONS FROM SPECIFIC REQUIREMENTS IN THIS INSTRUMENT**

### **Foreign derivatives dealers**

38. (1) A derivatives dealer whose head office or principal place of business is in a foreign jurisdiction specified in Appendix A is exempt from this Instrument in respect of a transaction if all of the following apply:
- (a) it 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) it 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;
  - (c) it is subject to and complies with the laws of the foreign jurisdiction applicable to the derivatives dealer set out in Appendix A relating to the activities being conducted;
  - (d) it reports to the regulator or the securities regulatory authority in a timely manner any circumstance in which, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with the laws of the foreign jurisdiction or securities legislation relating to trading in derivatives that is listed in Appendix A and if any of the following applies:
    - (i) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to a derivatives party located in Canada;
    - (ii) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to capital markets;
    - (iii) the non-compliance is part of a pattern of non-compliance.

- (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 unless all of the following apply:
- (a) the derivatives dealer engages in the business of a derivatives dealer in the foreign jurisdiction in which its head office or principal place of business is located;
  - (b) the derivatives dealer has delivered to the derivatives party a statement in writing disclosing all of the following:
    - (i) the foreign jurisdiction in which the derivatives dealer's head office or principal place of business is located;
    - (ii) that all or substantially all of the assets of the derivatives dealer may be situated outside of the local jurisdiction;
    - (iii) that there may be difficulty enforcing legal rights against the derivatives dealer because of the above;
    - (iv) the name and address of the agent for service of the derivatives dealer in the local jurisdiction;
  - (c) the derivatives dealer has submitted to the regulator or the securities regulatory authority a completed Form 93-102F1 *Submission to Jurisdiction and Appointment of Agent for Service*;
  - (d) the derivatives dealer undertakes to the regulator or the securities regulatory authority to provide the regulator or the securities regulatory authority with prompt access to its books and records upon request.
- (4) A derivatives dealer that relied on the exemption in subsection (1) during the 12-month period preceding December 1 of a year must notify the regulator or 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*.
- (6) A person or company is exempt from the requirements in subsections (4) and (5) if the person or company is registered as a derivatives dealer in the local jurisdiction.
- (7) In determining whether a person or company satisfies the conditions in subsection (1), a person or company is not required to consider activities conducted with an affiliated entity, other than an affiliated entity that is an investment fund.
- (8) The requirement in paragraph (3)(b) does not apply if the derivatives party is an affiliated entity that is not an investment fund.

#### **Investment dealers**

39. A derivatives dealer that is a dealer member of IIROC is exempt from the requirements set out in Appendix B if all of the following apply:
- (a) the derivatives dealer complies with the corresponding conduct and other regulatory requirements of IIROC in connection with a transaction or other related activity;
  - (b) the derivatives dealer promptly notifies the regulator or the securities regulatory authority of each instance of material non-compliance with a requirement or guideline
    - (i) to which it is subject, and
    - (ii) that is specified in Appendix B.

#### **Canadian financial institutions**

40. A derivatives dealer that is a Canadian financial institution is exempt from the requirements set out in Appendix C if all of the following apply:
- (a) the derivatives dealer is subject to and complies with the corresponding conduct and other regulatory requirements of its prudential regulator in connection with a transaction or other related activity;

- (b) the derivatives dealer promptly notifies the regulator or the securities regulatory authority of each instance of material non-compliance with a requirement or guideline
  - (i) to which it is subject, and
  - (ii) that is specified in Appendix C.

#### **Derivatives traded on a derivatives trading facility that are cleared**

41. A derivatives firm is exempt from sections 10 [*Know your derivatives party*] and 27 [*Content and delivery of transaction information*] in respect of a transaction to which all of the following apply:
- (a) the execution of the transaction is on and subject to the rules of a derivatives trading facility;
  - (b) as soon as technologically practicable following the transaction,
    - (i) the derivative is submitted for clearing to a qualifying clearing agency that provides clearing services in respect of the type of derivative, and
    - (ii) the derivative is accepted for clearing by the qualifying clearing agency;
  - (c) the derivatives firm does not know the identity of the derivatives party prior to execution of the transaction;
  - (d) at the time of the transaction, the derivatives party to the derivative that is submitted for clearing is an eligible derivatives party.

### **DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS**

#### **Advising generally**

42. (1) For the purpose 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, 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) A person or company that acts as a derivatives adviser is exempt from the requirements of this Instrument applicable to 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 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 person or company were a reporting issuer.

#### **Foreign derivatives advisers**

43. (1) A derivatives adviser whose head office or principal place of business is in a foreign jurisdiction specified in Appendix D

is exempt from this Instrument in respect of advice provided to a derivatives party if all of the following apply:

- (a) it 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) it 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;
  - (c) it is subject to and complies with the laws of the foreign jurisdiction applicable to the derivatives adviser set out in Appendix D relating to the activities being conducted; and
  - (d) it reports to the regulator or the securities regulatory authority in a timely manner any circumstance in which, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with the laws of the foreign jurisdiction or securities legislation relating to advising in derivatives, if any of the following applies:
    - (i) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to a derivatives party located in Canada;
    - (ii) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to capital markets;
    - (iii) the non-compliance is part of a pattern of non-compliance.
- (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 unless all of the following apply:
- (a) the derivatives adviser engages in the business of a derivatives adviser in the foreign jurisdiction in which its head office or principal place of business is located;
  - (b) the derivatives adviser has delivered to the derivatives party a statement in writing disclosing the following:
    - (i) the foreign jurisdiction in which the derivatives adviser's head office or principal place of business is located;
    - (ii) that all or substantially all of the assets of the derivatives adviser may be situated outside of the local jurisdiction;
    - (iii) that there may be difficulty enforcing legal rights against the derivatives adviser because of the above;
    - (iv) the name and address of the agent for service of the derivatives adviser in the local jurisdiction;
  - (c) the derivatives adviser has submitted to the regulator or the securities regulatory authority a completed Form 93-102F2 *Submission to Jurisdiction and Appointment of Agent for Service*;
  - (d) the derivatives adviser undertakes to the regulator or the securities regulatory authority to provide the regulator or the securities regulatory authority with prompt access to its books and records upon request.
- (4)** A derivatives adviser that relied on the exemption in subsection (1) during the 12-month period preceding December 1 of a year must notify the regulator or the securities regulatory authority of that fact by December 1 of that year.
- (5)** In Ontario, subsection (4) does not apply to a derivatives adviser that complies with the filing and fee payment requirements applicable to an unregistered exempt international firm under Ontario Securities Commission Rule 13-502 *Fees*.
- (6)** A person or company is exempt from the requirements in subsections (4) and (5) if they are registered as a derivatives adviser in the local jurisdiction.
- (7)** In determining whether a person or company satisfies the conditions in subsection (1), a person or company is not required to consider activities conducted with an affiliated entity, other than an affiliated entity that is an investment fund.

- (8) The requirement in paragraph (3)(b) does not apply if the derivatives party is an affiliated entity that is not an investment fund.

## PART 7 GRANTING AN EXEMPTION

### Granting an exemption

44. (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

45. (1) This Instrument comes into force on *[insert date of publication + one year]*.
- (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 subsections (1) and (2), and except section 8 *[Fair dealing]*, section 20 *[Daily reporting]* and section 28 *[Derivatives party statements]*, the requirements of this Instrument do not apply in respect of a transaction if all of the following apply:
- (a) the transaction was entered into before *[insert date of publication + one year]*;
  - (b) the derivatives firm has taken reasonable steps to determine that the derivatives party is one or more of the following:
    - (i) a permitted client, as that term is defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;
    - (ii) an accredited counterparty, as that term is defined in the *Derivatives Act* (Quebec);
    - (iii) a qualified party, as that term is defined in any of the following:
      - (A) Alberta Blanket Order 91-507 *Over-the-Counter Derivatives*;
      - (B) British Columbia Blanket Order 91-501 *Over-the-Counter Derivatives*;
      - (C) Manitoba Blanket Order 91-501 *Over-the-Counter Trades in Derivatives*;
      - (D) New Brunswick Local Rule 91-501 *Derivatives*;
      - (E) Nova Scotia Blanket Order 91-501 *Over-the-Counter Trades in Derivatives*;
      - (F) Saskatchewan General Order 91-908 *Over-the-Counter Derivatives*.

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

**FOREIGN DERIVATIVES DEALERS  
(Section 38)**

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

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

[To be completed]

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

**IIROC DEALER MEMBERS**  
**(Section 39)**

**[To be completed]**



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

**CANADIAN FINANCIAL INSTITUTIONS**  
**(Section 40)**

**[To be completed]**

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

**FOREIGN DERIVATIVES ADVISERS  
(Section 43)**

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

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

[To be completed]

**ANNEX III  
PROPOSED COMPANION POLICY 93-101  
DERIVATIVES: BUSINESS CONDUCT**

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<b><i>PART</i></b>	<b><i>TITLE</i></b>
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## 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* (**NI 14-101**). "Securities legislation" is defined in NI 14-101, 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*;

"regulator" means the regulator or securities regulatory authority in a jurisdiction.

### 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* (**NI 45-106**) with one exception. The definition of this term in NI 45-106 does not include a Schedule III bank (due to the separate definition of the term "bank" in NI 45-106), with the result that NI 45-106 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.

"Schedule III bank" means an authorized foreign bank named in Schedule III of the *Bank Act* (Canada).

#### Section 1 – Definition of commercial hedger

The concept of "commercial hedger" is meant to apply to a business entering into a transaction for the purpose of managing risks inherent in its business. This could include, for example, a commodity producer managing risks associated with fluctuations in the price of the commodity it produces or a company entering into an interest rate swap to hedge its interest rate risks associated with a loan obligation. It is not intended to include a circumstance where the commercial enterprise enters into a transaction for speculative purposes; there has to be a significant link between the transaction and the business risks being hedged.

Paragraphs (n) and (q) of the definition of "eligible derivatives party" provide that a commercial hedger will qualify as an eligible derivatives party if it meets the conditions in those paragraphs.

#### 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 it is 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 it is either of the following:

- in the business of trading derivatives or in the business of advising others in respect of derivatives;
- 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 (NI 93-102)*.

### **Factors in determining a business purpose – derivatives dealer**

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. Several factors that we consider relevant are described below. This is not a complete list and other factors may also be considered.

- *Acting as a market maker* – Market making is generally understood as the practice of routinely standing ready to transact derivatives by
  - responding to requests for quotes on derivatives, or
  - making quotes available to other persons or companies that seek to transact derivatives, whether to hedge a risk or to speculate on changes in the market value of the derivative.

Market makers are typically compensated for providing liquidity through spreads, fees or other compensation, including fees or compensation paid by an exchange or a trading facility that do not relate to the change in the market value of the derivative transacted. A person or company that contacts another person or company about a transaction to accommodate its own risk management needs or to speculate on the market value of a derivative will not, typically, be considered to be acting as a market maker.

A person or company will be considered to be “routinely standing ready” to transact derivatives if it is responding to requests for quotes or it is making quotes available with some frequency, even if it is not on a continuous basis. Persons or companies that respond to requests or make quotes available occasionally are not “routinely standing ready”.

A person or company would also typically be considered to be a market maker when it holds itself out as undertaking the activities of a market maker.

Engaging in bilateral discussions relating to the terms of a transaction will not, on its own, constitute market making activity.

- *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 its sole or even primary endeavour for it 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 between third-party counterparties to derivatives contracts.
- *Transacting with the intention of being compensated* – The person or company receives, or expects to receive, any form of compensation for carrying on transaction activity. This would include any compensation that is transaction or value-based including compensation 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 transactions* – The person or company directly solicits 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 would include providing quotes to derivatives parties or potential derivatives parties that are not provided in response to a request. 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, unless it is the person or company’s intention or expectation to be compensated as a result of the contact. For example, a person or company that wishes to hedge a specific risk is not necessarily soliciting for the purpose of the Instrument if it contacts multiple potential counterparties to enquire about potential 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 it is, for the purposes of the Instrument, a derivatives dealer, a person or company should consider its 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.

#### **Factors in determining a business purpose – derivatives adviser**

Under securities legislation, a person or company engaging in or holding itself out as engaging in the business of advising others in relation to derivatives is generally required to register as a derivatives adviser unless an exemption is available.

As with the definition of “derivatives dealer”, the definition of “derivatives adviser” (and the definition of “adviser” in securities legislation generally) requires an assessment of whether the person or company is “in the business” of conducting an activity. In the case of derivatives advisers, it is necessary to determine whether a person or company is “advising others” in relation to derivatives.

As with derivatives dealers, a person or company that is determining whether or not it is a derivatives adviser should consider its 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.

The definition of “derivatives adviser” also contains an additional element that the derivatives adviser should be in the business of “advising others” in relation to derivatives. Examples of persons and companies that may be considered to be in the business of advising others in relation to derivatives include the following:

- a registered adviser under securities or commodity futures legislation that provides advice to an investment fund or another person or company in relation to derivatives or derivatives trading strategies;
- a registered adviser under securities or commodity futures legislation that manages an account for a client and makes trading decisions for the client in relation to derivatives or derivatives trading strategies;
- an investment dealer that provides advice to clients in relation to derivatives or derivatives trading strategies;
- a person or company that recommends a derivative or derivatives trading strategy to investors as part of a general solicitation by an online derivatives trading platform.

A person or company that discusses the merits of a particular derivative or derivatives trading strategy in a newsletter or on a website may be considered to be advising others in relation to derivatives but would be exempt if it meets the conditions in section 42 [*Advising generally*].

Similarly, a derivatives dealer that recommends a particular derivative or derivatives trading strategy to a customer in connection with a proposed transaction may be considered to be advising the customer in relation to derivatives. However, so long as the derivatives dealer is appropriately registered and has the necessary proficiency to provide the advice (or is otherwise exempt from registration), the derivatives dealer does not need to also register as a derivatives adviser.

If the derivatives firm’s trading or advising activity is incidental to the firm’s primary business, we may not consider it to be for a business purpose. For example, appropriately licensed professionals, such as lawyers, accountants, engineers, geologists and teachers, may provide advice in relation to derivatives in the normal course of their professional activities. We would generally not consider them to be advising on derivatives for a business purpose if such activities are incidental to their *bona fide* professional activities.

#### **Factors in determining a business purpose – general**

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. 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 purposes of the Instrument.

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 derivatives dealer or a derivatives adviser in a local jurisdiction is a person or company that conducts the described activities 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 activities 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 activities with a derivatives party located in the local jurisdiction.

Where dealing or advising activities are provided to derivatives parties in a local jurisdiction or where dealing or advising activities are otherwise conducted within a local jurisdiction, regardless of the location of the derivatives party, we would generally consider a person or company to be a derivatives dealer or derivatives adviser.

### **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.

### **Section 1 – Definition of derivatives party**

The term “derivatives party” is similar to the concept of a “client” in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registration Obligations (NI 31-103)*. We have used the term “derivatives party” instead of “client” to reflect the circumstance where the derivatives firm may not regard its counterparty as its “client.”

### **Section 1 – Definition of eligible derivatives party**

The term “eligible derivatives party” is intended to refer to those derivatives parties that have the requisite knowledge and experience to evaluate the information about derivatives that has been provided to the person or company by the derivatives firm. These persons or companies may not require the full set of protections that are provided to other derivatives parties that are not eligible derivatives parties.

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

A derivatives firm should take reasonable steps to determine if a derivatives party is an eligible derivatives party. In determining whether the person or company that it transacts with, solicits 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 representations.

### **Section 1 – Definition of eligible derivatives party – paragraphs (m) to (q)**

Under paragraphs (m) to (q) of the definition of “eligible derivatives party”, a person or company will only be considered to be an eligible derivatives party if it has made certain representations to the derivatives firm in writing.

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

We expect that a derivatives firm would maintain a copy of each derivatives party's written representations that is relevant to 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. Subsection 1(7) provides that a derivatives firm must not rely on such a written representation if reliance on that representation would be unreasonable. See subsection 1(7) of this Policy for further guidance.

For the purposes of paragraphs (m) and (n), net assets must have an aggregate realizable value, before taxes, but after deduction of the corresponding liabilities, that are more than the prescribed threshold (\$25 000 000 in paragraph (m) and \$10 000 000 in paragraph (n)) or an equivalent amount in another currency. Unlike in paragraph (o), assets considered for the purposes of paragraphs (m) and (n) are not limited to “financial assets”.

A person or company is only an eligible derivative party under paragraphs (n) and (q) if the person or company has, at the time the transaction occurs, represented to be a commercial hedger. The derivatives firm may rely on a written representation from the derivatives party that it is a commercial hedger for the derivatives it transacts with the derivatives firm unless a reasonable person would have grounds to believe that the statement is false or it is otherwise unreasonable to believe that the representation is accurate. This representation may be tailored by the eligible derivatives party and the derivatives firm to provide for specific derivatives or types of derivatives.

In the case of paragraph (o), the individual must beneficially own financial assets, as that term is defined in section 1.1 of NI 45-106, that have an aggregate realizable value before tax but net of any related liabilities of at least \$5 000 000 (or an equivalent

amount in another currency). “Financial assets” is defined to include cash, securities or a deposit, or an evidence of a deposit that is not a security for the purposes of securities legislation.

Paragraph (p) of the definition of “eligible derivatives party” provides that a derivatives firm may treat a derivatives party as an eligible derivatives party if the derivatives party represents to the derivatives firm that all of its obligations under a derivative are guaranteed or otherwise fully and unconditionally supported (under a letter of credit or credit support agreement) by one or more eligible derivatives parties, other than eligible derivatives parties qualifying as such under paragraph (n) or (o).

Subparagraph (q)(ii) of the definition of “eligible derivatives party” is similar to paragraph (p), but does not exclude qualifying guarantors or credit support providers that are eligible derivatives parties under paragraph (n).

### **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 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.<sup>1</sup> As of the time of the publication of this Instrument the following countries and their political subdivisions are permitted jurisdictions: 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 area<sup>2</sup> and countries using the euro under a monetary agreement with the European Union.<sup>3</sup>

### **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 (NI 94-102)*, 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**

The term “valuation” is defined to mean the value of a derivative determined in accordance with accounting principles for fair value measurement that are consistent with accepted methodologies within the derivatives firm’s industry. Where market quotes or market-based valuations are unavailable, we expect the value to represent the current mid-market level derived from market-based metrics incorporating a fair value hierarchy. The mid-market level does not have to include adjustments incorporated into the value of a derivative to account for the characteristics of an individual counterparty.

### **Subsection 1(7) – Relying on a written representation unless unreasonable to do so**

Whether it is reasonable for a derivatives firm to rely on a derivatives 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 derivatives 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,

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

<sup>2</sup> 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](http://ec.europa.eu/economy_finance/euro/adoption/euro_area/index_en.htm)).

<sup>3</sup> 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](https://ec.europa.eu/info/business-economy-euro/euro-area/euro/use-euro/euro-outside-euro-area_en)).



- whether the derivatives party has retained independent advice in relation to its derivatives, and
- publicly available financial information.

## 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 that, under securities legislation is

- registered as a “derivatives dealer” or “derivatives adviser”,
- exempt from the requirement to register as a “derivatives dealer” or “derivatives adviser”, and
- excluded from registration as a “derivatives dealer” or “derivatives adviser”.

Accordingly, derivatives firms that may be exempt from the requirement to register in a jurisdiction, such as Canadian financial institutions and individuals acting on their behalf in relation to transacting in, or providing advice in relation to, a derivative, will nevertheless be subject to the same standard of conduct towards their derivatives parties that apply to registered derivatives firms and their registered representatives.

### Section 3 – Scope of instrument

Section 3 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 purposes of the Instrument.

### Section 6 – Governments, central banks and international organizations

Section 6 provides that the Instrument does not apply to certain governments, central banks and international organizations specified in the section. Section 6 does not, however, exclude derivatives firms that deal with or advise these entities from the application of the Instrument.

### Section 7 – Exemptions from the requirements of this Instrument when dealing with or advising an eligible derivatives party

We are of the view that, because of their nature, regulatory oversight, financial resources or experience, eligible derivatives parties do not require the full set of protections afforded to derivatives parties that are not eligible derivatives parties (we refer to them as **non-eligible derivatives parties**).

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

*Dealing with or advising a derivatives party that is a non-eligible derivatives party*

If a derivatives firm is dealing with or advising a non-eligible derivatives party, no exemption is available from the requirements in Parts 3, 4 and 5.

*Dealing with or advising an eligible derivatives party that is not an individual or a specified commercial hedger*

A derivatives firm is exempt from the requirements of the Instrument if it is dealing with or advising a derivatives party that is an eligible derivatives party that is not an individual or a specified commercial hedger, except for the following:

- in Part 3 [*Dealing with or advising derivatives parties*], all of the requirements in Division 1 [*General obligations towards all derivatives parties*]:
  - section 8 [*Fair dealing*],
  - section 9 [*Conflicts of interest*], and
  - section 10 [*Know your derivatives party*];
- in Part 4, Division 2 [*Derivatives party assets*]:
  - section 23 [*Interaction with other instruments*], and
  - section 24 [*Segregating derivatives party assets*];
- in Part 5 [*Compliance*]:

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

*Dealing with or advising an eligible derivatives party that is an individual or a specified commercial hedger*

Under subsection 7(2), a derivatives firm is exempt from certain requirements in the Instrument in respect of dealing with or advising an eligible derivatives party that is an individual or a specified commercial hedger if the eligible derivatives party waives, in writing, one or more of those requirements. Subsection 7(3) specifies certain requirements that cannot be waived by the eligible derivatives party for the purpose of the exemption in subsection 7(2). The eligible derivatives party that is an individual or a specified commercial hedger can waive specific requirements for a derivative, a type of derivatives or for all derivatives. For example a producer of a certain commodity may choose to waive certain requirements in relation to derivatives where the underlying asset is a commodity that they produce but may not want to waive protections in relation to other types of derivatives.

A written waiver contemplated under subsection 7(2) may be made by an eligible derivatives party that is an individual or a specified commercial hedger as part of account-opening documentation. For clarity, there is no obligation under the Instrument to update the waiver after it is made. However, it is always open to an eligible derivatives party that is an individual or a specified commercial hedger to withdraw, in whole or in part, any waiver it has made to a derivatives firm.

There is no prescribed form for the waiver contemplated by subsection 7(2). 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. We would consider it to be a breach of section 8 [Fair Dealing] to put unreasonable pressure on any derivatives party to waive any requirements. We would also expect the derivatives firm to remind the derivatives party that it has the option to obtain independent advice before signing the waiver.

### PART 3 DEALING WITH OR ADVISING DERIVATIVES PARTIES

#### DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES

##### Section 8 – Fair dealing

The obligation in section 8 (the **fair dealing obligation**) is a principles-based obligation and is intended to be similar to the duty to act fairly, honestly and in good faith applicable to registered firms and registered individuals under securities legislation (the **registrant fair dealing obligation**).<sup>1</sup>

*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. 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 interpreted differently if the derivatives party is an individual or small business than from how it would be interpreted if the derivatives party is 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 where it would be expected that each party negotiating the derivative is seeking to ensure favourable financial terms.

When a derivatives firm is dealing with or advising an eligible derivatives party, we generally interpret the fair dealing obligation in section 8 in a similar manner to the "fair and balanced communications" obligation as it is conceived in the context of similar rules in the United States.

<sup>1</sup> 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].

Abusive practices, including fraud, price fixing, manipulation of benchmark rates, and front-running of trades are violations of securities legislation; we take the view that each of these would be a severe breach of the fair dealing obligation.

Derivatives firms have an obligation to transact with a derivatives party under terms that are fair. What constitutes “fair” will vary depending on the particular circumstances. Misrepresenting the nature of the product and related risks, or deliberately selling a derivative that is not suitable for a derivatives party, would not be considered to be “fair” and, in our view, would be a breach of the fair dealing obligation. We also expect the derivatives firm to provide a derivatives party with information about the implications of terminating a derivative prior to maturity, including potential exit costs. As part of the policies and procedures required under section 30, a derivatives firm is expected to be able to demonstrate that it has established and follows policies and procedures that are reasonably designed to achieve fair terms, in the context, for the derivatives firm’s derivatives parties and that these policies and procedures are reviewed regularly and amended as required.

We interpret the fair dealing obligation to include determining prices for derivatives transacted with derivatives parties in a fair and equitable manner. We expect there to be a rational basis for a discrepancy in price where essentially the same derivative is transacted with different derivatives parties. Factors that indicate a rational basis could include the level of counterparty risk of a derivatives party, the derivatives party’s trading activity, or relationship pricing. Lack of sophistication, knowledge or understanding about a derivatives product should never be a factor in providing less advantageous pricing. Both the compensation component and the market value or price component of the derivative are relevant in determining whether the price for a derivatives party is fair. A derivatives firm’s policies and procedures under section 30 must address how both the price of the derivative as well as the reasonableness of compensation are determined. A derivatives party should be given an opportunity, at their option, to obtain independent advice before transacting in a derivative.

Derivatives firms are expected to obtain information from each derivatives party to allow them to meet their fair dealing obligation.

## **Section 9 – Conflicts of interest**

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.

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 example, a derivatives firm and the derivatives party with which it transacts bilaterally hold opposing positions under the same derivative and this may represent an inherent conflict of interest in the narrow context of that specific derivative. We recognize, therefore, that it may not necessarily be appropriate to apply the conflict of interest provisions under the Instrument to derivatives market participants in the same manner as the relevant conflict of interest provisions would apply to securities market participants.

We take the view that a 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 viewed differently when dealing with a non-eligible derivative party that is an individual or a small business than they would be viewed if the derivatives party were an eligible derivatives party, which may be different again from how conflicts of interest would be viewed if the derivatives 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 eligible derivatives party is reasonably aware that the derivatives firm is seeking terms favourable to its own interests.

### **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, to both the derivatives firm and a derivatives party, that a conflict of interest raises, and
- respond appropriately to conflicts of interest.

When responding to any conflict of interest, we expect the derivatives firm to consider the fair dealing obligation in section 8 as well as any other standard of care that may apply when dealing with or advising a derivatives party.

We are of the view that there are three methods that are generally reasonable to respond to a conflict of interest, depending on the circumstances: avoidance, control and disclosure.

We expect that if there is a risk of material 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 there is not a risk of material harm and 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. We are generally of the view that conflicts that have a lesser impact on the interests of a derivatives party can be managed through controls or disclosure.

Where conflicts of interest between a derivatives party and a derivatives firm cannot be managed using controls or disclosure, we expect the derivatives firm to avoid the conflict. This may require the derivatives firm to stop providing the service or stop transacting derivatives with, or providing advice in relation to derivatives to, the derivatives party.

#### *Controlling conflicts of interest*

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

- 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 derivatives firm may be able to reasonably respond to the conflict of interest by controlling the conflict in an appropriate way. This may include

- assigning a different individual to provide a service to the derivatives party,
- creating a group or committee to review, develop or approve responses to a type of conflict of interest,
- monitoring trading activity, or
- using information barriers for certain internal communication.

Where a conflict of interest is such that no control is effective, we expect the conflict to be avoided.

### **Subsection 9(3) – Disclosing conflicts of interest**

#### *When disclosure is appropriate*

We expect a derivatives firm to inform each derivatives party it transacts derivatives with, or provides advice in relation to derivatives to, about any conflicts of interest that could affect the services the firm provides to the derivatives party.

#### *Timing of disclosure*

Under subsection 9(3), a derivatives firm and individuals acting on its behalf must disclose a conflict of interest in a timely manner. We expect a derivatives firm and its representatives to disclose the conflict 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 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.

More specifically, we would generally expect that disclosures would be separated into two categories:

- (i) general conflicts of interest disclosures applicable to all counterparties (those which affect all counterparties and transaction types, addressed in a written general disclosure) that could be disclosed to counterparties on an annual basis, and
- (ii) disclosures specific to a counterparty or a specific contemplated transaction (i.e., disclosure regarding specific conflicts of interest that are material and specific to a counterparty or a particular transaction prior to entering into a transaction) by providing written notice of or disclosing the conflict to a trader of their derivatives party over a taped line prior to trading.

We recognize that it may be appropriate in some circumstances for a derivatives firm to disclose a conflict where it arises after the original transaction has taken place. This might arise, for example, in the case of an equity total return swap where subsequent to entering into a transaction with a derivatives party, the derivatives dealer becomes a mergers and acquisitions adviser in respect of the equity underlier (where the proposed merger and acquisitions activity has been announced).

### **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 policies and procedures to evaluate the balance of these interests.

#### *Acting on behalf of derivatives parties*

When a derivatives firm, or the individuals acting on its behalf, exercise discretionary authority over the accounts of its derivatives parties to enter into transactions on their behalf, we would expect the derivatives firm to have policies and procedures to address the potential conflicts of interest ensuing from the contractual relationship governing the exercise of discretionary authority.

#### *Compensation practices*

We expect that a derivatives firm would consider whether any 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.

### **Section 10 – Know your derivatives party**

Derivatives firms act as gatekeepers of the integrity of the derivatives markets. They should not, by act or omission, facilitate conduct that brings the market into disrepute. As part of their gatekeeper role, derivatives firms are required to establish the identity of, and conduct due diligence on, their clients or counterparties under the know-your-derivatives party obligation in section 10 (the “**KYDP obligation**”). Complying with this obligation can help ensure that derivatives transactions are completed in accordance with securities laws.

The KYDP obligation requires derivatives firms to take reasonable steps to obtain and periodically update information about their derivatives parties.

Section 41 provides an exemption for derivatives firms from the obligations under this section for transactions that are executed on a derivatives trading facility and that are cleared.

## **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 neither an individual nor a specified commercial hedger or an eligible derivatives party that is an individual or specified commercial hedger that has waived these obligations.

### **Section 11 – Derivatives-party-specific needs and objectives**

Information on a derivatives party’s specific needs and objectives (referred to below as “**derivatives-party-specific KYC information**”) forms the basis for determining whether transactions 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 fair terms of a derivative for a derivatives party under subsection 8(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 the impact of making a trading interest public.

Before transacting with a derivatives party, we expect a derivatives firm to have the appropriate information 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, we would expect the derivatives party to be notified. The derivatives firm would be expected to advise the derivatives party that

- this information is required to determine whether the derivative is suitable for the derivatives party, and
- without this 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 derivative.

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

The extent of derivatives-party-specific KYC information that a derivatives firm needs in order 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 derivatives-party-specific 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

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

In other cases, a derivatives firm may need to obtain less derivatives-party-specific 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 with or for, or recommends 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 a derivatives firm 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 should not

- delegate its suitability obligations to anyone other than an officer or employee of the derivatives firm, 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 specific needs and objectives and suitability*

The conduct obligations set out in the Instrument, including the derivatives-party-specific KYC and suitability obligations in sections 11 and 12, are intended to be “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 a derivatives firms' obligations pursuant to sections 11 and 12 is solicited through an online service or questionnaire, we expect that this process would amount to a meaningful discussion with the derivatives party.

An online service or questionnaire is expected to achieve this objective if it

- uses a series of behavioural questions to establish risk tolerance and elicit other derivatives-party-specific 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 inconsistencies or conflicts are 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’s name and contact information to an individual or a firm. “Referral fee” is also broadly defined. It includes any benefits received from referring a derivatives party, including 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 specific contents of the disclosure to be provided to referred derivatives parties, and
- who provides the disclosure to referred derivatives parties.

If the person or company receiving the referral is a derivatives firm or an individual acting on behalf of that derivatives firm, they would be responsible for carrying out all obligations of a derivatives firm towards the referred derivatives party in respect of the derivatives-related activities for which the derivatives party is referred and communicating with the referred derivatives party. However, if the referring person or company is a derivatives firm, the referring derivatives firm is still required to comply with sections 13 [*Permitted referral arrangements*], 14 [*Verifying the qualifications of the person or company receiving the referral*] and 15 [*Disclosing referral arrangements to a derivatives party*].

If a derivatives party is referred by or to an individual acting on behalf of a derivatives firm, we expect the derivatives firm to be a party to the referral agreement. This ensures that the derivatives firm is aware of these arrangements so it can adequately supervise the individuals acting on its behalf and monitor compliance with the agreements. It 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 itself does not 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, or individual acting on its behalf, 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, or individual acting on its behalf, is responsible for determining the steps that are reasonable in the 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 the 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 is directly participating in the referral arrangement, to take reasonable steps to ensure that a derivatives party understands

- which entity it is dealing with,
- what it can expect that entity to provide to it,
- the derivatives firm’s key responsibilities to it,
- if applicable, the limitations of the derivatives firm’s registration category or exemptive relief,
- if applicable, any relevant terms and conditions imposed on the derivatives firm’s registration or exemptive relief,



- 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 16 – Handling complaints**

### *General duty to document and respond to complaints*

Section 16 requires a derivatives firm to document complaints and to effectively, fairly and promptly 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*

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 system 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 that is the subject of a complaint, 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, promptly in writing:

- 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 its complaint.

### *Timeline for responding to complaints*

We expect that a derivatives firm would

- promptly send an initial written response to a 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 CERTAIN 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 neither an individual nor a specified commercial hedger or an eligible derivatives party that is an individual or a specified commercial hedger that has waived these obligations.

#### **Section 17 – Tied selling**

Section 17 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 17 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 17 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.

## **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 a specified commercial hedger or an eligible derivatives party that is an individual or a specified commercial hedger that has waived these obligations.

#### **Section 18 – Relationship disclosure information**

##### *Content of relationship disclosure information*

The Instrument does not prescribe a form for the relationship disclosure information required under section 18. 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 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 18(1), an individual acting on behalf of a derivatives firm must spend sufficient time with a derivatives party in a manner consistent with their operations to adequately explain the relationship disclosure information that is delivered to the derivatives party. 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 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.

#### **Paragraphs 18(1)(a) to (k) – Required relationship disclosure information**

##### *Description of the nature or type of the derivative party’s account*

Under paragraph 18(1)(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 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. Under paragraph 18(1)(n) the derivatives firm must disclose how the derivatives party assets will be held, used and invested.

We 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.

#### *Describe the conflicts of interest*

Under paragraph 18(1)(b) 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, 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, fees and other compensation*

Paragraphs 18(1)(c), (d) and (e) require a derivatives firm to provide a derivatives party information on fees and costs they might be charged when entering into a transaction. 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.

We also expect a derivatives firm to provide the derivatives party with general information on any transaction and other charges that a derivatives party may be required to pay, including general information about potential break costs if a derivative is terminated prior to maturity, as well as other compensation the derivatives firms may receive from a third party as a result of their business relationship.

We recognize that a derivatives firm may not be able to provide all information about the costs associated with a particular derivative or transaction until the terms of the derivative have been agreed upon. However, before entering into an initial transaction, a derivatives firm must meet the applicable pre-transaction disclosure requirements in section 19.

#### *Description of content and frequency of reporting*

Under paragraph 18(1)(f) 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 20,
- transaction confirmations under section 27, and
- derivatives party statements under section 28.

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 18(1)(i) requires a derivatives firm to disclose the type of information that it must collect from the derivatives party. We expect this disclosure will also indicate how this information will be used in assessing and determining the suitability of a derivatives party transaction.

### **Section 19 – Pre-transaction disclosure**

The Instrument does not prescribe a form for the pre-transaction disclosure that must be provided to a derivatives party under section 19. 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 19(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. This disclosure document may be communicated by email or other electronic means.

#### *Identify the derivatives-related products or services the derivatives firm offers*

Under paragraph 19(1)(a), a derivatives firm must provide a general description of the derivatives products and services related to derivatives that 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. The information required to be delivered under paragraph 19(1)(a) may be provided orally or in writing.

*Describe the types of risks that a derivatives party should consider*

Paragraph 19(1)(b)(i) requires 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. The risks disclosed may include market, credit, liquidity, operational, legal and currency risks, as applicable.

The information required to be delivered under paragraph 19(1)(b) may be provided orally or in writing.

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

Paragraph 19(1)(c) 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 derivatives parties are only required to deposit a percentage of the total value of the derivative 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 the total value of the derivative. This means leverage magnifies a derivatives party's profit or loss on a transaction, and losses can exceed the amount of funds deposited.

### **Subsection 19(2) – Disclosure before transacting in a derivative**

We understand that the use of the term "price" is not always appropriate in relation to a derivative or transaction in a derivative. Therefore, under paragraph 19(2)(b), disclosure with respect to spreads, premiums, costs, etc., could be more appropriate than the price.

### **Section 20 – Daily reporting**

We do not expect a derivatives dealer to make the daily mid-market mark (or valuation) available to a derivatives party for a derivative that is cleared through a regulated clearing agency because we expect that derivatives parties will already be able to access valuation information from the clearing agency. However, we would expect the derivatives dealer to notify the derivatives party of its right to request and receive the clearing agency's daily mid-market mark.

### **Section 21 – Notice to derivatives parties by non-resident derivatives firms**

The notice required under section 21 may be provided by a derivatives firm to a derivatives party in standard form industry documentation; a separate statement is not required to be provided to satisfy the obligations of this section.

## **DIVISION 2 – DERIVATIVES PARTY ASSETS**

### **Section 23 – Interaction with other instruments**

A derivatives firm is exempt from the requirements of this Division in respect of derivatives party assets if the derivatives firm is subject to and complies with or is exempt from sections 3 to 8 of NI 94-102 in respect of the derivatives party assets. The exemption from the requirements of this Division set out in paragraph (a) also extends to derivatives firms that rely on substituted compliance under NI 94-102.

A derivatives firm is exempt from the requirements of this Division in respect of derivatives party assets if the derivatives firm is subject to and complies with securities legislation relating to margin and collateral requirements or National Instrument 81-102 *Investment Funds* in respect of derivatives party assets. The exemption from the requirements of this Division on this basis extends to derivatives firms that rely on exemptions from the requirements under securities legislation relating to margin and collateral requirements.

### **Section 24 – Segregating derivatives party assets**

A derivatives firm is required to segregate derivatives party assets from its own property and from the property of the firm's other derivatives parties either by separately holding or accounting for derivatives party assets.

### **Section 25 – Holding initial margin**

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

- 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 immobilized or dematerialized 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 initial margin, 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 26– Investment or use of initial margin**

Section 26 requires that a derivatives firm receive written consent from a derivatives party before investing or otherwise using collateral provided as initial margin. In order to provide consent a derivatives party needs to be made aware of and agree to any potential investment or use. If applicable, we would expect such disclosure to take the form of the disclosures contemplated by paragraph 18(1)(k) [*Relationship disclosure information*], which requires the derivatives firm to disclose the manner in which the assets are used or invested and to provide a description of the risks and benefits to the derivatives party that arises from the derivatives firm having access to use or invest derivatives party assets.

## **DIVISION 3 – REPORTING TO DERIVATIVES PARTIES**

The obligations in this Division, other than subsection 27(1) [*Content and delivery of transaction information*], do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or a specified commercial hedger or an eligible derivatives party that is an individual or a specified commercial hedger that has waived these obligations.

### **Section 27– Content and delivery of transaction information**

The requirement to provide a written confirmation under subsection 27(1) can be satisfied by electronic confirmations (including SWIFT confirmations).

We are of the view that the written description of the derivative transacted required by paragraph 27(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 28 – Derivatives party statements**

We are of the view that the description of the derivative transacted required by paragraphs 28(2)(b) and 28(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**

The objective of this Division is to further a culture of compliance and personal accountability within a derivatives firm. Section 31 imposes certain obligations on a senior derivatives manager, further discussed below, with respect to ensuring compliance by individuals performing activities relating to transacting in, or advising in relation to, derivatives within the area of the business the senior derivatives manager is responsible for, which is referred to in the Instrument and below as a “derivatives business unit”.

Sections 30 and 32 set out certain obligations on the derivatives firm regarding policies and procedures relating to compliance and responding to material non-compliance. We are of the view that a derivatives firm should be afforded flexibility with respect to who fulfills these obligations of the derivatives firm. The obligations on the derivatives firm under these sections may be carried out by, for example, one or more senior derivatives managers designated by the derivatives firm.

## Section 29 – Definitions

The definition of “derivatives business unit” is not intended to dictate that a derivatives firm must organize its derivatives activity in any particular organizational structure. A derivatives business unit could relate to any of, or any combination of, a class of derivatives, an asset class or sub-asset class, a geographic territory, a business line or a division of the derivatives firm.

The definition of “senior derivatives manager” refers to the individual designated as primarily responsible for a particular derivatives business unit. This definition is intended to lead to the designation of the individual who is responsible for

- implementing, within the derivatives business unit, management business priorities within the risk parameters that have been established by the department that is responsible for the management of risk of the derivatives firm, and,
- operationalizing, within the derivatives business unit, policies and procedures relating to compliance established by the department that is responsible for compliance of the derivatives firm.

We generally expect that the individual designated as the senior derivatives manager of a derivatives business unit would have regular interactions with the individuals in the derivatives business unit. We interpret “regular” in this context to mean day-to-day and not to mean infrequent but regular, e.g., once per quarter. Therefore, our expectation is that a senior derivatives manager will be an individual informed of and, in some cases, involved with, the day-to-day activities within the derivatives business unit.

Depending on its size, level of derivatives activity and organizational structure, a derivatives firm may have a number of different derivatives business units. Further, the specific title or job description of the individual designated as “senior derivatives manager” for a derivatives business unit could vary between derivatives firms, depending once again on their size, level of derivatives activity and organizational structures.

Except in a small derivatives firm, we would not expect a senior derivatives manager to be the chief executive officer of the derivatives firm, or an individual registered under NI 93-102 (if applicable) as any of the derivatives ultimate designated person, derivatives chief compliance officer or derivatives chief risk officer of the derivatives firm. In a smaller firm, some of these roles may be assigned to the same individual or individuals.

In a large derivatives firm, we would also generally expect that a senior derivatives manager would not be the officer in charge of the division of the derivatives firm that conducts the activities that result in the firm meeting the definition of “derivatives dealer” or “derivatives adviser” in the Instrument.

It is the responsibility of the derivatives firm to identify within the organizational structure of their business the individual that should be designated as the senior derivatives manager of a derivatives business unit.

## Section 30 – Policies, procedures and designation

Section 30 requires a derivatives firm to establish, maintain and apply policies and procedures and a system (i.e., a “**compliance system**”) of controls and supervision sufficient to provide reasonable assurance that

- the derivatives firm and those acting for it, as applicable, comply with applicable securities legislation,
- the derivatives firm and each individual acting on its behalf manage derivatives-related risks prudently,
- individuals performing a derivatives-related activity on behalf of the firm, prior to commencing the activity and on an ongoing basis,
  - possess the experience, education and training that a reasonable person would consider necessary to perform these activities in a competent manner, and
  - conduct themselves with integrity.

We expect that the policies, procedures and controls referred to in section 30 would include internal controls and monitoring that are reasonably likely to identify non-compliance at an early stage and would allow the derivatives firm to correct non-compliance in a timely manner.

We do not expect that the policies, procedures and controls referred to in section 30 would be applicable to derivatives firm’s activities other than its activities relating to transacting in, or advising in relation to, derivatives. For example, a derivatives dealer may also be a reporting issuer. The policies, procedures and controls established to monitor compliance with the Instrument would not necessarily reference matters related only to the derivatives firm’s status as a reporting issuer. Nevertheless, a derivatives firm would not be precluded from establishing a single set of policies, procedures and controls related to the derivatives firm’s compliance with all applicable securities laws.

We interpret “risks relating to its derivatives activities” in paragraph 30(1)(b) to include the risks inherent in derivatives trading (including credit risk, counterparty risk, and market risk) that relate to a derivatives firm’s overall financial viability.

## **Paragraph 30(1)(c) – Policies and procedures relating to individuals**

Paragraph 30(1)(c) establishes a reasonable person standard with respect to proficiency, rather than prescribing specific courses or other training requirements. However, we note that a derivatives firm and an individual transacting in, or providing advice in relation to, a derivative on behalf of the derivatives firm may be subject to more specific education, training and experience requirements, including under NI 93-102, if applicable.

Subparagraph 30(1)(c)(i) contemplates that industry experience can be a substitute for formal education and training. We are of the view that this is particularly relevant in respect of formal education and training prior to commencing an activity on behalf of the derivatives firm relating to transacting in, or providing advice in relation to, a derivative. However, we expect that all individuals who perform such activity receive appropriate training on an ongoing basis.

Subparagraph 30(1)(c)(iii) relates to integrity of the individuals who perform an activity on behalf of the derivatives firm relating to transacting in, or providing advice in relation to, a derivative. Prior to employing an individual in a derivatives business, we expect that a derivatives firm will assess the integrity of the individual by having regard to the following:

- references provided by previous employers, including any relevant complaint of fraud or misconduct against the individual;
- if the individual has been subject to disciplinary action by its previous employer or to any adverse finding or settlement in civil proceedings;
- whether the individual has been refused the right to carry on a trade, business or profession requiring a licence, registration or other professional designation;
- in light of the individual's responsibility, whether the individual's reputation may have an adverse impact on the firm for which the activity is to be performed.

## **Section 31 – Responsibilities of senior derivatives managers**

Under paragraph 31(1)(b), an appropriate response to material non-compliance is a contextual determination, depending on the harm or potential harm, of the non-compliance. We are of the view that an appropriate response could include one or more of the following, depending on the circumstances:

- rectifying the non-compliance;
- disciplining one or more individuals who perform an activity on behalf of the derivatives firm relating to transacting in, or providing advice in relation to, a derivative;
- improving (or recommending improvements to) processes, policies and procedures aimed at ensuring compliance with the Instrument, applicable securities legislation and the policies and procedures required under section 30 [*Policies, procedures and designation*].

An appropriate response could include directing a subordinate to respond to the non-compliance.

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

### **Subsection 31(2) – Senior derivatives manager's report**

We consider non-compliance with the Instrument or applicable securities legislation to be material if the non-compliance creates a risk of material harm to a derivatives party or to capital markets or otherwise reflects a significant pattern of non-compliance. Whether the harm is "material" is dependent on the specific circumstances. For example, material harm to a small, unsophisticated derivatives party may differ from the material harm to a large, more sophisticated derivatives party.

We would expect that in complying with the requirement to submit a report under paragraph 31(3)(a) that reasonable care will be exercised 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 of the misconduct.

## **Section 32 – Responsibility of a derivatives firm to report material non-compliance**

The requirement on a derivatives firm to make a report to the securities regulatory authority under section 32 will depend on whether the particular non-compliance would reasonably be considered by the derivatives firm to be material non-compliance with the Instrument or applicable securities legislation and create a risk of material harm to a derivatives party or to capital markets or otherwise reflect a significant pattern of non-compliance.

The derivatives firm should establish a standard for determining when there is a risk of material harm to a derivatives party of the firm or to the capital markets. Whether the harm is “material” is dependent on the specific circumstances. Material harm to a small, unsophisticated derivatives party may differ from the material harm to a large, more sophisticated derivatives party.

For registered derivatives firms, the expectation is that the report to the regulator could be provided by the derivatives chief compliance officer or the derivatives ultimate designated person. The term “ultimate designated person” means,

- (a) the chief executive officer of the derivatives firm, or if the derivatives firm does not have a chief executive officer, an individual acting in a capacity similar to that of a chief executive officer;
- (b) a partner or the sole proprietor of the registered derivatives firm;
- (c) if the registered derivatives firm has other significant business activities, the officer in charge of the division of the derivatives firm that acts as a derivatives dealer or as a derivatives adviser.

## **DIVISION 2 – RECORDKEEPING**

### **Subsection 33(2) – Derivatives party agreement must establish all material terms**

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 include terms that cover margin requirements, assets that are acceptable as collateral, collateral valuation methods, investment and rehypothecation of collateral, and custodial arrangements for initial margin, if applicable.

### **Section 34 – Records**

Section 34 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 sets out the minimum records that must be kept. 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 principle underlying section 34 is that a derivatives firm must document, through its records,

- compliance with all applicable securities legislation (including the Instrument) for its derivatives-related activities,
- the details and evidence of each derivative 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-transaction 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 they are 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 the conditions of the exemption or exclusion are met.

With respect to records required under paragraph 34(b), demonstrating the existence and nature of the derivatives firm’s derivatives, and records required under paragraph 34(c) documenting the transactions relating to the derivatives, we expect a derivatives firm to accurately and fully document every transaction it enters into and to keep records to the extent that they demonstrate the existence and nature of the derivative. 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 records of communications kept by a derivatives firm may include notes of 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 35 – Form, accessibility and retention of records**



Paragraph 35(1)(a) 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 firm is exempt from a requirement in the Instrument, the individuals acting on its behalf are likewise exempt.

### **DIVISION 1 – EXEMPTION FROM THIS INSTRUMENT**

#### **Section 37 – Exemption for certain derivatives end-users**

Section 37 provides an exemption from the application of the Instrument for a person or company that does engage in the activities described in section 37 and not have the status described in section 36.

For example, a person or company that frequently and regularly transacts in derivatives to hedge business risk but that does not undertake any of the activities in paragraphs (a) to (e) of subsection (1) may qualify for this exemption. Typically, such a person or company would transact with a derivatives dealer who itself may be subject to some or all of the requirements of the Instrument.

### **DIVISION 2 – EXEMPTIONS FROM SPECIFIC REQUIREMENTS IN THIS INSTRUMENT**

#### **Section 38 – Foreign derivatives dealers**

##### *General principle*

Section 38 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. If a foreign derivatives dealer is not subject to the requirements in a foreign jurisdiction listed in Appendix A, including where it relies on an exclusion or an exemption (including discretionary relief) from those requirements in the foreign jurisdiction, the exemption in section 38 will not be available. If the foreign derivatives dealer relies on an exclusion or exemption in the foreign jurisdiction, it would need to apply to the relevant securities regulatory authorities for consideration of similar exemptive or discretionary relief from the Instrument.

##### *Conditions*

This exemption in section 38 is available if the foreign derivative dealer is dealing only with persons or companies that are eligible derivatives parties. The foreign derivatives dealer must comply with each of the conditions set out in subsections (2), (3) and (4). Furthermore, there may be “residual” provisions of the Instrument listed in Appendix A which must be complied with even if the foreign derivatives dealer is in compliance with the laws of a foreign jurisdiction set out in Appendix A.

The disclosures contemplated in paragraph 38(3)(b) can be made by a derivatives firm in a master trading agreement with its derivatives party.

#### **Section 41 – Derivatives traded on a derivatives trading facility that are cleared**

Where a derivatives firm enters into a transaction with a derivatives party on an anonymous derivatives trading facility or an analogous platform (e.g., a swap execution facility), it may not be possible for the derivatives firm to establish the identity of the derivatives party prior to entering into the transaction. We understand that a trading platform would perform know-your-derivatives party diligence prior to accepting a derivatives party for trading on the platform; accordingly, this section of the Instrument includes an exemption for the derivatives firm in these circumstances.

We do not expect that derivatives trading facilities rules will permit non-eligible derivatives parties to transact anonymously on a derivatives trading facility.

### **DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS**

#### **Section 42 – Advising generally**

Section 42 contains an exemption from the requirements applicable to a derivatives adviser if advice is not tailored to the needs of the recipient.

In general, we would not consider advice to be tailored to the needs of the recipient if it

- is a general discussion of the merits and risks of a derivative or class of derivatives,
- is delivered through newsletters, articles in general circulation newspapers or magazines, websites, e-mail, internet chat rooms, bulletin boards, television or radio, and
- does not claim to be tailored to the needs and circumstances of any recipient.

This type of general advice can also be given at conferences. However, if a purpose of the conference is to solicit the audience and generate specific transactions in specific derivatives or class of derivatives, we may consider the advice to be tailored or we may consider the individual or firm giving the advice to be engaged in trading activity.

Under subsection 42(3), if an individual or a firm relying on the exemption has a financial or other interest in the derivative or class of derivatives it recommends, or in an underlying interest of the derivative, it must disclose the interest to the recipient when it makes the recommendation.

### **Section 43 – Foreign derivatives advisers**

#### *General principle*

Section 43 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. If a foreign derivatives adviser is not subject to the requirements in a foreign jurisdiction listed in Appendix D, including where it relies on an exclusion or an exemption (including discretionary relief) from those requirements in the foreign jurisdiction, the exemption in section 43 will not be available. If the foreign derivatives adviser relies on an exclusion or exemption in the foreign jurisdiction, 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 if the foreign derivative adviser is advising persons or companies that are eligible derivatives parties. The foreign derivatives adviser must also comply with each of the conditions set out in subsections (2), (3) and (4). 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. The disclosures contemplated in paragraph 43(3)(b) can be made by a derivatives firm in account opening documentation.

## **PART 8 EFFECTIVE DATE**

### **Section 45 – Effective Date**

This Instrument comes into force on [●] and therefore any transaction entered into by a derivatives firm from this date forward is subject to the terms of the Instrument, except only section 8 [*Fair dealing*], section 20 [*Daily reporting*] and section 28 [*Derivatives party statements*] will apply to pre-existing transactions if the following conditions are met:

- the transaction was entered into before the in-force date; and
- the derivatives firm has taken reasonable steps to determine that its derivatives party is either (i) a “permitted client” under NI 31-103, (ii) an “accredited counterparty” under the *Derivatives Act* (Quebec), or (iii) a “qualified party” as that term is defined the relevant blanket orders in the provinces of Alberta, British Columbia, Manitoba, New Brunswick or Nova Scotia.

## ANNEX IV

### Alternative version of the definition of "affiliated entity"

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

- (a) the first party and the second party are consolidated in consolidated financial statements prepared in accordance with
  - (i) IFRS, or
  - (ii) generally accepted accounting principles in the United States of America;
- (b) all of the following apply:
  - (i) neither the first party's nor the second party's financial statements, nor the financial statements of another person or company, were prepared in accordance with the principles or standards specified in subparagraphs (a)(i) or (ii);
  - (ii) the first party and the second party would have been, at the relevant time, required to be consolidated in consolidated financial statements prepared by the first party, the second party or the other person or company, if the consolidated financial statements were prepared in accordance with the principles or standards specified in subparagraphs (a)(i) or (ii);
- (c) both parties are prudentially regulated entities that are supervised on a consolidated basis.