POLICY STATEMENT TO REGULATION 93-101 RESPECTING DERIVATIVES: BUSINESS CONDUCT

PART 1
GENERAL COMMENTS

Introduction

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

Except for Part 1, the numbering and headings of Parts, sections and subsections in this Policy Statement correspond to the numbering and headings in the Regulation. 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 Statement 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 Statement is a reference to the corresponding Part, section, subsection, paragraph, subparagraph or definition in the Regulation.

Definitions and interpretation

Unless defined in the Regulation or this Policy Statement, terms used in the Regulation and in this Policy Statement have the meaning given to them in securities legislation, including in *Regulation 14-101 respecting Definitions* (chapter V-1.1, r. 3) ("Regulation 14-101"). "Securities legislation" is defined in Regulation 14-101, and includes statutes and other regulations related to both securities and derivatives.

In this Policy Statement,

"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* (chapter I-14.01, r. 0.1);

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

Interpretation of terms defined in the Regulation

Section 1 – Definition of Canadian financial institution

The definition of "Canadian financial institution" in the Regulation is consistent with the definition of this term in *Regulation 45-106 respecting Prospectus Exemptions* (chapter V-1.1, r. 21) ("Regulation 45-106") with one exception. The definition of this term in Regulation 45-106 does not include a Schedule III bank (due to the separate definition of the term "bank" in Regulation 45-106), with the result that Regulation 45-106 contains certain references to "a Canadian financial institution or a Schedule III bank". The definition of this term in the Regulation includes a Schedule III bank.

"Schedule III bank" means an authorized foreign bank named in Schedule III of the *Bank Act* (S.C., 1991, c. 46).

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 that meets the definition of "derivatives adviser" or "derivatives dealer" in a local jurisdiction is subject to the Regulation in that jurisdiction, whether or not it is registered or exempted from the requirement to be registered in that jurisdiction.

A person will be subject to the requirements of the Regulation 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 *Regulation 93-102 respecting Derivatives: Registration* (*insert here the reference*) ("Regulation 93-102").

Factors in determining a business purpose – derivatives dealer

In determining whether a person 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 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 that contacts another person 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 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 that respond to requests or make quotes available occasionally are not "routinely standing ready".

A person 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 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 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 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 actually receives compensation or what form the compensation takes. However, a person 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 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. A person 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's intention or expectation to be compensated as a result of the contact. For example, a person that wishes to hedge a specific risk is not necessarily soliciting for the purpose of the Regulation 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 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 provides services to allow third parties, including counterparties to transactions involving the person, to clear derivatives through a clearing agency. These services are actions in furtherance of a trade conducted by a person 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 Regulation, a derivatives dealer, a person 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 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 is "in the business" of conducting an activity. In the case of derivatives advisers, it is

necessary to determine whether a person is "advising others" in relation to derivatives.

As with derivatives dealers, a person 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 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 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 that recommends a derivative or derivatives trading strategy to investors as part of a general solicitation by an online derivatives trading platform.

A person 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.

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 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 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 being considered to be a derivatives dealer for the purposes of the Regulation.

A person 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 that conducts the described activities in that jurisdiction. For example, this would include a person 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 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 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 *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registration Obligations* (chapter V-1.1, r. 10) ("Regulation 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 by the derivatives firm. These persons 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 Regulation 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 Statement 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 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 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 Statement 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 is only an eligible derivative party under paragraphs (n) and (q) if the person 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 Regulation 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.[1] As of the time of the publication of this Regulation 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[2] and countries using the euro under a monetary agreement with the European Union.[3]

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 *Regulation 94-102 respecting Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* (chapter

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

[2] 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).

[3] 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).

I-14.01, r. 0.001) (“Regulation 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,

- 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 Regulation applies to “derivatives advisers” and “derivatives dealers” as defined in subsection 1(1) of the Regulation. These definitions include a person 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 Regulation

Section 3 ensures that the Regulation 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 Regulation.

Section 6 – Governments, central banks and international organizations

Section 6 provides that the Regulation 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 Regulation.

Section 7 – Exemptions from the requirements of this Regulation 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 Regulation 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, all of the requirements in Division 1:
    - section 8,
    - section 9, and
    - section 10;
- in Part 4, Division 2:
    - section 23, and
    - section 24;
- in Part 5:
    - all of Division 1, and
    - all of Division 2.

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

Regulation 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 Regulation 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 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").[1]

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 Regulation 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 Regulation. Similarly, the guidance in this Policy Statement 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

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

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.

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 Regulation 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 3 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 2 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 Regulation, 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 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 is a derivatives firm, the referring derivatives firm is still required to comply with sections 13, 14 and 15.

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 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 to obtain a product or service from a particular person, 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 Regulation 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 Regulation 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 regulations

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 Regulation 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 Regulation 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 *Regulation 81-102 respecting Investment Funds* (chapter V-1.1, r. 39) 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 Regulation,

- 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 Regulation, 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 Regulation. 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), 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), 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

Regulation 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 Regulation 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 Regulation.

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 Regulation 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 Regulation 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 Regulation, applicable securities legislation and the policies and procedures required under section 30.

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 Regulation 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 Regulation 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 Regulation) 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 and, if applicable, the obligations in section 11 and section 12 (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 Regulation 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 Regulation provides several exemptions from the requirements in the Regulation. If a firm is exempt from a requirement in the Regulation, the individuals acting on its behalf are likewise exempt.

DIVISION 1 – Exemption from this Regulation

Section 37 – Exemption for certain derivatives end-users

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

For example, a person 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 would transact with a derivatives dealer who itself may be subject to some or all of the requirements of the Regulation.

DIVISION 2 – Exemptions from specific requirements in this Regulation

Section 38 – Foreign derivatives dealers

General principle

Section 38 contemplates an exemption from the Regulation 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 Regulation. This exemption applies to the provisions of the Regulation 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 Regulation

Conditions

This exemption in section 38 is available if the foreign derivative dealer is dealing only with persons 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 Regulation 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 Regulation 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 Regulation 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 Regulation. This exemption applies to the provisions of the Regulation 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 Regulation.

Conditions

This exemption is only available if the foreign derivative adviser is advising persons 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 Regulation 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 Regulation comes into force on (*insert here the date of coming into force*) and therefore any transaction entered into by a derivatives firm from this date forward is subject to the terms of the Regulation, except only section 8, section 20 and section 28 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 Regulation 31-103, (ii) an "accredited counterparty" under the *Derivatives Act* (chapter I-14.01), 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.