POLICY STATEMENT TO REGULATION 93-102 RESPECTING DERIVATIVES: REGISTRATION

PART 1
GENERAL COMMENTS

Introduction

This Policy Statement sets out the views of the Canadian Securities Administrators (the "CSA" or "we") on various matters relating to *Regulation 93-102 respecting Derivatives: Registration* (*insert reference*) (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.

Additional requirements applicable to registrants

In addition to the requirements in the Regulation, registrants must comply with additional requirements. These additional requirements include

- *Regulation 31-102 respecting National Registration Database* (chapter V-1.1, r. 9) ("Regulation 31-102") and *Policy Statement to Regulation 31-102 respecting National Registration Database* (Decision 2009-PDG-0132), and

- *Regulation 33-109 respecting Registration Information* (chapter V-1.1, r. 12) ("Regulation 33-109") and *Policy Statement to Regulation 33-109 respecting Registration Information* (Decision 2014-PDG-0142).

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 instruments 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.

Requirement to register

The requirement to register is found in securities legislation. A derivatives firm must register if it is

- in the business of trading derivatives,
- in the business of advising others on derivatives,
- holding themselves out as being in the business of trading or advising, or
- otherwise required to be registered under section 6 of the Regulation.

Individuals must register if they trade or advise on behalf of a registered derivatives dealer or a registered derivatives adviser unless they are exempted from the requirement to register under subsection (3) or (4) of section 16 of the Regulation or under the securities legislation of a jurisdiction. Individuals are also required to register if they act as the derivatives ultimate designated person, derivatives chief compliance officer or derivatives chief risk officer of a registered derivatives firm.

All individual registrants and permitted individuals of any registered derivatives firm or firm that is applying to become a registered derivatives firm must file Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals* ("Form 33-109F4").

"Permitted individual" has the meaning given to the term in Regulation 33-109. It means, for a registered derivatives firm, an individual who

- is a member of the registered derivatives firms board of directors, or the chief executive officer, chief financial officer, or chief operating officer of the registered derivatives firm, or an individual that is the functional equivalent of any of those positions,
- has beneficial ownership of, or direct or indirect control or direction over, 10 percent or more of the voting securities of the registered derivatives firm, or
- is a trustee, executor, administrator or other personal or legal representative, that has direct or indirect control or direction over 10 percent or more of the voting securities of the registered derivatives firm.

There is no renewal requirement for registration, but fees must be paid every year to maintain registration.

Factors in determining a business purpose

In determining whether a person is in the business of trading or advising in derivatives, a number of factors should be considered. Guidance relating to these factors is included in Part 3 of this Policy Statement.

Exemptions from the requirement to register and exemptions from specific requirements applicable to registered firms

Divisions 1 and 3 of Part 10 provide exemptions from the derivatives dealer and the derivatives adviser registration requirement. There may be additional exemptions in securities legislation.

Where a person is exempted from the requirement to be registered as a derivatives dealer or derivatives adviser, it will not be subject to the requirements in the Regulation applicable to registered dealers or registered advisers. It is, however, subject to the terms and conditions of the exemption.

Divisions 2 and 4 of Part 10 establish exemptions from specific requirements under the Regulation applicable to persons that are registered as derivatives dealers or derivatives advisers. A person is still required to register and comply with each registration requirement where an exemption does not apply.
The exemptions in Part 10 do not require an application if the conditions of the exemption are met.

In other cases, upon application, the relevant regulator may grant exemptions from the requirement to register as a derivatives dealer or a derivatives adviser or may grant exemptions from specific requirements in the Regulation.

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, including the specified financial assets threshold.

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 a derivatives party that may not require the full set of protections that are provided to other derivatives parties that are not eligible derivatives parties.

Subsection 16(3) includes an exemption for an individual from the requirement to register as a derivatives dealing representative of a registered derivatives firm if the individual does not solicit or otherwise transact with a derivatives party that is a non-eligible derivatives party.

A similar exemption for derivatives advising representatives is included in subsection 16(4).

In addition, many of the exemptions in Part 10 are conditional on the derivatives firm not transacting with, soliciting or advising persons that are not eligible derivatives parties.

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. Under subsection 46(1), a derivatives firm is required to keep records it uses in determining whether a derivatives party is an eligible derivatives party.

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

Under paragraphs (m) through (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 are 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 is, at the time the transaction occurs, a commercial hedger. In determining that a derivatives party is 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 supported (under a letter of credit or credit support agreement) by one or more eligible derivatives parties, other than eligible derivatives parties that only qualify as eligible derivatives parties under paragraph (n).

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 notional amount

The term "notional amount" has the meaning set out in Appendix A to the Regulation. The term is used in sections 50 and 51, which provide for certain exemptions to persons from the requirement to register as a derivatives dealer, on conditions including a condition that the person, together with its affiliated entities, have a notional amount under all outstanding derivatives below a specified threshold.

While, in most cases, the notional amount for a specific derivative will be the monetary amount specified in the derivative, in some cases, the derivative may reference a non-monetary amount, such as a notional quantity (or volume) of an underlying asset. In these latter cases, calculating the monetary notional amount outstanding will require converting the notional quantity of the underlying asset into a monetary value. Appendix A to the Regulation establishes how the monetary notional amount must be calculated for these derivatives.

Section 1 – Definition of valuation

The term "valuation" is defined to mean the current value of a derivative. The value should be 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)

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.

Section 2 – Information may be given to the principal regulator

Section 2 reduces the regulatory burden for registered derivatives firms and individuals acting for registered derivatives firms, by allowing the firm or individual that is subject to an obligation to report or notify, or to deliver or submit a document, to more than one regulator by providing the foregoing to its principal regulator. However, foreign derivatives dealers and foreign derivatives advisers relying on the exemptions in section 52 and section 59, respectively, must report in each jurisdiction where it is relying on the exemption and not only to the principal regulator.

The definition of "principal regulator" in subsection 1(1) establishes the criteria for determining the principal regulator for a derivatives firm.

PART 2
APPLICATION

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 purpose of the Regulation.

Section 5 - Governments, central banks and international organizations

Section 5 provides that the Regulation does not apply to certain governments, central banks, international organizations and crown corporations that meet the conditions set out in the section, from the application of the Regulation. Section 5 does not, however, exclude derivatives firms that deal with or advise these entities from the application of the Regulation.

PART 3
REQUIREMENT TO REGISTER AND CATEGORIES OF REGISTRATION FOR DERIVATIVES FIRMS

Fitness for registration

We will only register a firm if it appears to be fit for registration. Following registration, a firm must maintain its fitness in order to remain registered. If we determine that a registrant has become unfit for registration, we may suspend or revoke the registration. See Division 2 of this Part for guidance on suspension and revocation of a registered derivatives firm's registration.

Terms and conditions

We may impose terms and conditions on a registrant at the time of registration or at any time after registration. Terms and conditions imposed at the time of registration are generally permanent, for example, in the case of a restricted derivatives dealer who is limited to specific activities. Terms and conditions imposed after registration are generally temporary and are intended to address specific issues relating to the registrant. For example, if a registered derivatives dealer is having financial problems that lead to the firm struggling to maintain the required capital, we may impose a condition to its registration requiring the firm to file weekly financial statements and capital calculations until the concerns are addressed.

Opportunity to be heard

An applicant has an opportunity to be heard by the regulator before its application for registration is denied. It also has an opportunity to be heard before the regulator imposes terms and conditions on its registration if it disagrees with the terms and conditions.

Assessing fitness for registration – firms

We assess whether a firm is or remains fit for registration through the information that the firm is required to provide on forms and through compliance reviews. Based on this information, we consider whether the firm is able to carry out its obligations under securities legislation. For example, a firm that has a history of compliance issues may not be fit for registration.

In addition, when determining whether a registered derivatives firm whose head office is outside Canada is, and remains, fit for registration, we will consider whether the firm maintains registration or regulatory organization membership in the foreign jurisdiction that is appropriate for the derivatives related business that it carries out there.

DIVISION 1 – Firm Registration and Categories of Registration

The categories of registration for registered derivatives firms have 2 main purposes:

- to specify the type of business that the firm may conduct, and
- to provide a framework for the requirements the firm must meet.

A firm may be required to register in more than one category. For example, a derivatives dealer that acts as a portfolio manager for a fund that holds derivatives must register both as a derivatives dealer and as a derivatives adviser. In addition, if a person acts as a securities dealer and as a derivatives dealer, it must register in the appropriate dealer category under Regulation 31-103 and as a derivatives dealer under the Regulation.

Individual registered in a firm category

An individual can be registered in both a firm and individual category. For example, a sole proprietor who is registered in the firm category of derivatives adviser must, if required under the Regulation, also be registered in the individual category of derivatives advising representative.

Registration triggers

A person will be required to register as a derivatives dealer if it is

- in the business of trading derivatives, or
- required to register under section 6.

A person will be required to register as a derivatives adviser if it is in the business of advising others in respect of derivatives.

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 bids or 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 bids or quotes or 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 bids or 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 from the transaction. For example, a person that wishes to hedge a specific risk might not be considered to be 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, for the purposes of the Regulation, 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.

In determining whether a person may be considered to be in the business of advising others in relation to derivatives, it may be helpful to consider certain exemptions from the derivatives adviser registration requirement including the following:

- Section 57;

- Section 58.

For example, 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. However, so long as the conditions in section 57 [*Advising generally*] are satisfied, including the condition that the person discloses any financial or other interest, the person would be exempt from the adviser registration requirement.

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 purpose 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.

Section 6 – Derivatives dealer registration – additional registration triggers

In addition to the general requirement, under securities legislation, for a person to register if it is in the business of trading derivatives or in the business of advising others in relation to derivatives, section 6 describes other types of activity that will require a person to register as a derivatives dealer without the need for a general business trigger analysis.

If a person engages in an activity specified in paragraphs (a) to (c), it will be required to register as a derivatives dealer or rely on an exemption from the requirement to register.

Paragraphs (a) and (b) impose an obligation to register as a derivatives dealer if a person transacts a derivative with or solicits or initiates contact to encourage a derivatives party to enter into a transaction with a person that is not an eligible derivatives party.

Paragraph (b) imposes the obligation to register where a person "solicits or initiates contact" with a person that is not an eligible derivatives party. Examples of situations where a person is initiating contact include

- contacting a person directly through any means, including an in-person meeting, by telephone, through a seminar, including a seminar offered through the internet or by other similar medium, or by e-mail,

- advertising using a medium that is reasonably available to a person in the local jurisdiction that is not an eligible derivatives party, and

- operating a website that offers or purports to offer services in the local jurisdiction.

Paragraph (c) requires a person to register as a derivatives dealer if it facilitates clearing of one or more derivatives for another person, other than an affiliated entity, through a clearing agency or a clearing house, as applicable. A person that facilitates clearing for another person would be a "clearing intermediary" under *Regulation 94-102 respecting Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* (chapter I-14.01, r. 0.001) and subject to applicable obligations under that regulation.

Paragraphs 7(1)(b) and 7(2)(b) – Restricted derivatives dealer

The restricted derivatives dealer category in paragraph 7(1)(b) allows a specialized dealer to carry on a limited trading business while being subject to requirements that are tailored to its business. If there is a compelling case for the proposed trading to take place outside of the general derivatives dealer category, the restricted derivatives dealer category may be used.

If a person registers in the restricted derivatives dealer category, we will impose terms and conditions that restrict the dealer's activities. The CSA will co-ordinate terms and conditions for restricted dealers that trigger registration in more than one Canadian jurisdiction.

For example, a person that deals in a specific type of derivatives, such as certain commodity-based derivatives, may want staff to fill a role where the person does not meet the proficiency requirements in section 18 but that do have the necessary skills and experience to deal in the specific type of derivatives that the firm transacts. We may register such a firm with terms and conditions that will restrict dealing activity to the applicable commodities.

Paragraphs 8(1)(b) and 8(2)(b) – Restricted derivatives adviser

This is analogous to the restricted dealer category described above. The restricted derivatives adviser category in paragraph 8(1)(b) permits individuals or firms to advise in specific derivatives. The regulator will impose terms and conditions on a restricted derivatives adviser's registration that limit the adviser's activities. For example, a restricted derivatives adviser might be restricted to advising in respect of a specific type of derivatives, such as agricultural commodities.

Section 9 – IIROC membership for certain derivatives dealers

Under section 9, a derivatives firm that is registered as a derivatives dealer must also be a dealer-member of IIROC if the firm transacts or solicits transactions with a derivatives party

(i) who is an individual, and

(ii) who is not an eligible derivatives party.

This means that a registered derivatives dealer will not be required to be an IIROC member if it only transacts with or solicits transactions with either or both of the following:

(i) derivatives parties that are not individuals;

(ii) derivatives parties that are individuals who qualify as eligible derivatives parties.

However, the Regulation does not preclude such a dealer from seeking IIROC membership if it chooses to do so on a voluntary basis.

Under section 55, a registered derivatives dealer that is a dealer-member of IIROC is exempt from specific requirements in the Regulation applicable to registered derivatives dealers that are specified in Appendix E, if the registered derivatives dealer complies with the corresponding IIROC provisions that are identified in Appendix E.

DIVISION 2 – Suspension and revocation of registration – derivatives firms

The requirements for surrendering registration and additional requirements for suspending and revoking registration are found in the securities legislation of each jurisdiction. The guidance for Division 2 of Part 3 relates to requirements under securities legislation which includes the Regulation.

There is no renewal requirement for registration but a registered derivatives firm must pay fees every year to maintain its registration and the registration of individuals acting on its behalf. A registered derivatives firm may carry on the activities for which it is registered until its registration is

- suspended automatically under the Regulation
- suspended by the regulator under certain circumstances, or
- surrendered by the registered derivatives firm.

Suspension

A registered derivatives firm whose registration has been suspended must not carry on the activity for which it is registered. The derivatives firm remains a registrant, although it may not carry out activities that require registration and remains subject to the jurisdiction of the regulator. A suspension remains in effect until the regulator reinstates or revokes the firm's registration.

If a registered derivatives firm that is registered in more than one category is suspended in one of the categories, the regulator will consider whether to suspend the firm's registration in other categories or to impose terms and conditions, subject to an opportunity to be heard.

Automatic suspension

A registered derivatives firm's registration will automatically be suspended if

- it fails to pay its annual fees within 30 days of the due date, or
- it is a member of IIROC, IIROC revokes or suspends the firm's membership.

Registered derivatives firms do not have an opportunity to be heard by the regulator in the case of any automatic suspension. If a registered derivatives firm is voluntarily terminating its membership with IIROC but wishes to continue to be registered, it should consult with its principal regulator before it terminates it status as a dealer member of IIROC.

Suspension in the public interest

A registered derivatives firm's registration may be suspended if the regulator exercises its power under securities legislation and determines that it is no longer in the public interest for the firm to be registered. The regulator may do this if it has serious concerns about the ongoing fitness of the registered derivatives firm or any of its registered individuals. For example, this may be the case if a registered derivatives firm, or one or more of its registered individuals or permitted individuals, is charged with a crime, in particular fraud or theft.

Reinstatement

"Reinstatement" means that a suspension on a registration has been lifted. Once reinstated, a derivatives firm may resume carrying on the activity it is registered for.

Section 13 – Revocation of a suspended registration – firm
Section 14 – Exception for firms involved in a hearing or proceeding

If a registered derivatives firm's registration has been suspended and has not been reinstated, section 13 results in it being revoked on the 2nd anniversary of the suspension. Section 14 is an exception from section 13 and provides that if a hearing or proceeding concerning the suspended firm has commenced, the registration remains suspended.

"Revocation" means that the regulator has terminated the registered derivatives firm's registration. A firm whose registration has been revoked must submit a new application if it wants to be registered again.

Surrender

A registered derivatives firm may apply to surrender its registration in one or more categories at any time by filing an application with its principal regulator. There is no prescribed form for an application to surrender.

Before the regulator accepts a registered derivatives firm's application to surrender registration, the derivatives firm must provide the regulator with evidence that its existing derivatives parties have been dealt with appropriately.

The regulator does not have to accept a registered derivatives firm's application to surrender its registration. Instead, the regulator can act in the public interest by suspending, or imposing terms and conditions on the firm's registration.

When considering a registered derivatives firm's application to surrender its registration, the regulator typically considers the registered derivatives firm's actions, the completeness of the application and the supporting documentation.

The firm's actions

The regulator may consider whether the registered derivatives firm

- has stopped carrying on activity requiring registration,

- proposes an effective date to stop carrying on activity requiring registration that is within a reasonable period of the date of the application to surrender,

- has outstanding derivatives that will continue after the date of the application to surrender, and

- has paid any outstanding fees and submitted any outstanding filings at the time of filing the application to surrender.

Completeness of the application

Among other things, the regulator may look for

- the registered derivatives firm's reasons for ceasing to carry on activity requiring registration,

- satisfactory evidence that the registered derivatives firm has given all of its derivatives parties reasonable notice of its intention to stop carrying on activity requiring registration, including an explanation of how it will affect its derivatives parties in practical terms,

- how the registered derivatives firm will manage derivatives that will expire after the date that the firm proposes to surrender its registration, and

- satisfactory evidence that the derivatives firm has given appropriate notice to other regulators of the firm, if applicable.

Supporting documentation

The regulator may look for

- evidence that the registered derivatives firm has resolved all outstanding complaints from derivatives parties, settled all litigation, satisfied all judgments or made reasonable arrangements to deal with and fund any payments relating to them, and any subsequent complaints, settlements or liabilities,

- confirmation that all money or securities owed to derivatives parties have been returned or transferred to another derivatives dealer, where possible, according to instructions,

- up-to-date audited financial statements with an auditor's comfort letter,

- evidence that the registered derivatives firm has satisfied any requirements imposed by IIROC for withdrawing as a dealer member, and

- an officer's or partner's certificate supporting these documents.

PART 4
CATEGORIES OF REGISTRATION FOR INDIVIDUALS

Responsibilities of a sponsoring derivatives firm

A registered derivatives firm is responsible for the conduct of the individuals who act on its behalf.

A registered derivatives firm

- must undertake due diligence before sponsoring an individual to be registered to act on its behalf (see further guidance in Part 4 of *Policy Statement to Regulation 33-109 respecting Registration Information*), and

- has an ongoing obligation under section 38 to establish, maintain and apply written policies and procedures that are reasonably designed to establish a system of controls and supervision sufficient to ensure that the registered derivatives firm and each individual acting on its behalf in relation to derivatives complies with securities legislation.

These obligations apply even when the individual may be exempted from the requirement to register under subsection 16(3) or 16(4).

Failure of a registered derivatives firm to fulfill these responsibilities may be relevant to the firm's continued fitness for registration.

Fitness for registration

We will only register an individual applicant if they appear to be fit for registration. Following registration, an individual must maintain their fitness in order to remain registered. If we determine that a registrant has become unfit for registration, we may suspend or revoke the registration. See Division 2 of Part 5 of this Policy Statement for guidance on suspension and revocation of an individual's registration.

Assessing fitness for registration – individuals

We use 3 fundamental criteria to assess whether an individual is or remains fit for registration:

- proficiency
- integrity, and
- solvency

(a) Proficiency

Individual applicants must meet the applicable education, training and experience requirements prescribed in the Regulation and demonstrate knowledge of relevant regulatory requirements relating to derivatives and the derivatives they transact or recommend.

Registered individuals should continually update their knowledge and training to keep pace with changes in derivatives markets and developments in the industry that are relevant to their business. See Part 5 of this Policy Statement for more specific guidance on proficiency.

(b) Integrity

Registered individuals must conduct themselves with integrity and honesty. We will assess the integrity of individuals through the information they are required to provide on registration application forms and other forms required to be filed under securities legislation, including forms required under Regulation 33-109, and through compliance reviews. For example, applicants are required to disclose information about conflicts of interest, such as other employment or partnerships, service as a member of a board of directors, or relationships with affiliates, and about any regulatory or legal actions against them.

(c) Solvency

We will assess the overall financial condition of an individual applicant or registrant. An individual that is insolvent or has a history of bankruptcy may not be fit for registration. Depending on the circumstances, the regulator may consider the individual's contingent liabilities. The regulator may take into account an individual's bankruptcy or insolvency when assessing their continuing fitness for registration.

Section 16 – Individual registration categories

Multiple individual categories

Individuals who carry on more than one activity requiring registration on behalf of a registered derivatives firm must

- register in all applicable categories, and
- meet the proficiency requirements of each category.

For example, a derivatives advising representative of a registered derivatives adviser who is also the derivatives firm's derivatives chief compliance officer must register in the categories of derivatives advising representative and derivatives chief compliance officer. They must meet the proficiency requirements of both categories.

Individual registered in a firm category

An individual can be registered in both a firm and individual category. For example, a sole proprietor who is registered in the firm category of derivatives adviser must also be registered in the individual category of derivatives advising representative.

Exemption

Under subsection (3), an individual is, subject to certain conditions, exempt from the requirement to register as a derivatives dealing representative if they only transact with, for or on behalf of, or only solicit a transaction with, for or on behalf of, eligible derivatives parties or affiliated entities (other than certain affiliated entities that are investment funds).

Subsection (4) provides a similar exemption to derivatives advising representatives that only advise eligible derivatives parties. The exemption in subsection (4) does not apply to an individual that acts as an adviser for a managed account, even if the beneficiary of the managed account is an eligible derivatives party.

PART 5
REGISTRATION REQUIREMENTS FOR INDIVIDUALS

DIVISION 1 – Individual proficiency requirements

Section 18 – Initial and ongoing proficiency requirements

Proficiency principle

Section 18 has 2 types of proficiency requirements that are applicable to individuals that are required to register: a general requirement in subsection (1) and specific requirements in subsections (2), (3), (4) and (6).

To meet the general requirement in subsection 18(1), derivatives dealing representatives and derivatives advising representatives must have the necessary education, training and experience to understand the structure, features and risks of each derivative that they recommend to a derivatives party (also referred to as know-your-product). This requirement is in addition to the suitability obligation in section 12 of *Regulation 93-101 respecting Derivatives: Business Conduct* (*insert reference*) ("Regulation 93-101") and applies even where there is an exemption from the suitability obligation.

A registered derivatives firm should perform its own analysis of the derivatives its staff recommend to derivatives parties and provide product training to ensure its staff, including its registered derivatives dealing and registered derivatives advising representatives, have a sufficient understanding of those derivatives and their associated risks.

Derivatives chief compliance officers and derivatives chief risk officers must also not perform an activity that requires registration unless they have the education, training and

experience that a reasonable person would consider necessary to perform their responsibilities competently. Derivatives chief compliance officers must have a good understanding of the regulatory requirements applicable to their sponsoring derivatives firm and individuals acting on its behalf and have the knowledge and ability to design and implement an effective compliance system. Similarly, derivatives chief risk officers must have an understanding of the risks applicable to their sponsoring derivatives firm and have the knowledge and ability to implement an effective risk management system.

We will consider both the general and specific requirements in determining the individual's fitness for registration and may exercise discretion in making a determination.

Responsibility of the firm

Subsections (2), (3), (4) and (6) of section 18 preclude firms from designating individuals to act in roles that require individual registration unless the individual meets the applicable proficiency requirements. Section 38 requires a registered derivatives firm to have policies and procedures to ensure compliance with applicable securities legislation, including requirements that individuals acting on its behalf

- have, at all times, the proficiency necessary to do their derivatives related tasks, and

- are registered if they are required to be registered under securities legislation.

Exam based requirements

Where specific exams are referenced in section 18, individuals must pass the exams – not only take courses – to meet the education requirements in that section. For example, before an individual can be allowed to act as a derivatives dealing representative under paragraph 18(4)(a), they must pass the Derivatives Fundamentals Course Exam. Individuals are responsible for completing the necessary preparation to pass an exam and for having the necessary proficiency in all areas covered by the exam.

Time limits on examination requirements

Under subsection 18(8), there is a time limit on the validity of exams prescribed in section 18. Individuals must pass an exam within 36 months before they apply for registration. However, this time limit does not apply if the individual

- was registered in an active capacity (i.e., not suspended), in the same category in a jurisdiction of Canada at any time during the 36-month period before the date of their application, or

- has gained relevant securities or derivatives industry experience for a total of 12 months during the 36-month period before the date of their application. These months do not have to be consecutive, or with the same firm or organization.

These time limits do not apply to the CFA Charter or the Risk Manager Designation since we do not expect the holders of these designations to have to retake the courses or successfully retake the exams that form part of the requirements applicable to these designations. However, if the individual no longer has the right to use the CFA Charter or the Risk Manager Designation, by reason of revocation of the designation or otherwise, we may consider the reasons for such a revocation to be relevant in determining an individual's fitness for registration. Registered individuals are required to notify the regulator of any change in the status of their CFA Charter or their designations within 10 days of the change, by submitting Form 33-109F5 *Change of Registration Information* in accordance with Regulation 31-102.

When assessing an individual's fitness for registration, the regulator may consider

- the date on which the relevant examination was passed, and

- the length of time between any suspension and reinstatement of registration during the 36 -month period.

See guidance relating to Division 2 of this Part, below, for guidance on the meaning of “suspension” and “reinstatement”.

Relevant industry experience

The relevant experience under paragraph 18(9)(b) should be relevant to the category applied for. It may include experience acquired in any of the following:

- during employment at a firm that is a derivatives dealer or derivatives adviser;

- in related fields, such as investment banking; securities or derivatives trading on behalf of a financial institution; securities, derivatives or commodities research; portfolio management; investment advisory services; or supervision of those related fields;

- in legal, accounting or consulting practices related to derivatives or the securities industry;

- in other professional service fields that relate to derivatives or the securities industry;

- in a derivatives or securities-related business in a foreign jurisdiction.

Granting exemptions

We may grant an exemption from any of the education and experience requirements if we are satisfied that an individual has qualifications or relevant experience that are equivalent to, or more appropriate in the circumstances than, the prescribed requirements.

Proficiency for representatives of restricted derivatives dealers and restricted derivatives advisers

We will decide on a case-by-case basis what education and experience are required for registration as

- a derivatives dealing representative, derivatives chief compliance officer or derivatives chief risk officer of a restricted derivatives dealer, and

- a derivatives advising representative, derivatives chief compliance officer or derivatives chief risk officer of a restricted derivatives adviser.

The regulator will determine these requirements when it assesses the individual’s fitness for registration.

Proficiency requirements for derivatives advising representatives

The 48 months of relevant investment management experience referred to in subparagraph 18(6)(b)(iii) does not have to be consecutive, or with the same firm or organization.

For individuals with a CFA Charter, the regulator will decide on a case-by-case basis whether the experience they gained to earn the CFA Charter qualifies as relevant experience.

What constitutes relevant experience may vary according to the level of specialization of the individual. It may include

- securities or derivatives research and analysis experience, demonstrating an ability in, and understanding of, portfolio analysis or portfolio security selection, or

- management of investment portfolios on a discretionary basis, including investment or risk management decision making, rebalancing and evaluating performance.

Derivatives advising representatives with discretionary authority

A derivatives advising representative may have discretionary authority over portfolios of others, including for a managed account. Accordingly, this category of registration involves the most extensive proficiency requirements. We expect an individual who seeks registration as a derivatives advising representative to demonstrate a high quality of experience that is clearly relevant to discretionary portfolio management. Such experience may include working at one or more of the following:

- a derivatives adviser registered or operating under an exemption from registration in a foreign jurisdiction;
- an insurance company;
- a pension fund;
- a derivatives dealer;
- an investment dealer.

Restriction on acting for another registered firm

We will not usually allow registration for an individual if that same individual, regardless of the category of registration, acts on behalf of more than one sponsoring firm, whether it is a registered derivatives firm or a registered securities firm, unless the sponsoring firms are affiliated entities, and the scale and types of activities carried out make it reasonable for the same person to act for each firm. If sponsoring firms propose to permit an individual who is registered to act on behalf of another sponsoring firm, we will consider this on a case-by-case basis. When reviewing an application, we will consider if

- there are valid business reasons for the individual to be registered to act on behalf of both sponsoring firms,
- the individual will have sufficient time to adequately serve both sponsoring firms,
- the applicant's sponsoring firms have demonstrated that they have policies and procedures addressing any conflicts of interest that may arise due to the dual registration, and
- the sponsoring firms will be able to deal with these conflicts, including supervising how the individual will deal with these conflicts.

DIVISION 2 – Suspension and revocation of registration – individuals

The requirements for surrendering registration and additional requirements for suspending and revoking registration are found in the securities legislation of each jurisdiction. The guidance for this Division relates to requirements under securities legislation, which includes the Regulation.

There is no renewal requirement for registration. A registered individual may carry on the activities for which they are registered until their registration is

- suspended automatically under the Regulation,
- suspended by the local regulator under certain circumstances, or
- surrendered by the individual.

An individual whose registration is suspended must not carry on the activity for which they are registered. The individual otherwise remains a registrant and is subject to the

jurisdiction of the regulator. A suspension remains in effect until the individual's registration is reinstated or revoked.

If an individual who is registered in more than one category is suspended in one of the categories, the regulator will consider whether to suspend the individual's registration in other categories or to impose terms and conditions, subject to an opportunity to be heard.

Automatic suspension

An individual's registration will automatically be suspended if

- they cease to have a working relationship with their sponsoring firm,
- the registration of their sponsoring firm is suspended or revoked, or
- the individual is an approved person of IIROC, and IIROC revokes or suspends the individual's approval.

An individual must have a sponsoring derivatives firm to be registered. If an individual leaves their sponsoring derivatives firm for any reason, their registration is automatically suspended. Automatic suspension is effective on the day that an individual no longer has authority to act on behalf of their sponsoring derivatives firm.

Individuals do not have an opportunity to be heard by the regulator in the case of any automatic suspension.

Suspension in the public interest

An individual's registration may be suspended if the regulator exercises its power under securities legislation and determines that it is no longer in the public interest for the individual to be registered. The regulator may do this if it has serious concerns about the ongoing fitness of the individual. For example, this may be the case if an individual is charged with a crime, in particular fraud or theft.

Reinstatement

"Reinstatement" means that a suspension on a registration has been lifted. Once reinstated, an individual may resume carrying on the activity they are registered for. If a suspended individual joins a new sponsoring derivatives firm, they will have to apply for reinstatement under the process set out in Regulation 33-109. Subject to certain conditions in Regulation 33-109, reinstatement or transfer to the new firm will be automatic if the individual

- transfers directly from one sponsoring derivatives firm to another registered derivatives firm in the same jurisdiction,
- joins the new sponsoring derivatives firm within 90 days of leaving their former sponsoring derivatives firm,
- seeks registration in the same category as the one previously held, and
- completes and files Form 33-109F7 *Reinstatement of Registered Individuals and Permitted Individuals* ("Form 33-109F7").

This allows individuals to engage in activities requiring registration from their first day with the new sponsoring derivatives firm.

Individuals are not eligible for an automatic reinstatement if they

- have new information to disclose regarding regulatory, criminal, civil or financial matters as described in Item 9 of Form 33-109F7, or
- as a result of allegations of criminal activity or breach of securities legislation,

- were dismissed by their former sponsoring derivatives firm, or
- were asked by their former sponsoring derivatives firm to resign.

In these cases, the individual must apply to have their registration reinstated under Regulation 33-109 using Form 33-109F4.

Section 19 – If individual ceases to have authority to act for the derivatives firm

Under section 19, if a registered individual ceases to have authority to act on behalf of their sponsoring derivatives firm because their working relationship with the firm ends or changes, the individual's registration with the registered derivatives firm is suspended until reinstated or revoked under securities legislation. This applies whether the individual or the firm ends the relationship.

If a registered derivatives firm terminates its working relationship with a registered individual for any reason, the firm must complete and file a notice of termination on Form 33-109F1 *Notice of Termination of Registered Individuals and Permitted Individuals* ("Form 33-109F1") no later than 10 days after the effective date of the individual's termination. This includes situations where an individual resigns, is dismissed or retires.

The registered derivatives firm must file additional information about the individual's termination prescribed in Part 5 of Form 33-109F1 (except where the individual is deceased), no later than 30 days after the date of termination. We use this information to determine if there are any concerns about the individual's conduct that may be relevant to their ongoing fitness for registration.

Section 20 – If IIROC approval is revoked or suspended

If IIROC suspends or revokes its approval of an individual, the individual's registration in the category requiring IIROC approval will be automatically suspended. If IIROC suspends an individual for reasons that do not involve significant regulatory concerns and subsequently reinstates the individual's approval, the individual's registration will usually be reinstated by the regulator as soon as possible.

Section 23 – Revocation of a suspended registration – individual

"Revocation" means that the regulator has terminated the individual's registration. An individual whose registration has been revoked must submit a new application if they want to be registered again.

Surrender or termination of registration

If an individual wants to terminate their registration in one or more of the non-principal jurisdictions where the individual is registered, the individual may apply to surrender their registration at any time by completing Form 33-109F2 *Change or Surrender of Individual Categories* ("Form 33-109F2") and having their sponsoring derivatives firm file it.

If an individual wants to terminate their registration in their principal jurisdiction, Form 33-109F1 must be filed by the individual's sponsoring derivatives firm. Once Form 33-109F1 is filed, the individual's termination of registration will be reflected in all jurisdictions.

PART 6
DERIVATIVES ULTIMATE DESIGNATED PERSON, DERIVATIVES CHIEF COMPLIANCE OFFICER AND DERIVATIVES CHIEF RISK OFFICER

Part 6 requires registered derivatives firms to designate a derivatives ultimate designated person, a derivatives chief compliance officer and a derivatives chief risk officer. While each of these individuals have specific functions for compliance and risk management, they are not solely responsible for compliance and risk management; it is the responsibility of the firm as a whole. Part 6 also imposes responsibilities on individuals that are designated as derivatives

ultimate designated persons, derivatives chief compliance officers or derivatives chief risk officers by registered derivatives firms.

The obligations of the derivatives ultimate designated person in subsection 27(3) and the obligations of a derivatives chief compliance officer in subsection 28(3) only apply to compliance with securities legislation relating to derivatives.

The same person registered in more than one category

The same person may be registered in more than one category if they meet the requirements for each registration category. For example, one person may be designated as both the derivatives chief compliance officer and derivatives chief risk officer. We prefer firms to separate these functions, but we recognize that it might not be practical for some registered derivatives firms, particularly very small firms.

Section 27 – Derivatives ultimate designated person

The derivatives ultimate designated person is responsible for promoting a culture of compliance and overseeing the effectiveness of a registered derivatives firm's compliance system. They do not have to be involved in the day-to-day management of the compliance group. There are no specific education or experience requirements for the ultimate designated person. However, they are subject to the general proficiency principle in subsection 18(1).

Subparagraphs 27(3)(d)(i) and (ii) refer to a risk of material harm to a derivatives party or to capital markets. The registered 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 material harm to a larger, more sophisticated derivatives party.

Section 28 – Derivatives chief compliance officer

The derivatives chief compliance officer is responsible for the monitoring and oversight of the registered derivatives firm's compliance system as it relates to derivatives. This includes

- establishing and updating policies and procedures for the firm's compliance system relating to derivatives, and

- managing the compliance monitoring and reporting, relating to derivatives, according to the firm's policies and procedures.

At the firm's discretion, the derivatives chief compliance officer may also have authority to take supervisory or other action to resolve compliance issues.

The derivatives chief compliance officer must meet the proficiency requirements set out in Part 5. No other compliance staff have to be registered unless they trigger registration in another category. The derivatives chief compliance officer may set the knowledge and skills necessary or desirable for individuals who report to them.

Registered derivatives firms must designate one derivatives chief compliance officer. However, in large firms, the scale and kinds of activities carried out by different operating divisions may warrant the designation of more than one derivatives chief compliance officer. We will consider applications, on a case-by-case basis, for different individuals to act as the derivatives chief compliance officer of a firm's operating divisions.

Paragraph 28(3)(c) requires the derivatives chief compliance officer to report to the ultimate designated person any instances of non-compliance with securities legislation relating to derivatives if any of the conditions in subparagraphs (i) through (iii) apply. The derivatives chief compliance officer should report non-compliance to the derivatives ultimate designated person even if it has been corrected.

Subparagraph 28(3)(d)(ii) requires, as an element of the chief compliance officer's annual report, an assessment of the effectiveness of the registered derivatives firm's policies and procedures to assess compliance with securities legislation relating to derivatives.

Whether the harm is "material" is dependent on the specific circumstances. Material harm to a small unsophisticated derivatives party may differ from material harm to a larger, more sophisticated derivatives party.

Subparagraph 28(3)(d)(iii) requires, as an element of the chief compliance officer's annual report, that the report recommend potential changes to compliance policies and procedures to address needed improvements. Where a previous report discussed future improvements that were being planned, subsequent reports should discuss the outcomes of the changes that were implemented during the most recent scope period, any monitoring or testing of those changes, whether any compliance issues arose from the changes and, if there were any issues with how those issues were handled.

The description of circumstances of non-compliance required under subparagraph 28(3)(d)(v) should include a discussion of how the registered derivatives firm reached a decision on a course of remediation, how the implementation of the remediation was executed, any follow-up testing of the remediation and any noteworthy results from such testing.

While there is no requirement under paragraph 28(3)(d) to deliver to the regulator the annual report referred to in paragraph 28(3)(d), a regulator, may request this report from time to time.

Section 29 – Derivatives chief risk officer

The derivatives chief risk officer is responsible for the monitoring and oversight of the registered derivatives firm's risk management systems associated with the firm's derivatives related activities. This includes

- establishing and updating policies and procedures to implement and operate a risk management system that identifies and manages risk, particularly risk relating to derivatives, and

- managing and monitoring compliance with the registered derivatives firm's risk management system according to the firm's policies and procedures.

The derivatives chief risk officer must meet the proficiency requirements set out in Part 5. No other risk staff have to be registered unless they trigger registration in another category.

Registered derivatives firms must designate one derivatives chief risk officer. However, in large firms, the scale and type of activities carried out by different operating divisions and the variety of risks associated with these operating divisions may warrant the designation of more than one derivatives chief risk officer. We will consider applications, on a case-by-case basis, for different individuals to act as the derivatives chief risk officer of a firm's operating divisions.

Under paragraph 29(3)(c), the derivatives chief risk officer must report potential material non-compliance with the registered derivatives firm's risk management policies and procedures to the firm's derivatives ultimate designated person. Instances of non-compliance should be reported even if the non-compliance has been corrected.

The registered derivatives firm should establish a standard for determining when there is material non-compliance with the firm's risk management policies and procedures. Whether non-compliance is "material" is dependent on the specific circumstances.

PART 7
FINANCIAL REQUIREMENTS

Section 34 – Annual financial statements
Section 35 – Interim financial statements

Accounting Principles

Registered derivatives firms are required to deliver annual financial statements and interim financial information that comply with *Regulation 52-107 respecting Acceptable Accounting Principles and Auditing Standards* (chapter V-1.1, r. 25) ("Regulation 52-107").

Part 3 of Regulation 52-107 refers to Canadian GAAP applicable to publicly accountable enterprises, which is IFRS as incorporated into the Handbook. Under Part 3 of Regulation 52-107, annual financial statements and interim financial information delivered by a registrant must be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises except that any investments in subsidiaries, jointly controlled entities and associates must be accounted for as specified for separate financial statements in International Accounting Standard 27 - *Consolidated and Separate Financial Statements*. Separate financial statements are sometimes referred to as non-consolidated financial statements.

Subsection 3.2(3) of Regulation 52-107 requires annual financial statements to include a statement and description about this required financial reporting framework. Section 2.7 of *Policy Statement to Regulation 52-107 respecting Acceptable Accounting Principles and Auditing Standards* (Decision 2010-PDG-0217) ("Policy Statement 52-107") provides guidance on subsection 3.2(3). We remind registered derivatives firms to refer to these provisions in Regulation 52-107 and Policy Statement 52-107 in preparing their annual financial statements and interim financial information.

Part 4 of Regulation 52-107 refers to Canadian GAAP for public enterprises, which is Canadian GAAP as it existed before the mandatory effective date for the adoption of IFRS, included in the Handbook as Part V. Under Part 4 of Regulation 52-107, annual financial statements and interim financial information delivered by a registered derivatives firm must be prepared in accordance with Canadian GAAP for public enterprises except that the financial statements and interim financial information must be prepared on a non-consolidated basis.

Section 36 – Delivering financial statements

Subsections 36(3) and (4) provide exclusions from the requirement to deliver annual and interim financial statements where the registered derivatives firm is a reporting issuer that is in compliance with its obligation to file its annual and interim financial statements. These exclusions will reduce the regulatory burden of registered derivatives firms that are already filing financial information.

PART 8
COMPLIANCE AND RISK MANAGEMENT

Section 38 – Compliance policies and procedures

Section 38 requires a registered derivatives firm to establish, maintain and apply policies and procedures that establish a system of controls and supervision (i.e., a "compliance system") to ensure that the registered derivatives firm and each individual acting on its behalf, in relation to its activities relating to transacting in or advising on derivatives, complies with applicable securities legislation.

We expect that a compliance system that is sufficient to meet the requirements of this section will include internal controls and monitoring systems that are reasonably likely to identify non-compliance at an early stage and supervisory systems that allow the firm to correct non-compliant conduct in a timely manner.

As previously stated in Part 1, "securities legislation" is defined in Regulation 14-101, and includes statutes and other instruments related to both securities and derivatives. We do not

expect that the compliance system established in accordance with the Regulation would be applicable to activities other than a derivatives firm's derivatives activities. For example, a registered derivatives dealer may also be a reporting issuer. The compliance system established to monitor compliance with the Regulation would not necessarily be concerned with matters related only to the registered derivatives firm's status as a reporting issuer, though it would be acceptable to have a single compliance system related to the registered derivatives firm's compliance with all applicable securities legislation. These policies and procedures should be reviewed periodically and updated as appropriate.

Section 39 – Risk management policies and procedures

We expect that risk management policies and procedures establish a risk management system that is sufficient to meet the requirements of section 39 and include internal controls and monitoring systems that are reasonably likely to identify potential risks relating to derivatives at an early stage and supervisory systems that allow the firm to mitigate risk in a timely manner. While section 39 is limited to risks associated with a registered derivatives firm's derivatives activities, the risk management system should take into account all sources of risk that could impact the registered derivatives firm's derivatives activities, including the firm's obligations under derivatives.

The risk management system of a registered derivatives firm should, at a minimum

- take into account market, credit, liquidity, foreign currency, legal, operational, settlement, and any other applicable risks,

- establish risk tolerance limits and allow for the detection of breaches of those limits, and

- take into account risks relating to derivatives posed by affiliated entities.

Paragraph 39(3)(f) requires that the risk management policies and procedures provide for periodic reports to the registered derivatives firm's ultimate designated person and board of directors. We expect these reports to include

- a description of all applicable risk exposures including market, credit, liquidity, foreign currency, legal, operational, and settlement exposures,

- any recommended or completed changes to the policies and procedures or the risk management system,

- the recommended time frame for implementing changes, and

- the status of any incomplete implementation of previously recommended changes.

The policies and procedures should also allow the registered derivatives firm to assess the risks of any derivative, including a novel type of derivative that the registered derivatives firm transacts. In doing the assessment for a novel type of derivative, a registered derivatives firm may consider

- the type of derivatives party with which the new derivative will be transacted,

- the new derivative's characteristics and economic function,

- whether the derivative requires a novel pricing methodology or presents novel legal and regulatory issues,

- all relevant risks associated with the new derivative and how the risks will be managed,

- whether the new derivative would materially alter the overall risk profile of the registered derivatives firm, and

- whether the registered derivatives firm needs to make any changes to the policies and procedures prior to engaging in transactions involving the new derivative.

Subsection 39(4) requires an independent review of the registered derivatives firm's risk management systems on a reasonably frequent basis (at least once every 2 years). These reviews should be conducted by a party that is independent and at arm's length from the derivatives business unit. This could include a review conducted by the registered derivatives firm's internal audit group (or a comparable unit within the firm) if that group has the appropriate expertise and has sufficient independence from the derivatives business unit.

In addition to the independent review required under subsection 39(4), we expect that a registered derivatives firm's risk management policies and procedures will provide for more frequent internal reviews of its effectiveness, as appropriate.

Section 40 – Confirmation of material terms

Where the derivatives party is an individual or a firm that is not an eligible derivatives party, the registered derivatives firm complies with the requirements of subsection 40(1) by delivering the written confirmation required in section 29 of Regulation 93-101.

Subsection 43(3) – Business continuity and disaster recovery

Subsection 43(3) requires a registered derivatives firm to conduct independent tests of its business continuity and disaster recovery plans. Staff of the registered derivatives firm may conduct these tests if the firm has the necessary expertise and are sufficiently independent from the business unit responsible for business continuity and disaster recovery.

Section 44 – Portfolio reconciliation

Section 44 requires a registered derivatives firm to conduct a portfolio reconciliation for all derivatives to which the firm is a counterparty. Portfolio reconciliation entails verifying the existence of all outstanding transactions with a counterparty, comparing principal economic terms, ensuring that the records of each counterparty relating to the derivative or a portfolio of derivatives are consistent, and identifying and remediating any inconsistencies. When a registered derivatives firm is developing its policies and procedures for conducting portfolio reconciliations, it should consider industry practices such as the practices published by the International Swaps and Derivatives Association.[1]

Section 45 – Portfolio compression

Portfolio compression is a risk reduction process by which 2 or more counterparties wholly or partially terminate some or all of the derivatives between them, and replace the terminated derivatives with another derivative whose combined notional amount is less than the combined notional amount of the terminated derivatives. The process reduces the market exposure of derivatives in a portfolio by eliminating matched derivatives or derivatives that do not contribute risk to the portfolio. Compression may be done bilaterally, (i.e., with just one other counterparty), or multilaterally (i.e., between several counterparties).

The process to simplify the management of the portfolio by aggregating positions into fewer contracts without reduction of the notional value (with a view, for instance, to standardise the terms of derivatives, to make them eligible for clearing or to facilitate the management of the contract) is not included in the scope of portfolio compression.

Section 45 does not impose specific timelines for conducting portfolio compression. When establishing written policies and procedures relating to portfolio compression, a registered derivatives firm should consider a number of factors, including the size of the firm's portfolio in relation to each of its counterparties. Smaller derivatives firms that have relatively small derivatives positions may apply for exemptive relief from any or all of the requirements in section 45.

[1] See the ISDA website located at http://www2.isda.org/ for further information relating to portfolio reconciliation practices.

PART 9
RECORDS

Section 47 – Form, accessibility and retention of records

Paragraph 47(1)(a) requires a registered derivatives firm to keep its 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 registered 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 registered derivatives firm to have a confidentiality agreement with the third party.

PART 10
EXEMPTIONS FROM THE REQUIREMENT TO REGISTER AND EXEMPTIONS FROM SPECIFIC REQUIREMENTS IN THIS REGULATION

The Regulation provides several exemptions from the registration requirement as well as several exemptions from certain requirements in the Regulation. We also note that there may be additional exemptions in securities legislation.

If a firm is exempt from the requirement to register, the individuals acting on its behalf under that exemption are likewise exempt.

Sections 52, 54, 56, 59 and 61 require persons that rely on those exemptions to promptly notify the regulator of any material non-compliance with specific regulatory requirements of another regulatory authority. The specific regulatory requirements are listed in the applicable Appendix referenced in the section. Sections 27 and 28 of this Policy Statement provide guidance about when non-compliance with applicable requirements is material.

DIVISION 1 – Exemptions from the requirement to register as a derivatives dealer

This Division provides a derivatives dealer with exemptions from the requirement to register as a derivatives dealer if it complies with the conditions of the exemption. A derivatives dealer that is exempt from the derivatives dealer registration requirement will not be subject to other requirements in the Regulation that would be applicable to it if it was registered as a derivatives dealer.

Section 49 – Exemption for certain derivatives end-users

Section 49 provides an exemption from the requirement to register as a derivatives dealer for a person that does not have the status described in subsection (1) and does not engage in the activities described in subsection (2).

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 subsection (2) 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.

Under paragraph 49(2)(c), this exemption is not available to a person that regularly makes a market in derivatives.

Section 50 – Derivatives dealers with a limited notional amount under derivatives
Section 51 – Commodity derivatives dealers with a limited notional amount under derivatives

Section 50 provides an exemption from the requirement to register for derivatives dealers that do not have more than $250 million in aggregate gross notional amount outstanding, whose derivatives parties are all eligible derivatives parties and that meet the other conditions in paragraphs 50(a) to (d).

Section 51 provides an exemption from the requirement to register for derivatives dealers that are only in the business of trading derivatives that have commodities as their only underlying asset and that meet the other conditions in paragraphs 51(2)(a) to (e).

To comply with the condition in paragraph 51(2)(e), a person cannot conduct any activity that would require it to register as a derivatives dealer for a derivative that is not a commodity derivative.

Determination of notional amount

Appendix A establishes requirements for determining the notional amount for a derivative for the purpose of both sections 50 and 51. To determine the aggregate gross notional amount outstanding, a derivatives dealer must aggregate the notional amount of each outstanding derivative to which the derivatives dealer or its affiliated entities are a party, without netting. The notional amounts for derivatives between affiliated entities are not included when aggregating notional amount outstanding for the purpose of the thresholds in sections 50 and 51.

Under sections 50 and 51, a derivatives dealer that has its head office or principal place of business outside of Canada is only required to aggregate its notional amounts under outstanding derivatives with a Canadian counterparty. A Derivatives dealer that has its head office or principal place of business in Canada is required to aggregate the notional exposure of all derivatives to which it is a counterparty regardless of whether the derivatives party is a Canadian counterparty.

Section 52 – Foreign derivatives dealers– exemption from registration

General principle

Section 52 allows a derivatives dealer with its head office or principal place of business in a foreign jurisdiction listed in Appendix B to transact with, or on behalf of derivatives parties, without being registered as a derivative dealer, if,

- each of the firm's derivatives parties are eligible derivatives parties, and
- the derivatives dealer satisfies the other conditions specified in section 52.

The exemption in section 52 is only available where a foreign derivatives dealer is subject to and in compliance with the requirements of the laws of the applicable foreign jurisdiction specified in Column 1 of Appendix B. Where a foreign derivatives dealer is not subject to the requirements in a foreign jurisdiction listed in Appendix B, including where it relies on an exclusion or an exemption (including discretionary relief) from those requirements in the foreign jurisdiction, the exemption in section 52 will not be available.

Notice requirement

If the foreign derivatives dealer is relying on the exemption, it must provide an initial notice by submitting a Form 93-102F2 *Submission to Jurisdiction and Appointment of Agent for Service* ("Form 93-102F2") with the regulator in each jurisdiction where it relies on the exemption. If there is any change to the information in the foreign derivatives dealer's Form 93-102F2, it must update it by filing a replacement Form 93-102F2 with those jurisdictions.

So long as the foreign derivatives dealer continues to rely on the exemption, it must file an annual notice with the corresponding regulators in accordance with subsection 52(3). Subsection 52(3) does not prescribe a form of annual notice; an email or letter will be acceptable.

In Ontario, compliance with the filing and fee payment requirements applicable to an unregistered exempt foreign dealer under Ontario Securities Commission *Rule 13-502 Fees* satisfies the annual notification requirement in subsection 52(3).

DIVISION 2 – Exemptions from specific requirements for derivatives dealers

The exemptions in Division 2 provide registered derivatives dealers with exemptive relief from the requirements to comply with specific requirements in the Regulation that are applicable to registered derivatives dealers.

Section 54 – Foreign derivatives dealers – exemption from specific requirements

Section 54 provides to registered derivatives dealers, whose head office or principal place of business is in a foreign jurisdiction specified in Column 1 of Appendix D, exemptions from certain requirements in the Regulation specified in Column 2 of Appendix D, on the terms set out in section 54.

Paragraph 54(1)(b) requires that the foreign registered derivatives dealer be subject to and in compliance with the corresponding requirements or guidelines of the foreign jurisdiction specified in Column 3 of Appendix D.

Column 3 of Appendix D does not incorporate any exemption or discretionary relief granted to the foreign derivatives dealer under the laws of the foreign jurisdiction. Where a foreign registered derivatives dealer proposes to rely upon any such exemption or discretionary relief, it will need to address this through an application for exemptive relief in the applicable local Canadian jurisdictions.

DIVISION 3 – Exemptions from the requirement to register as a derivatives adviser

This Division provides a derivatives adviser with an exemption from the requirement to register as a derivatives adviser if it complies with the conditions of the exemption.

A derivatives adviser that is exempt from the derivatives adviser registration requirement will not be subject to other requirements in the Regulation that would be applicable to it if it was registered as a derivatives adviser.

Section 57 – Advising generally

Section 57 contains an exemption from the requirement to register as 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 57(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 59 – Foreign derivatives advisers – exemption from registration

Section 59 allows a derivatives adviser with its head office or principal place of business in a foreign jurisdiction listed in Appendix G to act as an adviser to derivatives parties, without being registered as a derivative adviser, if

- each of the firm's derivatives parties are eligible derivatives parties, and
- the derivatives adviser satisfies the other conditions specified in section 59.

The exemption in section 59 is only available where a foreign derivatives adviser is subject to and in compliance with the requirements of the laws of the applicable foreign jurisdiction specified in Column 1 of Appendix G. If a foreign derivatives adviser is not subject to the requirements in a foreign jurisdiction listed in Appendix G, including where it relies on an exclusion or an exemption (including discretionary relief) from those requirements in the foreign jurisdiction, the exemption in section 59 will not be available.

DIVISION 4 – Exemptions from specific requirements in this Regulation for derivatives advisers

Section 61 – Foreign derivatives advisers – exemption from specific requirements

Section 61 provides to registered derivatives advisers, whose head office or principal place of business is in a foreign jurisdiction specified in Column 1 of Appendix H, exemptions from certain requirements in the Regulation specified in Column 2 of Appendix H, on the terms set out in section 61.

Paragraph 61(1)(b) requires that the foreign registered derivatives adviser be subject to and comply with the corresponding requirements or guidelines of the foreign jurisdiction specified in Column 3 of Appendix H.

Column 3 of Appendix H does not incorporate any exemption or discretionary relief granted to the foreign derivatives adviser under the laws of the foreign jurisdiction. Where a foreign registered derivatives adviser proposes to rely upon any such exemption or discretionary relief, it will need to address this through an application for exemptive relief in the applicable local Canadian jurisdictions.