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CSA Notice and Request for Comment

Proposed National Instrument 93-102 *Derivatives: Registration*

Proposed Companion Policy 93-102 *Derivatives: Registration*

April 19, 2018

Introduction

We, the Canadian Securities Administrators (the **CSA** or **we**), are publishing the following for a 150-day comment period, expiring on September 17, 2018:

- Proposed National Instrument 93-102 *Derivatives: Registration* (the **Instrument**);
- Proposed Companion Policy 93-102 *Derivatives: Registration* (the **CP**).

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

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

On April 4, 2017, we published for comment Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101 *Derivatives: Business Conduct* (the instrument and the companion policy are collectively referred to as the **Business Conduct Instrument**). The comment period for the Business Conduct Instrument published in 2017 closed on September 1, 2017. We have considered the comments made on that publication to develop the Proposed Instrument, whenever appropriate.

The Proposed Instrument together with the Business Conduct Instrument are intended to implement a comprehensive regime for the regulation of persons or companies that are in the business of trading derivatives and in the business of advising on derivatives. We expect that a future version of the Business Conduct Instrument will be published for a second comment period shortly after the publication of the Proposed Instrument so that there will be considerable overlap of each instrument's comment period. This will allow commenters to consider the Proposed Instrument and the revised Business Conduct Instrument together when making their comments.

In developing the Proposed Instrument, the CSA has consulted with the Bank of Canada, the Office of the Superintendent of Financial Institutions (**OSFI**) and the Department of Finance

(Canada). We intend to continue to consult with these entities through the development of the Proposed Instrument.

This version of the Proposed Instrument does not include provisions that will facilitate the transition to the new regulatory requirements applicable to derivatives firms. Appropriate provisions relating to transition will be included in a future version of the Proposed Instrument and may include, for example, transitional relief from proficiency requirements in section 18.

We intend to consider amendments to other instruments and policies that establish the existing operational infrastructure for registration, including National Instrument 33-109 *Registration Information*.

Background

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

After considering the comments received on the Consultation Paper and reviewing developments internationally, we have developed the Proposed Instrument.

As we indicated in the CSA Notice that accompanied the 2017 publication of the Business Conduct Instrument, we have chosen to split the proposed derivatives registration and business conduct regimes into two separate rules. This approach simplifies each rule and is intended to ensure that all derivatives firms remain subject to certain minimum standards in all Canadian jurisdictions.

Staff from certain jurisdictions will consider whether modifications to securities legislation, including act amendments, are needed to implement the Proposed Instrument. In particular, it is known that accredited counterparties are exempt by law from the registration requirement under the Québec Derivatives Act when transacting with each other. The implementation of the Proposed Instrument is therefore subject to the Québec National Assembly's decision to revoke this exemption.

While the registration regime contemplated by the Proposed Instrument would apply in all CSA jurisdictions, Ontario's Securities Act provides that certain specified financial institutions are exempt from registration. As a result, the Ontario Securities Commission (the **OSC**) will not register those specified financial institutions when they act as derivatives dealers or advisers in the Ontario market.

OSC staff note that to the extent these financial institutions are acting as derivatives dealers or advisers, they will be subject to the Business Conduct Instrument, other relevant requirements and prohibitions under Ontario securities law, and various powers that are available to the OSC to promote compliance with the law. These specified financial institutions are also subject to certain prudential obligations and oversight. OSC staff would expect to employ all of the available tools, as appropriate, to attempt to achieve outcomes that are as closely aligned as possible to the outcomes of the Proposed Instrument.

Even with the regulatory tools discussed above, the OSC has identified a gap that relates to the registration of individual representatives of specified financial institutions and is currently assessing potential regulatory solutions that are available to address this gap.

Substance and Purpose of the Proposed Instrument

The CSA have developed the Proposed Instrument to help protect investors, reduce risk and, improve transparency and accountability in the over-the-counter (**OTC**) derivatives[1] markets.

During the financial crisis of 2008, some firms dealing in derivatives contributed to the crisis by not effectively managing their own derivatives related risks. The International Organization of Securities Commissions (**IOSCO**) noted in 2012 that "historically, market participants in OTC derivatives markets have, in many cases not been subject to the same level of regulation as participants in the traditional securities market. This lack of sufficient regulation allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008."[2]

The Proposed Instrument includes requirements

- designed to mitigate risks to market participants,
- designed to ensure that key staff members of derivatives dealers and derivatives advisers have the necessary education, training and experience needed to carry out their obligations, and
- for derivatives firms and individual representatives to register with applicable securities regulators in Canada and allow those regulators to deny registration to a firm or an individual or suspend registration of a firm or an individual in appropriate circumstances.

The Proposed Instrument, together with the Business Conduct Instrument, is intended to establish a robust investor protection regime that meets IOSCO's international standards. The resulting proposed regime is consistent with the regulatory approach taken by most IOSCO jurisdictions with active derivatives markets.[3]

A person or company is subject to the Proposed Instrument only if it must register as a derivatives adviser or a derivatives dealer under securities legislation. The Proposed Instrument also provides exclusions and exemptions for certain persons or companies from the requirements to register as a derivatives dealer or as a derivatives adviser. Persons or companies that are excluded or exempted from the requirement to register are not subject to any obligations under the Proposed Instrument other than the conditions relating to the exclusion or exemption.

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[1] The Proposed Instrument applies to derivatives as determined in accordance with the product determination rule applicable in the relevant jurisdiction.
[2] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD381.pdf (**DMI Report**) at p 1.
[3] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD497.pdf (**DMI Implementation Review**) at p. 13.

This version of the Proposed Instrument does not include registration requirements for persons that have very large gross notional amounts under derivatives but would not otherwise be required to be registered. After additional analysis relating to Canadian derivatives markets, a future version of the Proposed Instrument, that will be published for comment, may include an additional registration category for these large non-dealer derivatives participants.

Section 31 refers to minimum capital requirements that will be described in Appendix C. Appendix C is currently blank but we will propose capital requirements and seek comments on its content in a future version of the Proposed Instrument that will be published for comment. We expect that the minimum capital requirements will be consistent with capital requirements proposed by regulatory authorities in other jurisdictions, including the U.S. We also intend to include a conditional exemption from these capital requirements for derivatives dealers that are already subject to equivalent capital requirements imposed by other authorities, including prudential authorities.

Conditional exemptions from the requirement to register

The Instrument includes a number of exemptions from the requirement to register. These exemptions include an exemption from registration for derivatives dealers that have a limited notional amount of derivatives. Notional amount is determined based on the derivatives dealer's aggregate month-end gross notional amount under outstanding derivatives. Additional discussion of these exemptions, including a discussion of how notional amount is to be calculated for the purpose of these exemptions, is included later in the notice.

The Instrument also includes exemptions from the requirement to register for certain derivatives dealers and derivatives advisers that have their head office or principal place of business outside of Canada.

Each of the exemptions from the requirement to register is subject to specific terms and conditions.

Conditional exemptions from specific registration requirements

The Instrument provides an exemption from specific registration requirements in certain circumstances. Additional discussion of these exemptions is included later in this notice.

One exemption from specific registration requirements is for registered derivatives dealers that are dealer members of the Investment Industry Regulatory Organization of Canada (**IIROC**). This exemption is subject to the condition that they comply with the equivalent requirements imposed by IIROC. These requirements will be listed in Appendix E. We will consult with IIROC staff to complete Appendix E and publish it for comment in a future version of the Proposed Instrument that will be published for comment.

The Instrument contains a similar exemption for Canadian financial institutions where they are subject to and comply with equivalent requirements imposed by a federal or provincial prudential authority. We have completed an analysis of the requirements that apply to financial institutions that are regulated by OSFI and by the Autorité des marchés financiers (**AMF**).

Appendix F lists specific requirements from which financial institutions that are regulated by OSFI and the AMF will, subject to specific conditions, be exempted. We will work to complete the analysis for other provincial prudential authorities and intend to publish for comment a full version of Appendix F in a future version of the Proposed Instrument that will be published for comment.

Finally, the Instrument includes certain exemptions from the requirement to register and from specific registration requirements under the Instrument for persons or companies that have their head office or principal place of business outside of Canada. Exemptions from specific requirements may be available where these persons or companies are subject to and comply with equivalent requirements in the jurisdiction where their head office or principal place of business is located. We intend to publish for comment full versions of each of Appendix B, D, G and H in a future version of the Proposed Instrument that will be published for comment.

Summary of the Instrument

Part 1 – Definitions

Part 1 of the Instrument sets out relevant definitions and principles of interpretation. Some of the most important definitions in the Instrument are as follows.

Commercial Hedger
The term "commercial hedger" is referenced in the definition of "eligible derivatives party". Commercial hedgers are subject to a lower financial threshold to qualify as eligible derivatives parties when compared to other, non-individual, persons or companies.

Derivatives party
In the Proposed Instrument, the term "derivatives party" refers to a derivatives firm's counterparties, customers, and other persons or companies that the derivatives firm may deal with or advise. It is not necessary that the parties consider a client relationship to exist in order for one party to be a derivatives party to the other.

Eligible derivatives party
The term "eligible derivatives party" refers to those derivatives parties that do not require the full set of protections afforded to "retail" customers or investors, either because they may reasonably be considered to be sophisticated or because they have sufficient financial resources to obtain professional advice or otherwise protect themselves through contractual negotiation with the derivatives firm. The concept is important because firm and individual registration exemptions are not available if the firm or individual deals with or advises non-eligible derivatives parties.

As currently drafted, the definition of "eligible derivatives party" is consistent with the anticipated definition of that term in the future version of the Business Conduct Instrument, with modifications made to address comments received. The definition is also generally consistent with the current regulatory regimes in the U.S. and Canada in relation to OTC derivatives.[4] In

[4] See, for example, the definition of "eligible contract participant" under the U.S. *Commodity Exchange Act* and the *Securities Exchange Act of 1934* applicable to CFTC and SEC swap dealers and major swap participants, the

addition, the eligible derivatives party concept is similar to the definition of "permitted client" in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**), with a few modifications intended to reflect the different nature of derivatives markets.[5]

Notional amount

Notional amount is used in section 50 and in section 51 of the Instrument. These sections establish exemptions from registration for certain derivatives dealers that have a monetary notional amount below a prescribed threshold ($250 million in section 50 and $1 billion under commodities derivatives in section 51). Notional amount refers to the monetary amount or the amount of the underlying asset that is used to calculate a settlement payment or delivery obligation under a derivative.

For derivatives negotiated in monetary amounts, the methodology for determining the notional amount for the purpose of section 50 and section 51 should be in accordance with CPMI-IOSCO's Technical Guidance on Harmonisation of critical OTC derivatives data elements (other than UTI and UPI) (the **CDE Guidance**), published on April 9, 2018.[6,7]

In other cases, the derivatives contract will reference a non-monetary amount, such as a notional quantity (or volume) of an underlying asset. This is the case for commodity derivatives that reference a quantity of a commodity and equity derivatives that reference a number of a type of securities. Accordingly, expressing a threshold as a monetary amount requires converting the notional quantity of an underlying asset into a monetary amount. In general, the formula for converting a notional quantity of an underlying asset into a notional amount, expressed in monetary terms, is the following:

$$notional\ amount = price \times quantity$$

Annex I to this Notice sets out two proposed methodologies for determining, for the purpose of regulatory thresholds, the notional amount expressed in monetary terms for derivatives that are negotiated in non-monetary amounts. Column 1 sets out a methodology that is based on the CDE Guidance. The $250 million threshold in section 50 and the $1 billion threshold in the section 51 commodity derivatives exemption were determined using the methodology based on the CDE Guidance. Specifically, with respect to the "quantity" element for derivatives that reference a

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definition of "qualified party" in Alberta Blanket Order 91-507 *Over-the-Counter Derivatives*, the definition of "qualified party" in British Columbia Blanket Order 91-501 *Over-the-Counter Derivatives*, the definition of "qualified party" in Manitoba Blanket Order 91-501 *Over The Counter Trades in Derivatives*, the definition of "qualified party" in New Brunswick Local Rule 91-501 *Derivatives*, the definition of "qualified party" in Nova Scotia Blanket Order 91-501 *Over The Counter Trades in Derivatives*, the definition of "accredited counterparty" in section 3 of the Quebec *Derivatives Act*, and the definition of "qualified party" in Saskatchewan General Order 91-908 *Over-the-Counter Derivatives*.

[5] CSA Notice and Request for Comment - *Proposed National Instrument 93-101 Derivatives: Business Conduct Proposed Companion Policy 93-101CP Derivatives: Business Conduct*, dated April 4, 2017, particularly questions 1 through 4 on pages 13 and 14.

[6] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD598.pdf

[7] Where the notional amount is a monetary amount based in a currency other than Canadian dollars, the notional amount must be converted to Canadian dollars.

non-monetary amount, particularly commodity derivatives, the CDE Guidance calls for the use of "total notional quantity". The total notional quantity is determined by aggregating the notional quantity of the underlying asset for each settlement period in the derivatives contract. See Column 1 of Annex I for more details. We are seeking comment on the methodology, that is based on the CDE Guidance, set out in Column 1 of Annex I.

We are also considering, and seeking comment on, an alternative methodology (the **Regulatory Notional Methodology**) set out in Column 2 of Annex I. With respect to "quantity", the Regulatory Notional Methodology employs a concept of "monthly notional amount approximation" rather than aggregated total notional quantity. The monthly notional quantity approximation is aimed at equalizing different settlement period durations and quantities to facilitate comparability of notional amounts expressed in monetary terms. For derivatives (negotiated in non-monetary amounts) that have multiple settlement periods, for example a swap, the Regulatory Notional Methodology calls for the notional amount to be determined using the monthly notional quantity approximation. Similarly, for derivatives (negotiated in non-monetary amounts) that have a notional amount schedule, the notional amount for the purpose of regulatory thresholds would be determined using the monthly notional amount approximation, and would apply for the duration of the derivative. See Column 2 of Annex I for more details.

If the Regulatory Notional Methodology is adopted, we expect that we would implement a notional amount threshold in section 51 that is smaller than the proposed $1 billion threshold. Based on our analysis of trade reporting data, we anticipate that the threshold in section 51 would be in the range of $250 million to $500 million but note that this threshold may be significantly lower following further analysis.

The CSA will continue to monitor international work and to consult with foreign regulators relating to methodologies for determining a monetary notional amount for a derivative that references a notional quantity or volume.

The CSA is seeking specific comment on both the methodology that is based on the CDE Guidance, as set out in Column 1 of Annex I, and the Regulatory Notional Methodology, as set out in Column 2 of Annex I, for determining monetary notional amount for the purpose of regulatory thresholds. We are also interested in general comments on potential issues relating to the implementation of either methodology.

Affiliated entity

Subsection 1(3) establishes that persons or companies will be considered to be affiliated entities if one controls the other or if the same person or company controls both. Subsection 1(4) establishes when one person or company is considered to control another person or company for the purpose of the Instrument. We are seeking specific comment on the proposed definition of "affiliated entity" and the tests set out for "control".

In the context of other instruments relating to OTC derivatives, we are also considering a definition of "affiliated entity" that is based on the concept of "consolidation" under accounting principles. A draft of an alternative version of a definition of "affiliated entity" is included as Annex II of this CSA Notice. We intend to consider comments we receive on the two approaches

as we further develop the OTC derivatives regulatory regime. Either of these proposed definitions may be used in the final version of the Proposed Instrument.

Principal regulator
To adapt the proposed registration regime to the Canadian context and to reduce the regulatory burden, section 2 allows registered derivatives firms and individuals that are required to notify or to deliver documents under the Instrument to a Canadian securities regulator to comply with these obligations by notifying or by delivering the document to their principal regulator, as defined in subsection 1(1).

For derivatives firms that has its head office outside of Canada, the "principal regulator" will be the regulator or the securities regulatory authority in the jurisdiction of Canada where the derivatives firm has its primary business office in Canada or, if the derivatives firm has no business office in Canada, the jurisdiction of Canada where the firm expects to conduct the most of its activities that require registration as a derivatives firm as at the end of its current financial year or conducted most of its activities that require registration as a derivatives firm as at the end of its most recently completed financial year.

For a derivatives firm that has its head office located in a Canadian jurisdiction that exempts the firm from the requirement to register as a derivatives dealer or a derivatives adviser, including the exemption for certain financial institutions in Ontario, the "principal regulator" will be the regulator or the securities regulatory authority in the jurisdiction of Canada where the firm expects to conduct most of its activities that require registration as a derivatives firm as at the end of its current financial year or conducted most of its activities that require registration as a derivatives firm as at the end of its most recently completed financial year.

We intend to consider amendments to other instruments and policies that establish the existing operational infrastructure for registration, including National Instrument 33-109 *Registration Information* and National Policy 11-204 *Process for Registration in Multiple Jurisdictions.* Any such amendments will be published for comment.

Subsection 2(2) establishes the documents that must be provided to all applicable regulatory authorities rather than just the principal regulator. This section is similar in effect to subsection 1.3(5) of NI 31-103.

Part 2 – Application

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

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

Section 5 provides that the Instrument does not apply to:

- certain governments;
- central banks;
- certain crown corporations of Canada or a jurisdiction of Canada;
- certain international organizations;
- qualifying clearing agencies.

Part 3 – Requirement to register and categories of registration for derivatives firms

In all jurisdictions, unless an exclusion or an exemption applies, derivatives dealers and derivatives advisers are required to register under securities legislation. Section 6 establishes additional triggers for registration as a derivatives dealer where a person conducts certain specified activities.

Section 7 establishes the categories of registration for derivatives dealers and section 8 establishes the categories of registration for derivatives advisers.

Section 9 prohibits a derivatives dealer from transacting with an individual that is not an eligible derivatives party unless the derivatives dealer is a dealer member of IIROC. This prohibition applies even if most of the derivatives dealer's transactions involve derivatives parties that are either individuals that qualify as eligible derivatives parties or derivatives parties that are not individuals. Derivatives firms that are required to be a dealer member of IIROC will also be required to be registered with the CSA.

Division 2 of Part 3 establishes requirements relating to the suspension and revocation of registration for derivatives firms. The provisions in this Division are similar to the provisions in Part 10 of NI 31-103.

Part 4 – Categories of registration for individuals

Part 4 establishes registration categories for individual registrants and outlines the activities that each type of individual registrant may perform. The individual registration categories are:

- derivatives dealing representative;
- derivatives advising representative;
- derivatives ultimate designated person;
- derivatives chief compliance officer;
- derivatives chief risk officer.

Subsection 16(3) sets out two exemptions from the requirement to register as a derivatives dealing representative. The first exemption will apply where the individual is required to register solely because they transact with, or on behalf of, an affiliated entity of the individual's sponsoring derivatives firm, other than an affiliated entity that is an investment fund. The second exemption will apply where the individual does not solicit or transact with, or on behalf of, a derivatives party that is not an eligible derivatives party.

Subsection 16(4) sets out an exemption from the requirement to register as a derivatives advising representative that is comparable to the exemptions for derivatives dealing representatives in subsection 16(3). This exemption does not apply where the individual acts as an adviser for a managed account.

Part 5 – Registration requirements for individuals

Division 1 of Part 5 sets out proficiency requirements for individuals that are required to be registered under securities legislation. Subsection 18(1) establishes general proficiency requirements for all individuals that perform an activity that requires registration.

Subsections 18(2) to (6) establish a requirement that registered derivatives firms not designate or allow an individual to act in any role that requires individual registration unless the individual meets the proficiency requirements applicable to their individual registration category. These requirements are intended to ensure that each registered individual has the education, training and experience to carry out the responsibilities of their role. These specific requirements were developed after considering existing proficiency requirements under NI 31-103,[8] the Québec *Derivatives Regulation*,[9] and the dealer members rules of IIROC.[10] The proposals focus more on experience requirements than the proficiency requirements under NI 31-103 as there are few designations and courses that are tailored to the OTC derivatives markets. We anticipate amending the proficiency requirements in the future as OTC derivatives' specific designations or courses are offered.

Division 2 of Part 5 sets out requirements relating to suspension and revocation of registration for individual registrants. This Division is similar to the provisions in Part 6 of NI 31-103.

Part 6 – *Derivatives ultimate designated persons, derivatives chief compliance officers and derivatives chief risk officers*

Part 6 establishes specific obligations for persons registered as derivatives ultimate designated persons, derivatives chief compliance officers and derivatives chief risk officers. In developing these requirements, we considered comparable requirements in NI 31-103 as well as requirements under U.S. Commodities Futures Trading Commission rules relating to swap dealers.

[8] See Part 3, Division 2 of NI 31-103.
[9] https://lautorite.qc.ca/en/professionals/regulations-and-obligations/derivatives/derivatives-regulation/, sections 11.6, 11.6.1, 11.13 and 11.13.1.
[10] http://www.iiroc.ca/Rulebook/Pages/default.aspx, see IIROC dealer member rule 2900.

Section 26 establishes a requirement that each registered derivatives firm designate individuals to act as a derivatives ultimate designated person, as a derivatives chief compliance officer and as a derivatives chief risk officer.

Sections 27 through 29 establish, for each registered individual, their requirements, roles, and responsibilities. These include requirements for the derivatives ultimate designated person to escalate issues to the registered derivatives firm's board of directors and, in specified circumstances, report instances of non-compliance with the Instrument or with other securities legislation to the applicable regulator or the securities regulatory authority. Sections 28 and 29 establish requirements for the derivatives chief compliance officer and derivatives chief risk officer to escalate issues to the derivatives ultimate designated person.

Section 27 establishes a requirement that the ultimate designated person report certain material incidents of non-compliance with securities legislation to the applicable regulator or the securities regulatory authority.

Sections 28 and 29 also establish requirements for the chief compliance officer and chief risk officer to submit annual reports to the derivatives firm's board of directors. We may periodically request a copy of these reports, upon the entry into force of the Instrument and thereafter, to monitor the compliance and implementation of the Instrument and, from a broader perspective, of the OTC derivatives regulations. We may also periodically review the reports of the chief compliance officer to monitor the compliance of derivatives dealers with the conditions of the exemptions available under the Instrument.

These requirements in Part 6 are in addition to the requirements imposed on senior derivatives managers in the Business Conduct Instrument.

Part 7 – Financial requirements

Section 31 sets out a requirement that registered derivatives firms maintain capital in accordance with the requirements in Appendix C. Appendix C is blank in this version of the Instrument. As mentioned above, we intend to publish proposed capital requirements in a future version of the Instrument that will be published for comment.

Under section 32, a regulator or securities regulatory authority may require a registered derivatives firm to direct its independent auditor to conduct an audit or review and deliver a copy of the direction to the regulator or the securities regulatory authority. This is comparable to section 12.8 of NI 31-103.

Sections 34 and 35 describe the information to be included in the annual and interim financial statements that must be delivered by a registered derivatives firm to the applicable Canadian securities regulator under subsections 36(1) and 36(2), respectively. We expect that these financial statements comply with the requirements in National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards* (NI 52-107). If any consequential amendments to NI 52-107 are needed, they will be published for comment. These requirements are comparable to the requirements in sections 12.10 and 12.11 of NI 31-103.

Part 8 – Compliance and risk management

Part 8 establishes requirements relating to compliance and risk management policies and procedures.

Section 38 establishes a general requirement that registered derivatives firms establish, maintain and apply policies and procedures reasonably designed to ensure that the firm, and each individual acting on its behalf, complies with securities legislation in relation to its derivatives dealing or advising activities.

Section 39 requires registered derivatives firms to adopt written risk management policies and procedures that will allow the firm to monitor and manage risks associated with the firm's derivatives business. In particular, paragraph 39(3)(g) specifies that these policies and procedures must require the reporting of a material change to the registered derivatives firm's risk exposures or a material breach of a risk limit to the firm's derivatives ultimate designated person and board of directors. Also, subsection 39(4) requires a registered derivatives firm to conduct an independent review of its risk management systems at least every two years. Staff of the registered derivatives firm may conduct the review if they are sufficiently independent from the firm's derivatives business.

Sections 40, 41 and 42 are based on IOSCO standards for risk mitigation.[11] These standards "promote legal certainty, reduce risk and improve efficiency"[12] in the OTC derivatives market. These three sections set out minimum standards for (i) the confirmation of the material terms of each derivative transacted with or for a derivatives party, (ii) a written agreement with the derivatives party that establishes a process for determining the value of the derivative unless the transaction is cleared through a qualifying clearing agency, and (iii) a written agreement that establishes a process for resolving a dispute when there is a discrepancy about the material terms of the derivative or the value of the derivative. Subsection 42(3) establishes a requirement to report a dispute that has not been resolved within a reasonable period of time to the firm's board of directors. Subsection 42(4) establishes a requirement for the firm to report, to the regulator or the securities regulatory authority, a dispute that has not been resolved within 30 days of reporting the dispute to its board of directors.

Section 43 imposes an obligation for a registered derivatives firm to establish and maintain business continuity and disaster recovery plans, and to review these plans at least annually. Staff of the registered derivatives firm may conduct these reviews if they are sufficiently independent from staff responsible for the business continuity and disaster recovery plans.

[11] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD469.pdf (Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives)
[12] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD469.pdf (Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives)

Section 44 sets out requirements for a registered derivatives firm to conduct portfolio reconciliation for all derivatives to which the firm is a counterparty except derivatives cleared through a qualifying clearing agency. The section also requires registered derivatives firms to resolve material discrepancies in terms or valuations identified through the portfolio reconciliation process as soon as possible.

Section 45 imposes an obligation on a registered derivatives firm to establish, maintain and apply policies and procedures to terminate offsetting derivatives and conduct portfolio compression exercises.

Part 9 – Records

Part 9 establishes record keeping requirements for registered derivatives firms.

Section 46 establishes a requirement that registered derivatives firms must keep complete records of derivatives, derivatives transactions and advice provided in relation to derivatives. Section 47 establishes requirements about the form, accessibility and retention of the records referred to in section 46.

Part 10 - Exemptions from the requirement to register and exemptions from specific requirements in this instrument

Divisions 1 and 3 of Part 10 provide firms, local and foreign, with exemptions from the requirement to register. These exemptions are subject to a number of terms and conditions.

Divisions 2 and 4 of Part 10 provide registered derivatives firms, local and foreign, with exemptions from specific registration requirements when a registered derivatives firm is already subject to and compliant with equivalent requirements imposed by another (local or foreign) regulatory authority. The requirements for which these exemptions apply, and the corresponding equivalent requirements, are listed in an appendix of the Instrument.

We have tailored the exemptions from the requirement to register and the exemptions from specific requirements to the nature of the Canadian OTC derivatives market.

At the time of this publication, Appendices B, D, E, G and H are not yet completed. Appendix F contains the information related to the equivalent requirements under the guidelines of OSFI and AMF; the information relating to requirements from other provincial prudential authorities has not yet been included. The CSA will solicit comments on all appendices in a future version of the Proposed Instrument that will be published for comment.

<u>Division 1 and Division 3 – Exemptions from the requirement to register</u>

Division 1 and Division 3 of Part 10 provide exemptions from the requirement to register. Firms that meet the conditions for the exemptions in the Division will not be required to register.

Section 48 provides an exemption in British Columbia, Manitoba and New Brunswick from the requirement to register as a derivatives dealer for a person or company that meets the criteria in that section. Section 48 is necessary as securities legislation in these provinces has a registration requirement for dealers based on "trading" rather than "being in the business of trading". The exemption in this section results in the registration trigger being consistent in all jurisdictions in Canada.

Section 49 provides that a derivatives end-user (e.g., an entity that trades derivatives for its own account for commercial purposes) is exempt from the requirement to register as a derivatives dealer subject to specific terms and conditions set out in the Instrument.

Sections 50 and 51 also provide exemptions from the requirement to register as a derivatives dealer where a dealer's gross notional amount under derivatives does not exceed a prescribed threshold. Section 50 provides an exemption from the requirement to register for a derivatives dealer with a notional amount that does not exceed $250 million. Section 51 provides a similar exemption for a person or company that is a derivatives dealer only in respect of commodity derivatives (as defined in subsection 51(1) of the Instrument) if the dealer's gross notional amount of commodity derivatives does not exceed $1 billion.

For a derivatives dealer whose head office or principal place of business is in Canada, the gross notional amount must be calculated using all derivatives to which the derivatives dealer is a counterparty. For a derivatives dealer whose head office or principal place of business is not in Canada, the gross notional amount will be calculated using only derivatives where the counterparty to the derivatives dealer is a Canadian counterparty. Canadian counterparty is defined in section 1 of the Instrument.

Each of these exemptions is only available if certain conditions are met, including that the derivatives dealer does not solicit or transact with, or on behalf of, a derivatives party that is not an eligible derivatives party. These sections are intended to reduce the regulatory burden on firms that only transact with, or on behalf of, eligible derivatives parties and that, because of their limited exposure, represent a small risk to our markets.

Section 52 establishes an exemption from the requirement to register as a derivatives dealer for a person or company whose head office or principal place of business is in a foreign jurisdiction and that is subject to regulatory requirements that are equivalent to the requirements in the Instrument. Amongst other conditions, the exemption applies only where the person or company

- does not solicit or transact a derivative with a person or company that is not an eligible derivatives party,

- is authorized to deal in derivatives in the jurisdiction where their head office or principal place of business is located and this jurisdiction is specified in Appendix B to the Instrument, and

- complies with all laws of that jurisdiction applicable to it as a derivatives dealer.

Appendix B will list the foreign jurisdictions that have regulatory requirements that are equivalent to the requirements in the Instrument.

In Division 3, section 57 provides an exemption for persons and companies that provide general advice in relation to derivatives, where the advice is not tailored to the needs of the person or company receiving the advice (e.g., analysis published in mass media), and the person or company discloses all financial or other interests in relation to the advice.

Section 59 provides an exemption from the requirement to register as a derivatives adviser for a person or company whose head office or principal place of business is in a foreign jurisdiction and that is subject to regulatory requirements that are equivalent to the requirements in the Instrument. The conditions under this exemption are similar to the conditions applicable to a derivatives dealer under the exemption in section 52. Appendix G will list the foreign jurisdictions that have regulatory requirements that are equivalent to the requirements in the Instrument for the purpose of section 59.

Division 2 and Division 4 – Exemptions from specific registration requirements

The exemptions provided in Division 2 and Division 4 aim to reduce the regulatory burden on firms already subject to requirements imposed by other regulatory bodies that are equivalent to the specific requirements of the Instrument. These exemptions are subject to some conditions, including the condition that the registered derivatives firm that benefits from the exemption remain subject to and in compliance with the equivalent requirement imposed by the other regulatory body.

The exemptions in these divisions do not provide an exemption from the requirement to register but instead exempts a person or company from specific registration requirements if they meet the specific conditions. Persons or companies that benefit from these exemptions will still be required to register as a derivatives dealer or a derivatives adviser, as applicable.

IIROC dealer members and Canadian Financial Institutions

Division 2 of Part 10 provides an exemption from specific requirements for registered derivatives dealers that are IIROC dealer members or for financial institutions that are regulated by a federal or provincial prudential authority. Sections 55 and 56 provide, under certain conditions, an exemption from the requirements in the Instrument listed in Appendix E, for IIROC dealer members, or in Appendix F, for Canadian financial institutions, where the requirement imposed by IIROC or the prudential authority achieves a substantially equivalent outcome as the Proposed Instrument.

Foreign derivatives dealers and foreign derivatives advisers

In Division 2, section 54 provides, under certain conditions, an exemption from certain requirements under the Instrument for a registered derivatives dealer whose head office or principal place of business is in a foreign jurisdiction and that is regulated under the laws of a foreign jurisdiction. In Division 4, section 61 provides a similar exemption for a registered

derivatives adviser whose head office or principal place of business is in a foreign jurisdiction. These exemptions from requirements under the Instrument are available when the registered derivatives dealer or registered derivatives adviser is in compliance with equivalent requirements under the laws of the foreign jurisdiction. Derivatives firms that benefit from these exemptions will still be required to register with the CSA.

These exemptions apply to the provisions of the Instrument where the registered derivatives dealer or the registered derivatives adviser meets all of the conditions in each section, including the condition that the firm is subject to and in compliance with the laws of a foreign jurisdiction set out in Appendix D, for registered derivatives dealers, and in Appendix H, for foreign derivatives advisers, opposite the name of the relevant foreign jurisdiction.

Anticipated Costs and Benefits

As mentioned above, we have developed the Proposed Instrument to help protect investors and counterparties, reduce risk and improve transparency and accountability in the OTC derivatives markets. Moreover, the registration requirement under the Instrument prevents persons from dealing in or advising on derivatives where they do not have the education, training and experience to carry out their responsibilities or their past behavior makes their registration contrary to the public interest.

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

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

(a) *Benefits*

The Proposed Instrument will protect participants in the Canadian OTC derivatives market by imposing requirements on key market participants, including requirements to provide Canadian securities regulators with information that will increase transparency into the finances of persons or companies dealing in or advising on derivatives. In addition, the Instrument imposes compliance and risk management requirements that require those derivatives dealers and derivatives advisers to take steps to identify and manage their derivatives related risks.

Securities legislation requires firms that are derivatives dealers and derivatives advisers, and key individuals acting on behalf of those dealers and advisers, to register. Registration allows us to assess the suitability of these firms before they are allowed to carry on the business of dealing or advising in our jurisdictions. In addition, registration allows us to review key individuals' suitability to act based on their education, training and experience as well as past incidents involving insolvency or inappropriate activity.

The registration of ultimate designated persons, chief compliance officers and chief risk officers allows us to identify key persons that will be points of contact for compliance and risk management issues. These requirements also allow us to impose specific obligations on these key persons who will be responsible for a failure of a firm to meet its regulatory obligations.

As mentioned above, the registration of individuals constitutes an important gatekeeping responsibility of a market regulator, by which individuals that do not satisfy minimum standards of integrity and proficiency or that have records of financial judgments or convictions for financial crimes, are not authorized to occupy important compliance and risk management-related functions in a derivatives firm.

Registration also allows securities regulatory authorities to suspend or revoke the registration of the firm or any individual registrants, as appropriate. It is worth noting that suspension or revocation of registration under securities legislation has historically only been used in extreme circumstances where the registered firm's ongoing operations would not be in the public interest. This would include where the firm has an ongoing history of material non-compliance, usually after sanctions have been imposed, or where the ongoing operation of the firm has the potential to harm investors.

The capital requirements, that will be introduced in a future version of the Proposed Instrument that will be published for comment, are an important tool for managing default risk by registered derivatives firms by ensuring the firms have sufficient assets to meet their derivatives obligations and by providing authorities with adequate information to identify and address potential risks.

Furthermore, requirements relating to compliance and risk management systems protect the derivatives firm's derivatives parties and the market as a whole by mitigating the risk that the derivatives firm experiences an event that could have an outcome that is contrary to the interest of its derivatives parties, such as a default on its derivatives obligations. Appropriately designed and applied compliance systems allow derivatives firms to identify, address and escalate issues at an early stage and provide securities regulatory authorities with appropriate information relating to those issues.

In summary, the Proposed Instrument is intended to foster confidence in the Canadian derivatives market by creating a regime that meets international standards and is, where appropriate, equivalent to the regimes in major trading jurisdictions. Currently, OTC derivatives are regulated differently across Canadian jurisdictions. The Proposed Instrument aims to reduce compliance costs for derivatives firms to the degree possible, by harmonizing the rules across Canadian jurisdictions and establishing a regime that is tailored for the derivatives market. This tailored regime will replace the existing securities registration regime that is inconsistent across jurisdictions and that is not tailored to the OTC derivatives markets.

(b) *Costs*

Generally, firms will incur costs from analyzing the requirements and establishing policies and procedures for compliance. Increased costs may also result from the introduction of financial

requirements for registered derivatives firms that are not already subject to equivalent financial requirements. Any costs associated with complying with the Proposed Instrument are expected to be borne by registered derivatives firms and in certain circumstances may be passed on to derivatives parties.

There is also a possibility that foreign derivatives firms may be dissuaded from entering or remaining in the Canadian market due to the costs of complying with the Proposed Instrument, which would reduce Canadian derivatives parties' options for derivatives services. However, the Instrument contemplates a number of exemptions, including exemptions for smaller derivatives dealers that only deal with eligible derivatives parties and for derivatives firms located in foreign jurisdictions, which are subject to and in compliance with equivalent requirements under foreign laws. These exemptions could significantly reduce compliance costs associated with the Proposed Instrument for derivatives firms located in and complying with the laws of approved foreign jurisdictions.

Finally, jurisdictions impose registration fees for registrants. These fees are established under the laws of each Canadian jurisdiction.

(c) *Conclusion*

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

Protection of derivatives parties and the integrity of the Canadian derivatives market are the fundamental principles of the Proposed Instrument. The Proposed Instrument aims to provide a level of protection similar to that offered to derivatives parties in other jurisdictions with significant OTC derivatives markets, while being tailored to the nature of the Canadian market. To achieve a balance of interests, the Proposed Instrument is designed to promote a safer environment in the Canadian derivatives market while offering exemptions to derivatives firms that represent a small risk to our markets, that only deal with eligible derivatives parties or that are already subject to and compliant with equivalent requirements.

Contents of Annexes

The following annexes form part of this CSA Notice:

- Annex I – Description of Proposed Methodologies for Determining Notional Amount
- Annex II – Alternative version of the definition of "affiliated entity"
- Annex III – Proposed National Instrument 93-102 *Derivatives: Registration*
- Annex IV – Proposed Companion Policy 93-102 *Derivatives: Registration*
- Annex V – Local Matters

Comments

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

1) Methodology for determining "notional amount"

Annex I describes two different methodologies for determining notional amount for derivatives that reference a notional quantity (or volume) of an underlying asset: (i) the methodology based on the CDE Guidance, set out in Column 1 of Annex I, and (ii) the Regulatory Notional Amount methodology set out in Column 2 of Annex I.

(a) Please provide any comments relating to the constituent elements (price, quantity, etc.) of the proposed methodologies.

(b) Please provide comments on the most appropriate approach to determining the notional amount, for the purpose of regulatory thresholds, of a derivative with a notional amount schedule, including a schedule with notional amounts not denominated in Canadian dollars.

(c) Please provide comments on the most appropriate approach to determining notional amount for a multi-leg derivative.

For example, in a multi-leg derivative with multiple legs that are exercisable, deliverable or otherwise actionable and that are not mutually exclusive, is it appropriate to determine the notional amount for the derivative by summing the notional amount for each such leg that is exercisable, deliverable or otherwise actionable and that is not mutually exclusive?

Other multi-leg derivatives may have multiple legs that are not exercisable, deliverable or otherwise actionable or that are mutually exclusive. For these types of multi-leg derivatives, is it appropriate to determine the notional amount for the derivative by using a weighted average of the notional amount of each such leg that is not exercisable, deliverable or otherwise actionable or that is mutually exclusive?

(d) Please provide any general comments on determining notional amount for the purpose of regulatory thresholds, including relating to implementation of the proposed methodologies.

2) Definition of "affiliated entity"

The Instrument defines "affiliated entity" on the basis of "control", and sets out certain tests for "control". In the context of other rules relating to OTC derivatives, we are also considering a definition of "affiliated entity" that is based on accounting concepts of "consolidation" (a proposed version of the definition is included in Annex II). Please provide any comments you

may have on (i) the definition in the Instrument, (ii) a definition in Annex II, and (iii) the appropriate balance between harmonization across related rules and using different definitions to more precisely target specific entities under different rules.

3) Definition of "eligible derivatives party"

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

4) Application of the derivatives adviser registration requirement to registered advisers/portfolio managers under securities legislation

Under the Proposed Instrument, a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others in derivatives will be required to register as a derivatives adviser unless an exemption from registration is available.

We understand that a registered adviser under securities or commodity futures legislation may provide advice in relation to derivatives or strategies involving derivatives, or may manage an account for a client and make trading decisions for the client in relation to derivatives or strategies involving derivatives. If the performance of these activities in relation to derivatives is limited in nature so that it could reasonably be considered incidental to the performance of their activities as a registered adviser for securities, we may consider the registered adviser/portfolio manager to not be "in the business of advising others in relation to derivatives".

(a) Do you agree with this approach? If not, why not? Alternatively, should we consider including an express exemption from the derivatives adviser registration requirement for a registered adviser under securities or commodity futures legislation? If yes, what if any conditions should apply to this exemption?

(b) When should the provision of advice by a registered adviser/portfolio manager in relation to derivatives be considered incidental to the performance of their activities as a registered adviser/portfolio manager? What factors should we consider in distinguishing between registered advisers who need to register as derivatives advisers from registered advisers that do not need to register as derivatives advisers?

5) IIROC membership for certain derivatives dealers

Section 9 prohibits a derivatives dealer from transacting with an individual that is not an eligible derivatives party unless the derivatives dealer is a dealer member of IIROC. Should a derivatives dealer that deals with an individual that is not an eligible derivatives party be required to become an IIROC dealer member? Are there any other circumstances where a derivatives dealer should be required to be an IIROC dealer member?

6) Exemption from the individual registration requirements for derivatives dealing representatives and derivatives advising representatives

Subsection 16(3) and subsection 16(4) provide an exemption from the requirement to register an individual as a derivatives dealing representative or as a derivatives advising representative in certain circumstances. Are the exemptions appropriate? In subparagraph 16(4)(b)(iii), individuals that act as an adviser for a managed account are not eligible for the exemption from the requirement to register as a derivatives advising representative. Is this carve out appropriate where an individual has discretionary authority over the account of an eligible derivatives party?

7) Specific proficiency requirements for individual registrants

Subsections 18(2) through (6) of the Instrument establish specific proficiency requirements for each individual registration category. Are these specific requirements appropriate? If not, what specific exams, designations or experience are appropriate?

8) Derivatives ultimate designated person

Subparagraph 27(3)(c)(i) requires a derivatives firm's ultimate designated person to report any instance of non-compliance with securities legislation, including the Instrument, relating to derivatives or the firm's risk management policies if the non-compliance creates a risk of material harm to any derivatives party. Is this requirement appropriate?

9) Requirements, roles and responsibilities of ultimate designated persons, chief compliance officers and chief risk officers

Sections 27 through 29 of the Instrument establish requirements, roles, and responsibilities of individuals registered as the ultimate designated person, the chief compliance officer and the chief risk officer for each registered firm. Considering the obligations imposed on senior derivatives managers in the Business Conduct Instrument, are the requirements, roles and responsibilities in sections 27 through 29 of the Instrument appropriate?

10) Minimum requirements for risk management policies and procedures

Section 39 sets out the minimum requirements for risk management policies and procedures. Are any of the requirements inappropriate? Are the requirements for an independent review of risk management systems appropriate?

11) Exemptions from the requirement to register for derivatives dealers with limited derivatives

Sections 50 and 51 establish exemptions from the requirement to register for derivatives dealers that have a gross notional amount that does not exceed prescribed thresholds. These exemptions provide that derivatives dealers that have their head office or principal place of business in Canada must calculate their gross notional amount based on outstanding derivatives with any counterparty, regardless of where the counterparty resides. Derivatives dealers that have their head office and principal place of business outside of Canada would calculate their gross notional amount based on outstanding derivatives where the counterparty is a Canadian resident.

Would this result in Canadian resident derivatives dealers being placed at a competitive disadvantage, particularly where foreign derivatives dealers may be exempt from regulatory requirements in their home jurisdiction?

12) Exemptions from specific requirements in this Instrument for investment dealers

Section 55 exempts IIROC dealer members from specific requirements under the Instrument where those dealer members are subject to equivalent IIROC requirements. The IIROC dealer members will also be required to register in each CSA jurisdiction where their activities result in an obligation to register as a derivatives dealer or derivatives adviser. Does this obligation to register result in an excessive regulatory burden for the firms? Please provide specific information relating to this burden.

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

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. In addition, all comments received will be posted on the websites of each of the Alberta Securities Commission at www.albertasecurities.com, the Autorité des marchés financiers at www.lautorite.qc.ca and the Ontario Securities Commission at www.osc.gov.on.ca. Therefore, you should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

Thank you in advance for your comments.

Please address your comments to each of the following:

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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

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

Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

Questions

Please refer your questions to any of the following:

Lise Estelle Brault
Co-Chair, CSA Derivatives Committee
Senior Director, Derivatives Oversight
Autorité des marches financiers
514-395-0337, ext. 4481
lise-estelle.brault@lautorite.qc.ca

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

Paula White
Deputy Director, Compliance and Oversight
Manitoba Securities Commission
204-945-5195
paula.white@gov.mb.ca

Chad Conrad
Legal Counsel, Corporate Finance
Alberta Securities Commission
403-297-4295
chad.conrad@asc.ca

Michael Brady
Manager, Derivatives
British Columbia Securities Commission
604-899-6561
mbrady@bcsc.bc.ca

Abel Lazarus
Director, Corporate Finance
Nova Scotia Securities Commission
902-424-6859
abel.lazarus@novascotia.ca

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

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