

CSA Notice of Publication

Multilateral Instrument 93-101 *Derivatives: Business Conduct*

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

September 28, 2023

Introduction

The securities regulatory authorities (collectively, the **Authorities** or **we**) of the Canadian Securities Administrators (the **CSA**) in Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, Yukon, Nunavut and Northwest Territories (the **Participating Jurisdictions**) are publishing in final form the following materials:

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

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

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

Substance and Purpose

Background

Derivatives play a critical role in Canadian financial markets and are now mainstream financial products that are used by a diverse group of market participants, including financial intermediaries, individuals, commercial end-users and commodities firms. However, Canada has remained the only G20 country that has not yet implemented business conduct standards for OTC derivatives markets. Accordingly, we developed the Instrument to address this significant regulatory gap in order to help protect market participants, reduce risks, including potential systemic risk, as well as

improve transparency, increase accountability, and promote responsible business conduct in OTC derivatives markets.¹

During the financial crisis of 2008, the inappropriate sale of financial instruments had a substantial impact on global financial markets and led to major losses for retail and institutional participants. The International Organization of Securities Commissions (IOSCO) noted in 2012 that “*until recently, OTC derivatives markets have not been subject to the same level of regulation as securities markets. Insufficient regulation allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008.*”² Moreover, since the financial crisis, there have been numerous cases of serious market misconduct in the global derivatives market and short-term FX market, including misconduct relating to the manipulation of benchmarks and front-running of customer orders, breaches of client confidentiality and failure to adequately manage conflicts of interest. The International Monetary Fund also reported in 2019 that Canada’s “[o]ngoing reforms in the areas of conduct of business of over-the-counter (OTC) derivatives and duties towards clients should be completed.”³

To address these issues, the Instrument will establish a robust market conduct regime that is tailored for OTC derivatives markets, meets IOSCO’s international standards, and is harmonized both within Canada and with the regulatory approach taken by most IOSCO jurisdictions with active derivatives markets.⁴ As a result, the Instrument will help protect participants in the OTC derivatives markets from unfair, improper or fraudulent practices and will foster confidence in the Canadian financial markets.

Structure of the Instrument

The Instrument is intended to provide valuable protections for OTC derivatives market participants regardless of the type of derivatives firm they deal with, balanced with efficient regulation of derivatives dealers and advisers that are operating in Canada.

The Instrument applies to a person or company if it meets the definition of “derivatives adviser” or a “derivatives dealer”, regardless of whether it is registered or exempted from the requirement to be registered in a jurisdiction. As a result, the Instrument applies to federally regulated Canadian financial institutions that are in the business of trading or advising in OTC derivatives.

As described in Annex B – *Summary of Comments and Responses*, a business trigger test is used to determine if the person or company is in the business of trading or advising in OTC derivatives. Even if a person or company is in the business of trading in OTC derivatives in a Participating Jurisdiction, they may be exempt from the requirements of the Instrument if they qualify for an exemption available in the Instrument. Finally, even if a person or company is subject to the requirements of the Instrument, those requirements are tailored depending on the nature of the derivatives dealer’s or derivatives adviser’s derivatives counterparty.

¹ The 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 Financial System Stability Assessment of Canada, published on June 24, 2019 (Country Report No.19/177).

⁴ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD497.pdf> (DMI Implementation Review) at p. 13.

The Authorities' principles-based approach to regulating the conduct of derivatives firms, includes requirements relating to the following:

- Fair dealing
- Conflicts of interest
- Know your derivatives party (KYDP)
- Suitability
- Pre-transaction disclosure
- Reporting of non-compliance
- Compliance
- Senior management duties
- Recordkeeping
- Treatment of derivatives party assets

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

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

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

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

Note that we are monitoring the implementation of Client Focused Reforms⁵ for securities market participants. We will consider whether comparable provisions are appropriate for the OTC derivatives market in the future.

⁵ See CSA Notice of Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations*—Reforms to Enhance the Client-Registrant Relationship (**Client Focused Reforms**)

Timeline

The Instrument was developed over the course of an extensive consultation process, including the most recent consultation on January 20, 2022 (the **third consultation**). The comment period for the third consultation closed on March 21, 2022.⁶ In addition, we held a public roundtable on September 28, 2022, where we explored a number of regulatory, implementation and compliance matters associated with the Instrument.

We have made revisions in response to the comments we received during the third consultation and are publishing the Instrument in final form.

Multilateral Instrument

The British Columbia Securities Commission (**BCSC**) intends to adopt substantially similar rules at a later date, at which time CSA staff intends for Multilateral Instrument 93-101 to be converted to a National Instrument.

Summary of Written Comments Received by the CSA

During the comment period for the third consultation, we received submissions from 10 commenters. We thank all commenters for their input. The names of the commenters and a summary of their comments, together with our responses, are contained in Annex A – *List of Commenters* and Annex B – *Summary of Comments and Responses* of this Notice.

Copies of the submissions on the Instrument can be found on the following websites:

- the Alberta Securities Commission at www.albertasecurities.com
- the Autorité des marchés financiers at www.lautorite.qc.ca
- the Ontario Securities Commission at www.osc.gov.on.ca

Summary of Changes to the Instrument

In finalizing the Instrument, we carefully reviewed the comments that we received during the third consultation. Public comments make a valuable contribution to the rule-making process. This includes finding the right balance between achieving regulatory goals and minimizing the

⁶ On April 18, 2013, CSA Consultation Paper 91-407 *Derivatives: Registration*, which outlined a proposed registration and business conduct regime for participants in the OTC derivatives markets was published for comment;

On April 4, 2017, Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101 *Derivatives: Business Conduct* was published for a first comment period;

On June 14, 2018, Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101 *Derivatives: Business Conduct* was published for a second comment period; and

On January 20, 2022, Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101 *Derivatives: Business Conduct* was published for a third comment period.

associated regulatory burdens. Commenters expressed overall support for the policy and recommended changes to certain parts of the Instrument prior to its finalization. We found many of the recommended changes to be persuasive and revised the Instrument accordingly.

We believe we have achieved an appropriate balance of promoting investor/customer protection, while preserving derivatives market access and reducing the impact of compliance costs. This balance is achieved by streamlining the Instrument to address potential negative impacts on derivatives market liquidity, as well as removing obstacles to a derivatives firm's ability to efficiently implement the market conduct requirements within its existing compliance system, which will all reduce burden on derivatives market participants.

The more notable changes to the Instrument, which are summarized in more detail below, include:

- adopting a bright-line test for qualifying clients as EDPs by removing the additional knowledge and experience representation in the EDP definition, which will harmonize the approach to obtaining status representations with the approach taken in NI 31-103, as well as the approach taken by foreign regulators;
- expanding the “commercial hedger” concept under the EDP definition to clarify that it is available for use by certain sole proprietorships;
- applying a more limited subset of provisions to derivatives dealers relying on the notional amount exemptions and increasing the financial threshold for commodity derivatives dealers relying on the notional amount exemption from CAD\$3 billion to CAD\$10 billion;
- expanding the list of status representations that derivatives firms can rely on for the purposes of the transition representations;
- clarifying that the inclusion of short-term FX contracts in the institutional FX market for the purposes of a limited sub-set of provisions does not require any of the Canadian financial institutions that are subject to this provision to obtain additional certifications or status representations from their clients;
- removing the requirement for foreign derivatives dealers to provide additional reports to Canadian regulators that were over and above what is required under NI 31-103 for foreign dealers that are relying on a similar type of exemption;
- including detailed guidance for registered advisers relying on the exemption in the Instrument available to registered advisers about the interaction of the exemption with the requirements that will apply to a registered adviser's derivatives activity under NI 31-103; and
- closely aligning the record retention requirements in the Instrument to the timeframe provided for in NI 31-103.

In addition to these changes, the Instrument includes other changes to the MI, as well as revisions to the guidance in the CP that are intended to clarify the interpretation of the MI.

Definition of Canadian financial institution

- We note that on September 13, 2023, amendments to National Instrument 14-101 *Definitions and Consequential Amendments* took effect, which would align the definition of Canadian financial institution in NI 14-101 to the definition found in the Instrument. The Instrument has been updated to cross-reference the definition in NI 14-101 to reflect the uniform definition of Canadian financial institution that will apply to all national and multilateral instruments.

Definition of CIRO

- As of January 1, 2023, the Investment Industry Regulatory Organization of Canada (**IIROC**) and the Mutual Fund Dealers Association of Canada amalgamated to become the Canadian Investment Regulatory Organization (**CIRO**). The Instrument has been updated to change the reference from IIROC to CIRO. This change has also been reflected in the exemption in the Instrument that is available to derivatives dealers that are also dealer members of CIRO.

EDP definition – certain sole proprietors hedging commercial risk can qualify as EDPs

- We understand that there are specific scenarios where sole proprietorships, which are legally treated as individuals, also use derivatives to hedge risks associated with their commercial activities. Accordingly, the “commercial hedger” concept under the EDP definition has been expanded to clarify that certain derivatives parties that are individuals operating as sole proprietorships may qualify as EDPs if they satisfy the conditions for qualifying as a commercial hedger and are entering into a transaction solely for the purposes of managing risks inherent to their commercial business.
- To ensure this prong of the EDP definition is used for its intended purpose, we intend to carefully monitor and review the use of this prong of the EDP definition and a derivatives firm’s compliance with relevant requirements.

EDP definition – bright-line status test

- The status test for determining if a derivatives party qualifies as an EDP has been changed to align with the existing ‘bright-line’ approach to status representations under securities legislation pertaining to securities and exchange-traded derivatives products. Accordingly, we have removed the additional knowledge and experience representation that had to be given by certain persons or companies.
- This change aligns more closely with bright-line tests used by foreign regulators to establish the status of a client or counterparty in OTC derivatives markets, which is important due to the global nature of these markets.

- Additionally, taking this approach is expected to significantly ease the re-papering burden on derivatives firms without reducing the protections afforded to qualifying individuals and commercial hedgers, since all of the obligations in the Instrument presumptively apply to the activity of a derivatives firm transacting with an EDP that is either an individual or an eligible commercial hedger, unless that derivative party has provided written notice waiving all (or some of) the additional protections in the Instrument.

Exemption from certain requirements for certain notional amounts of derivatives activity

- The overall scope of the Instrument is that it applies regardless of whether a derivatives firm is registered or not, subject to any available exemption.
- Recognizing that not all foreign derivatives dealers are regulated in their home jurisdiction and that the Instrument applies to derivatives firms (foreign and local) operating under other derivatives regulatory frameworks (including in the U.S. and the E.U.), the exemptions in section 44 [*Exemptions from certain requirements in this Instrument for certain notional amounts of certain commodity derivatives and other derivatives activity*] (the **notional amount exemptions**) have been broadened and further tailored in the following two ways to align them more closely with the exemptions contemplated in the U.S. and the E.U. regulatory frameworks:
 - first, we recognize that there are certain commodity derivatives dealers whose primary business purpose is to operate a physical commodities business (involving delivery of commodities, such as energy, agricultural goods, or other raw materials, to industrial, commercial and residential consumers) and that the U.S. and E.U. regulatory frameworks largely exempts such commodity derivatives dealers. Therefore, the derivatives activity threshold that is used to determine whether a commodity derivatives dealer may rely on the notional amount exemption that is available to commodity derivatives dealers (the **commodity derivatives dealer notional amount exemption**) has been increased from CAD \$3 billion to \$10 billion; and
 - second, we reduced the scope of the provisions that will apply to a derivatives dealer relying on one of the two available notional amount exemptions, so that only the provisions relating to fair dealing, conflicts of interest, and the requirement to deliver a trade confirmation will continue to apply to a derivatives dealer relying on a notional amount exemption.
- We will continue to monitor developments in derivatives markets that may affect the appropriateness of the threshold notional derivatives activity amounts that are used to calibrate the application of the Instrument (particularly, in relation to the commodity derivatives dealer notional amount exemption).

Short-term FX

- We have made changes to the MI and the CP to clarify that the inclusion of short-term FX contracts in the wholesale FX market for the purposes of a limited sub-set of provisions does not require a Canadian financial institution that is subject to this provision to obtain any status certifications or representations from its counterparties.
- The limited sub-set of provisions in the MI⁷ that apply to short-term FX contracts in the wholesale FX market is intended to overlay, on a principles basis, the existing policies and procedures that have already been adopted by the Canadian financial institutions that are subject to these provisions and have already been incorporated into their internal compliance regimes through their adherence to the FX Global Code of Conduct⁸ with the population of their counterparties that are covered by the FX Global Code of Conduct.

Registered advisers

- We have included additional guidance in the Companion Policy for registered advisers relying on the section 48 exemption [*Registered advisers under securities or commodity futures legislation*] about how the exemption interacts with the requirements applicable to a registered adviser's derivatives activity under NI 31-103, including providing an overview of the provisions in the Instrument that still apply to registered advisers relying on the section 48 exemption, as well as a summary of the provisions in the Instrument that do not apply to registered advisers that comply with the corresponding requirements in NI 31-103 in respect of their derivatives activity.

Specified foreign jurisdictions for substituted compliance

- Two additional countries (Norway and Iceland) where MiFID II⁹ and MiFIR¹⁰ are applicable have been included in Appendix A, Appendix D and Appendix E of the Instrument since they have comparable derivatives regulation on an outcomes basis to the requirements found in the Instrument. This means that foreign derivatives dealers, advisers and sub-advisers located in these two additional countries can utilize the exemptions in the Instrument that are available to a foreign dealer, foreign adviser or a foreign sub-adviser that complies with the conditions of the applicable exemption.
- The fact that a foreign jurisdiction is not included in the appendices is not intended to necessarily suggest any policy concern with the regulatory regime of that foreign jurisdiction. Rather, this decision reflects that staff in Participating Jurisdictions have not had an opportunity (or received fulsome submissions from industry associations or market participants) to consider if that foreign jurisdiction has in place, on an outcomes-basis, a comparable derivatives regulatory framework. We anticipate that these appendices may be

⁷ Section 9 [*Fair dealing*]; section 10 [*Conflicts of interest*]; section 12 [*Handling complaints*]; Division 1 [*Compliance*] of Part 5 [*Compliance and recordkeeping*].

⁸ FX Global Code: https://www.globalfxc.org/docs/fx_global.pdf

⁹ Markets in Financial Instruments Directive (MiFID) II: <https://www.efta.int/eea-lex/32014L0065>

¹⁰ Markets in Financial Instruments Regulation (MiFIR): <https://www.efta.int/eea-lex/32014R0600>

amended from time to time to include additional foreign jurisdictions once we have had a chance to consider the regulatory regimes in other foreign jurisdictions.

Record retention requirements

- We have aligned the approach taken in the Instrument with respect to records retention with the approach to records retention under securities legislation (namely, in NI 31-103) and significantly reduced the timeframe for retaining applicable records. Applicable records are now required to be retained for 7 years (or 8 years in Manitoba) from the record creation date.

Transition provisions and effective date

- The effective date of the Instrument is September 28, 2024.¹¹
- Additional changes have been made to Part 8 [*Transition and Effective Date*] of the Instrument to further assist derivatives firms with transitioning to the new regulatory framework, including the following:
 - the transition representations that derivatives firms can rely on under section 50 [*Transition for existing derivatives parties*] during the transition period have been further expanded to account for certain additional types of sophisticated parties that can qualify as EDPs;
 - in addition to the delayed effective date of one year from the date of the final publication, in circumstances where the derivatives firm is required to obtain a waiver from a client or counterparty under section 8(2)(a)(iii) in order for that derivatives party to qualify as an EDP, derivatives firms will have an additional one-year period following the effective date of the Instrument to obtain the required waiver; and
 - BCSC staff anticipates that MI 93-101 will take effect in British Columbia on September 28, 2024, together with the Participating Jurisdictions – BCSC staff will provide more specific information when BCSC publishes the final version of the Instrument in its jurisdiction.

In addition to these changes, additional related guidance is set out in the CP in order to help derivatives firms operationalize the requirements of the Instrument.

The changes to the Instrument and our reasons for making them are discussed in more detail in Annex B – *Summary of Comments and Responses*.

¹¹ In some Participating Jurisdictions, ministerial approval is required for the implementation of the Instrument. Provided ministerial approvals are obtained, the Instrument will come into force on September 28, 2024 in such Participating Jurisdictions.

List of Annexes

This notice contains the following annexes:

- Annex A – *List of Commenters*
- Annex B – *Summary of Comments and Responses*
- Annex C – *Multilateral Instrument 93-101 Derivatives: Business Conduct*
- Annex D – *Companion Policy 93-101 Derivatives: Business Conduct*

Questions

Please refer your questions to any of:

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