

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

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

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

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

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

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

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

Background

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

On April 4, 2017, we published for comment Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101 *Derivatives: Business Conduct* (the **first consultation**). The comment period for the first consultation closed on September 1, 2017. During the comment period, we received submissions from 21 commenters. We thank all commenters for their input. We have carefully reviewed the comments received and have revised the Proposed Instrument. The names of the commenters and a summary of their comments, together with our responses, are contained in Annex A of this Notice. Copies of the submissions on the Proposed Instrument can be found on the websites of the Alberta Securities Commission,¹ Ontario Securities Commission² and Autorité des marchés financiers.³

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

¹ Available at http://www.albertasecurities.com/Regulatory%20Instruments/5341884-v1-CSA_Note_and_Request_for_Comment_NI_93-101.PDF

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

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

The Proposed Instrument applies to a person or company that meets the definition of “derivatives adviser” or “derivatives dealer” regardless of whether it is registered or exempted from the requirement to be registered in a jurisdiction.

Substance and Purpose of the Proposed Instrument

The CSA have developed the Proposed Instrument to help protect investors, reduce risk, improve transparency, increase accountability and promote responsible business conduct in the over-the-counter (OTC) derivatives⁴ markets.

During the financial crisis of 2008, the inappropriate sale of financial investments led to major losses for retail and institutional investors. The International Organization of Securities Commissions (IOSCO) noted in 2012 that “until recently, OTC derivatives markets have not been subject to the same level of regulation as securities markets. Insufficient regulation allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008.”⁵ Moreover, since the financial crisis, there have been numerous cases of serious market misconduct in the global derivatives market, including, for example, misconduct relating to the manipulation of benchmarks and front-running of customer orders.

To address these issues, the Proposed Instrument, together with the Proposed Registration Instrument, establishes a robust investor protection regime that meets IOSCO’s international standards and takes into account CSA jurisdictions’ commitments to create a derivatives dealer regime that is also consistent with the regulatory approach taken by most IOSCO jurisdictions with active derivatives markets.⁶ As a result, the Proposed Instrument will help protect participants in the OTC derivatives markets from unfair, improper or fraudulent practices and foster confidence in the Canadian derivatives markets.

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

A person or company is subject to the Proposed Instrument only if it is a “derivatives adviser” or a “derivatives dealer”. As described below in the Summary of the Instrument, a test is used to determine if the person or company is in the business of trading or advising in OTC derivatives. Nevertheless, a person or company that may be in the business of trading in OTC derivatives may be exempt from the requirements of the Proposed Instrument if they qualify for the end-user exemption. Finally, even if a person or company is subject to the requirements of the Proposed Instrument, those requirements are tailored depending on the nature of the derivatives dealer’s or derivatives adviser’s derivatives party.

The Proposed Instrument sets out a comprehensive approach regulating the conduct of derivatives markets participants, including requirements relating to the following:

- Fair dealing
- Conflicts of interest
- Know your client (KYC)
- Suitability
- Pre-trade disclosure
- Reporting
- Compliance
- Senior management duties
- Recordkeeping
- Treatment of derivatives party assets

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

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

- certain obligations apply in all cases when a derivatives firm is dealing with or advising a derivatives party, regardless of the level of sophistication or financial resources of the derivatives party; and
- certain obligations:
 - do not apply if the derivatives firm is dealing with or advising a derivatives party that is an “eligible derivatives party” and is neither an individual nor a specified commercial hedger, and
 - apply but may be waived if the derivatives firm is dealing with or advising a derivatives party who is an “eligible derivatives party” that is an individual or a specified commercial hedger.

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

⁴ The Proposed Instrument applies to derivatives as determined in accordance with the product determination rule applicable in the relevant jurisdiction. Each jurisdiction has adopted a product determination rule that excludes certain types of contracts and instruments from being derivatives for the purpose of the Instrument. Only those OTC derivatives set out in the applicable product determination rule are relevant.

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

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

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

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

Summary of the Instrument

Part 1 – Definitions

Part 1 of the Instrument sets out relevant definitions and principles of interpretation.

Some of the most important definitions in the Instrument are provided below.

Derivatives adviser and derivatives dealer

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

It is important to note that the Instrument applies to a person or company that meets the definition of “derivatives adviser” or “derivatives dealer”, regardless of whether they are registered or exempted from the requirement to be registered in a jurisdiction. This is intended to ensure that certain derivatives markets participants that may benefit from an exemption from registration in certain jurisdictions nevertheless remain subject to certain minimum standards in relation to their business conduct towards their customers.

Paragraph (b) in the definitions of each of “derivatives adviser” and “derivatives dealer” has been included since the Proposed Registration Instrument may designate as or prescribe additional entities to be derivatives advisers or derivatives dealers based on specified activities (e.g., trading with non-eligible derivatives parties or engaging in certain market-making activities).

Derivatives party

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

Eligible derivatives party

The term “eligible derivatives party” is intended to refer to those sophisticated derivatives parties that do not require the full set of protections afforded to “retail” customers or investors, either because they may reasonably be considered to have sufficient knowledge and experience to assess the risks of transacting in derivatives or because they have sufficient financial resources to obtain professional advice in order to protect themselves through contractual negotiation with the derivatives firm.

As currently drafted, the definition of “eligible derivatives party” is generally consistent with the current regulatory regimes in the U.S. and Canada in relation to OTC derivatives.⁷ In addition, the definition is similar to the definition of “permitted client” in NI 31-103, with a few modifications intended to reflect differences between derivatives and securities markets.

Specified commercial hedger

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

Part 2 – Application

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

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

⁷ See, for example, the definition of “eligible contract participant” under the U.S. *Commodity Exchange Act* and the *Securities Exchange Act of 1934* applicable to CFTC and SEC swap dealers and major swap participants, the definition of “qualified party” in British Columbia Blanket Order 91-501 *Over-the-Counter Derivatives*, the definition of “qualified party” in Alberta Blanket Order 91-507 *Over-the-Counter Derivatives*, the definition of “qualified party” in Saskatchewan General Order 91-908 *Over-the-Counter Derivatives*, the definition of “qualified party” in Manitoba Blanket Order 91-501 *Over-the-Counter Trades in Derivatives*, the definition of “accredited counterparty” in section 3 of the Quebec *Derivatives Act*, the definition of “qualified party” in New Brunswick Local Rule 91-501 *Derivatives* and the definition of “qualified party” in Nova Scotia Blanket Order 91-501 *Over The Counter Trades in Derivatives*.

Section 7 provides that the requirements of the Instrument, other than the specific requirements listed in subsection 7(1), do not apply to a derivatives firm if it is dealing with or advising an eligible derivatives party that:

- is not an individual or a specified commercial hedger, or
- is an individual or specified commercial hedger that has waived in writing the protections provided by the requirements.

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

When a derivatives firm is dealing with or advising a specified eligible derivatives party, the derivatives firm will only be subject to the following requirements of the Instrument:

- (a) Division 1 [*General obligations towards all derivatives parties*] of Part 3 [*Dealing with or advising derivatives parties*];
- (b) sections 23 [*Interaction with other instruments*] and 24 [*Segregating derivatives party assets*] of Part 4 [*Derivatives party accounts*];
- (c) subsection 27(1) [*Content and delivery of transaction information*] of Part 4 [*Derivatives party accounts*]; and
- (d) Part 5 [*Compliance and recordkeeping*].

A derivatives firm and an eligible derivatives party may choose to incorporate additional protections in the contracts that govern their relationship and their derivatives trading activities. However, the CSA are of the view that, in the case of a derivatives firm dealing with or advising an eligible derivatives party, these protections should not be required but rather should be a matter of contract for the parties.

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

Part 3 – Dealing with or advising derivatives parties

DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES

Division 1 of Part 3 sets out the fundamental business conduct obligations that the CSA have recommended should apply to all derivatives firms when dealing with or advising derivatives parties, including eligible derivatives parties, namely:

- fair dealing,
- responding to conflicts of interest, and
- general (or “gatekeeper”) know-your-derivatives party obligations.

Fair dealing

The fair dealing obligation proposed in section 8 of the Instrument is consistent with international practice and is in line with the standards set by NI 31-103 while keeping in mind the differences between derivatives and securities markets. The CSA believe that the fair dealing obligation in section 8, as a principles-based obligation, should be interpreted flexibly and in a manner that is sensitive to context and to derivatives markets participants’ reasonable expectations. We expect that the fair dealing obligation will be applied differently depending on the sophistication of the market participant.

Identifying and responding to conflicts of interest

Section 9 of the Instrument contains obligations to identify and respond to conflicts of interest. This obligation applies when dealing with or advising market participants of all levels of sophistication. It is a principles-based obligation which should be interpreted flexibly and in a manner that is sensitive to context and to derivatives markets participants’ reasonable expectations. Furthermore, it is expected that in responding to any conflict of interest, the derivatives party will consider the fair dealing obligation as well as any other standard of care that may apply when dealing with or advising a derivatives party.

General (or “gatekeeper”) know-your-derivatives party obligations

Section 10 of the Instrument sets out the general “gatekeeper” know-your-derivatives party (**KYDP**) obligations. These obligations include requirements to verify the identity of a derivatives party, verify that the derivatives party is an eligible derivatives party, determine if the derivatives party is an insider of a reporting issuer, and comply with anti-money-laundering and terrorist financing obligations.

We would anticipate that many derivatives firms, including Canadian financial institutions, will already have policies and procedures in place to address these obligations and that section 10 should not result in any significant new obligations for these entities.

DIVISION 2 – ADDITIONAL OBLIGATIONS WHEN DEALING WITH OR ADVISING CERTAIN DERIVATIVES PARTIES

The obligations in Division 2 of Part 3 are intended to protect non-eligible derivatives parties. They do not apply to the extent that a derivatives firm is dealing with or advising a specified eligible derivatives party.

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

Derivatives-party-specific needs and objectives

Section 11 sets out the obligation on a derivatives firm to obtain information about a derivatives party's specific investment needs and objectives in order for the derivatives firm to meet its suitability obligations under section 12 and to provide the appropriate pre-transaction disclosure under subsection 19(1).

Information on a derivatives party's specific needs and objectives (sometimes referred to as "client-specific KYC information") forms the basis for determining whether transactions in derivatives are suitable for a derivatives party. The obligations in section 11 require a derivatives firm to take reasonable steps to obtain and periodically update information about its derivatives parties.

Suitability

Section 12 requires a derivatives firm to take reasonable steps to ensure that a proposed transaction is suitable for a derivatives party before making a recommendation or accepting instructions from the derivatives party to transact in a derivative.

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

The obligations in Division 3 focus on restricting certain business activities when dealing with less sophisticated derivatives parties. These obligations relate to tied selling. The obligations in this Division do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

Tied selling

Section 17 prohibits a derivatives firm from engaging in certain sales practices that would pressure or require a derivatives party to obtain a product or service as a condition of obtaining other products or services from the derivatives firm. An example of tied selling would be offering a loan on the condition that the derivatives party purchase another product or service, such as a swap to hedge the loan, from the derivatives firm or one of its affiliates.

As explained in the CP, section 17 is not intended to prohibit relationship pricing or other beneficial selling arrangements similar to relationship pricing. Relationship pricing refers to the practice of industry participants offering financial incentives or advantages to certain derivatives parties.

Part 4 – Derivatives Party Accounts

DIVISION 1 – DISCLOSURE TO DERIVATIVES PARTIES

The CSA believe that less sophisticated derivatives parties, or those individuals who may require a higher level of protection, need more detailed information concerning their transactions and their accounts. Below are some of the requirements designed to keep derivatives parties informed. The obligations in this Division do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

Section 18 requires a derivatives firm to provide a derivatives party with all information that the derivatives party needs in order to understand not only their relationship with the derivatives firm, but also the products and services that the derivatives firm will or may provide and the fees or other charges that the derivatives party may be required to pay.

Subsection 18(1) sets out the obligation for a derivatives firm to provide a derivatives party with disclosure that is reasonably designed to allow the derivatives party to assess the material risks of transacting in the derivative. This includes the derivatives party's potential exposure and the material characteristics of the derivative, which include the material economic terms and the rights and obligations of the counterparties to the type of derivative.

This section also requires a derivatives firm to provide a risk disclosure to a derivatives party before a transaction takes place, which explains that the leverage inherent in derivatives may require the derivatives party to deposit additional funds if the value of the derivative declines. The risk disclosure requires an explanation that borrowing money or using leverage to fund a derivatives transaction carries additional risk.

In addition, subsection 19(2) establishes obligations, before transacting a specific derivative,

- to advise the derivatives party about material risks in relation to the specific derivative that are materially different than the risks disclosed under subsection 19(1), and
- if applicable, to set out the price of the derivative to be transacted and the most recent valuation.

Further to these obligations, section 20 requires a derivatives firm to provide a derivatives party with a daily valuation of the derivatives that it has transacted with or on behalf of that derivatives party.

DIVISION 2 – DERIVATIVES PARTY ASSETS

Division 2 sets out certain requirements related to segregation and holding of collateral delivered to a derivatives firm as initial margin, and imposes a requirement on the derivatives firm to obtain the written consent of its derivatives party if the derivatives firm intends to use or invest the collateral that is delivered to it by or for a derivatives party.

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

- the derivatives firm is subject to and complies with or is exempt from sections 3 through 8 of National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*,
- the derivatives firm is subject to and complies with securities legislation relating to margin and collateral requirements or National Instrument 81-102 *Investment Funds (NI 81-102)*.

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

The obligations in this Division, other than section 23 and section 24, do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

DIVISION 3 – REPORTING TO DERIVATIVES PARTIES

Division 3 sets out obligations of derivatives firms to provide certain reports to derivatives parties.

Section 27 provides that a derivatives firm must provide its derivatives party with a confirmation of the key elements of a derivatives transaction. If the derivatives party is not a specified eligible derivatives party, the required contents of this confirmation are set out in subsection 27(2).

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

The obligations in this Division, other than the fundamental transaction confirmation requirement in subsection 27(1), do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

Part 5 – Compliance and recordkeeping

DIVISION 1 – COMPLIANCE

Section 30 provides that a derivatives firm must have policies, procedures and controls to assure that, with respect to transacting or advising on derivatives, the firms and individuals acting on its behalf comply with applicable laws, to manage risk and to ensure that individuals have the necessary training and expertise.

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

Section 32 sets out the requirement of a derivatives firm to respond to material non-compliance, and in certain circumstances to report material non-compliance to the regulator or securities regulatory authority.

Part 6 – Exemptions

DIVISION 1 – EXEMPTION FROM THE INSTRUMENT

End users

Section 37(1) provides that certain derivatives end-users (e.g., entities that trade derivatives for their own account for commercial purposes) are exempt from the Instrument provided they do not do any of the following:

- solicit or otherwise transact in a derivative with, for or on behalf of a person or company that is not an eligible derivatives party;
- advise persons or companies in respect of transactions in derivatives, if the person or company is not an eligible derivatives party, other than general advice that is provided in accordance with the conditions of section 42;
- regularly make or offer to make a market in a derivative with a derivatives party;
- regularly facilitate or otherwise intermediate transactions in derivatives for another person or company other than an affiliated entity that is not an investment fund;
- facilitate the clearing of a transaction in a derivative through the facilities of a qualifying clearing agency for another person or company.

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

Foreign derivatives dealers and foreign derivatives advisers

Divisions 2 and 3 provide, under certain conditions, an exemption from requirements in the Instrument for foreign derivatives dealers and foreign derivatives advisers that are regulated under the laws of a foreign jurisdiction that achieve substantially the same objectives, on an outcomes basis, as the Instrument.

These exemptions apply to the provisions of the Instrument where the derivatives dealer or derivatives adviser is subject to and in compliance with the laws of a foreign jurisdiction set out in Appendix A and Appendix D of the Instrument opposite the name of the foreign jurisdiction. The jurisdictions specified in Appendices A and D will be determined on a jurisdiction-by-jurisdiction basis, and based on a review of the laws and regulatory framework of the jurisdiction.

Investment dealers

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

Canadian financial institutions

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

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

DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS

Advising generally

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

Part 8 – Effective Date

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

Summary of Key Changes to the Proposed Instrument from Previous Publication

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

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

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

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

(c) Managed accounts of eligible derivatives parties

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

(d) Former section 19 – Fair terms and pricing

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

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

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

(f) Part 5, Division 1 – Compliance

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

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

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

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

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

(i) Section 45 – Effective date

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

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

(j) International harmonization and miscellaneous drafting clarifications

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

Anticipated Costs and Benefits

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

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

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

(a) Benefits

The Proposed Instrument will protect participants in the Canadian OTC derivatives markets by reducing the likelihood of suffering loss through inappropriate transactions, inappropriate sale of derivatives and market misconduct. The Proposed Instrument offers protections not only to retail market participants but also large market participants whose derivatives losses could impact their business operations and potentially the Canadian economy more broadly. The Proposed Instrument fills a regulatory gap in the Canadian OTC derivatives markets for certain derivatives firms that are not subject to business conduct regulation and oversight. It is intended to foster confidence in the Canadian derivatives markets by creating a regime that meets international standards and is, where appropriate, equivalent to the regimes in major trading jurisdictions. Currently, OTC derivatives are regulated differently across Canadian jurisdictions, and there is inconsistency in regulation of business conduct in OTC derivatives markets. The Proposed Instrument aims to reduce compliance costs for derivatives firms to the degree possible, by harmonizing the rules across Canadian jurisdictions and establishing a regime that is tailored for the derivatives market.

(b) Costs

Generally, firms will incur costs from analysing the requirements and establishing policies and procedures for compliance. Any costs associated with complying with the Proposed Instrument are expected to be borne by derivatives firms and in certain circumstances may be passed on to derivatives parties.

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

(c) Conclusion

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

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

Contents of Annexes

The following annexes form part of this CSA Notice:

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

Comments

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

1) Definition of “affiliated entity”

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

2) Definition of “eligible derivatives party”

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

3) Anonymous transactions executed on a derivatives trading facility

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

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

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

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

4) Handling complaints

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

5) Derivatives Party Assets

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

6) Policies, procedures and controls

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

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

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

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. In addition, all comments received will be posted on the websites of each of the Alberta Securities Commission at www.albertasecurities.com, 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:

M^e Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22^e 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
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Questions

Please refer your questions to any of:

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Appendix A

Comparison of protections that do not apply to, or may be waived by, “eligible derivatives parties” under Proposed NI 93-101 *Derivatives: Business Conduct* and “permitted clients” under NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

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

The extent to which obligations do not apply, or apply unless waived, when dealing with or advising an eligible derivatives party is set out in the following chart:

Obligation	Approach under NI 31-103	Approach under NI 93-101
Fair dealing ⁹	Applies in respect of all clients	Applies in respect of all derivatives parties (s. 8)
Identifying and responding to conflicts of interest	Applies in respect of all clients (s. 13.4) However, client relationship disclosure obligations in relation to conflicts of interest do not apply in respect of a permitted client that is not an individual (s. 14.2(6))	Applies in respect of all derivatives parties (s. 9) However, relationship disclosure obligations in Part 4 in relation to conflicts of interest do not apply in respect of <ul style="list-style-type: none"> • an EDP that is not an individual • an EDP that is an individual that has waived this disclosure • an EDP that is a specified commercial hedger that has waived this disclosure
Gatekeeper KYC (AML, etc.)	Applies in respect of all clients (s. 13.2) However, this does not apply if the client is a registered firm, Canadian financial institution or Schedule III bank (s. 13.2(5))	Applies in respect of all derivatives parties (s. 10) However, this does not apply if the derivatives party is a registered firm or a Canadian financial institution (including a Schedule III bank). Additionally, this does not apply to an anonymous transaction executed on a derivatives trading facility that is cleared.
Client-specific KYC (investment needs and objectives, etc.) Suitability	Applies in respect of all clients (ss. 13.2(2)(c) and 13.3) May be waived in writing by a permitted client (including an individual permitted client) if registrant does not act as an adviser in respect of a managed account for the client (ss. 13.2(6) and 13.3(4))	Applies in respect of all derivatives parties other than <ul style="list-style-type: none"> • an EDP that is not an individual • an EDP that is an individual that has waived in writing this obligation • an EDP that is a specified commercial hedger that has waived this obligation (ss. 7, 11 and 12)
Miscellaneous other obligations	Do not apply to a permitted client <ul style="list-style-type: none"> • Disclosure when recommending the use of borrowed money – s. 13.13(2) • When the firm has a relationship with a financial institution – s. 14.4(3) 	Apply in respect of all derivatives parties other than <ul style="list-style-type: none"> • an EDP that is not an individual • an EDP that is an individual that has waived in writing this obligation • an EDP that is a specified commercial hedger that has waived this obligation (ss. 7 and 19)

⁹ See section 2.1 of OSC Rule 31-505 *Conditions of Registration*; section 14 of the Securities Rules, B.C. Reg. 194/97 [B.C. Regulations] under the *Securities Act* (British Columbia), R.S.B.C. 1996, c. 418 [B.C. Act]; section 75.2 of the *Securities Act* (Alberta) R.S.A. 2000, c.S-4 [Alberta Act]; section 33.1 of *The Securities Act, 1988* (Saskatchewan), S.S. 1988-89, c. S-42.2 [Saskatchewan Act]; subsection 154.2(3) of *The Securities Act* (Manitoba) C.C.S.M. c. S50 [Manitoba Act]; section 65 of the *Derivatives Act* (Québec), R.S.Q., c. 14.01 [Québec Act]; subsection 54(1) of the *Securities Act* (New Brunswick) S.N.B. 2004, c. S-5.5 [N.B. Act]; section 90 of the *Securities Act* (Prince Edward Island), R.S.P.E.I. 1988, c. S-3.1 [P.E.I. Act]; section 39A of the *Securities Act* (Nova Scotia), R.S.N.S. 1989, c. 418 [N.S. Act]; subsection 26.2(1) of the *Securities Act* (Newfoundland and Labrador), R.S.N.L.1990, c. S-13 [Newfoundland Act]; section 90 of the *Securities Act* (Nunavut), S.Nu. 2008, c. 12 [Nunavut Act]; section 90 of the *Securities Act* (Northwest Territories), S.N.W.T. 2008, c. 10 [N.W.T. Act]; and section 90 of the *Securities Act* (Yukon), S.Y. 2007, c. 16 [Yukon Act].

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

Appendix B

Application of business conduct requirements

Regulatory Requirement	Derivatives firms dealing with EDPs	Derivatives firms dealing with non-EDPs
General obligations toward all (Part 3 Div 1) <ul style="list-style-type: none"> • Fair dealing • Conflict of interest management • General/gatekeeper know-your-derivatives party 	•	•
Additional obligations and restrictions (Part 3 Div 2–3) <ul style="list-style-type: none"> • Derivatives-party-specific know-your-derivatives party • Product suitability • Permitted referral arrangements • Complaint handling • Prohibition on tied selling 		•
Client and counterparty accounts (Part 4) <ul style="list-style-type: none"> • Relationship disclosure • Pre-trade disclosures re. leverage/borrowing, risk, product, price, and compensation • Report daily valuations • Notice by non-resident registrants • Holding of assets¹⁰ • Use and investment of assets • Transaction confirmations¹¹ • Quarterly statements 		•
Compliance and recordkeeping (Part 5) <ul style="list-style-type: none"> • Compliance and risk management systems • Senior manager report • Client/counterparty agreement • Recordkeeping 	•	•

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

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