

2008 BCSECCOM 510

August 8, 2008

Headnote

Mutual Reliance Review System for Exemptive Relief Applications

National Instrument 44-101 *Short Form Prospectus Distributions*, s. 8.1 – qualification criteria - Qualification - An issuer wants relief from the qualification criteria in NI 44-101 so it can file a short form prospectus - The issuer is a UK company regulated by the FSA; the issuer wishes to offer novel securities to retail investors in Canada under a short form shelf prospectus; the prospectus will contain supplementary disclosure in accordance with NI 41-101 *General Prospectus Requirements*; the securities will be offered through a Canadian registered dealer; the issuer will comply with NI 51-102 *Continuous Disclosure Obligations* and incorporate by reference in its base shelf prospectus the documents required to be incorporated under Form 44-101F1

National Instrument 41-101 *General Prospectus Requirements*, s. 19.1 – approved rating requirement for non-fixed price offering - Pricing – An issuer wants relief from the requirement in s. 7.2(2) to obtain a rating from an approved rating organization for a non-fixed price offering - The issuer is a UK company regulated by the FSA; the issuer wishes to offer novel securities to retail investors in Canada using a short form prospectus under NI 44-101 *Short Form Prospectus Offerings*, which will contain supplementary disclosure in accordance with NI 41-101; the securities cannot be offered at a fixed price, and no approved rating organization provides a rating for the securities; the value of the security depends on the covenant of the issuer to pay the amount payable under the security; the issuer is required under FSA rules to maintain required regulatory capital

Applicable British Columbia Provisions

NI 44-101, ss. 2.2(b), 2.2(e) and 8.1

NI 41-101, ss. 7.2(2) and 19.1

In the Matter of
the Securities Legislation of
British Columbia, Saskatchewan, Manitoba,
Ontario, New Brunswick, Nova Scotia, Prince Edward Island,
Newfoundland and Labrador, Northwest Territories and Nunavut Territory
(the Jurisdictions)

and

In the Matter of
the Mutual Reliance Review System for Exemptive Relief Applications

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and

In the Matter of
CMC Markets UK plc
(the Filer)

MRRS Decision Document

Background

The local securities regulatory authority or regulator (the Decision Maker) in each of the Jurisdictions has received an application from the Filer for a decision under the securities legislation of the Jurisdictions (the Legislation) that

1. the requirement under section 2.2(b) of National Instrument 44-101 *Short Form Prospectus Distributions* (NI 44-101) that the Filer be a reporting issuer in at least one Jurisdiction and the requirement under section 2.2(e) of NI 44-101 that the Filer have its equity securities listed and posted for trading on a short form eligible exchange (collectively, the Qualification Requirement); and
2. the requirement under section 7.2(2) of National Instrument 41-101 *General Prospectus Requirements* (NI 41-101) that the Filer obtain a rating, on a provisional or final basis from at least one approved rating organization for a non-fixed priced offering (the Non-Fixed Price Offering Requirement);

shall not apply to the Filer in connection with its proposed offering of contracts for differences (CFDs) in Canada (the Offering) by way of Shelf Prospectus (as described below) (the Requested Relief).

Under the Mutual Reliance Review System for Exemptive Relief Applications

- (a) the Ontario Securities Commission is the principal regulator for this application, and
- (b) this MRRS decision document evidences the decision of each Decision Maker.

Interpretation

Defined terms contained in National Instrument 14-101 *Definitions* have the same meaning in this decision unless they are defined in this decision.

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Representations

This decision is based on the following facts represented by the Filer:

The Filer

1. The Filer is a company organized under the laws of England and Wales with its principal offices in London, United Kingdom. Founded in 1989, the Filer is an established international on-line trading company which, with its affiliates, offers CFDs to a broad range of investors in many countries.
2. The Filer is a privately held company, controlled indirectly by its principal founder, Mr. Peter Cruddas and members of his family. CMC Markets Plc is the ultimate parent company of the Filer.
3. The Filer and its affiliates (CMC Markets) have offices that offer CFDs in 12 countries including the United Kingdom, Australia, Austria, Canada, China, Germany, Hong Kong, Ireland, Japan, New Zealand, Sweden and Singapore (with 23 global offices and in excess of 1000 staff). CMC Markets handled over 20.1 million trades during the period from March 31, 2007 to March 31, 2008 (the Filer's most recently completed financial year) with the trades executed having a total value of over US\$1.4 trillion.
4. The Filer is not currently a reporting issuer in any Jurisdiction. If the Requested Relief is granted, the Filer will become a reporting issuer in each of the Jurisdictions upon the issuance of a receipt for the final Base Shelf Prospectus (as described below) and will become subject to the continuous disclosure obligations and other requirements under the Legislation.
5. None of the Filer or any of its affiliates has any securities listed or quoted on an exchange or marketplace in any jurisdiction inside or outside of Canada.

CMC Canada

6. The Filer has established a Canadian dealer affiliate, CMC Markets Canada Inc. (CMC Canada), to act as a dealer for CFDs issued by the Filer to Canadian investors. The ultimate parent company of CMC Canada is CMC Markets Plc and is therefore an affiliate of the Filer. CMC Canada is a corporation amalgamated under the laws of Canada with its principal office in Toronto, Ontario.
7. The Filer currently offers CFDs to "accredited investors" (as defined in National Instrument 45-106 *Prospectus and Registration Exemptions*) (NI 45-

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106) in Canada on a private placement basis through CMC Canada as dealer and predominantly through the Filer's Marketmaker® on-line trading platform. The Filer's on-line trading platform software can be downloaded from <http://www.cmcmarkets.com>.

8. The Filer is not, to the best of its knowledge, in default of any requirements of the Legislation, including requirements relating to the filing of forms and payment of fees relating to the distribution of securities in reliance on the accredited investor exemption in NI 45-106.
9. The Filer is proposing to offer CFDs to investors, including retail investors, by way of a Base Shelf Prospectus (as described below) and is seeking the Requested Relief in connection with the Offering.
10. In connection with the proposed Offering, CMC Canada has applied for membership with the Decision Makers in each the Jurisdictions to become registered as a dealer in the category of "investment dealer". CMC Canada is currently registered as an investment dealer with the Ontario Securities Commission, British Columbia Securities Commission and Autorité des marchés financiers. Prior to March 3, 2008, CMC Canada was registered in Ontario as a dealer in the category of "limited market dealer", and had operated in such capacity since April 2002.
11. Similarly, in connection with the proposed Offering, CMC Canada applied for membership with the Investment Industry Regulatory Organization of Canada (IIROC) (formerly the Investment Dealers' Association or IDA). CMC Canada's membership application was approved by the IDA Board of Directors on January 30, 2008 and became effective as of March 3, 2008 following a transition period.

Structure of CFDs

12. A CFD is a derivative product that allows investors to obtain economic exposure to the price movement of an underlying financial instrument, such as a share, index, market sector, currency, treasury or commodity, without the need for ownership and physical settlement of the underlying financial instrument.
13. CFDs issued by the Filer are distributed over-the-counter (OTC) and are not transferable.
14. CFDs do not confer ownership of the underlying financial instrument. Rather, a CFD is an agreement between the Filer and an investor to exchange the

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difference between the value of the underlying financial instrument at the opening of a position and the value of the same financial instrument at the closing of the position. These values are generally reflective of the prices at which the underlying financial instrument is traded at the time of opening and closing the position in the CFD.

15. CFDs allow investors to take a long or short position on an underlying financial instrument, but unlike futures contracts they have no fixed expiry date or standard contract size.
16. CFDs allow investors to obtain exposure to volumes, markets and instruments that may not be available directly, or may not be available in a cost-effective manner. CFDs typically have
 - (a) execution costs ranging from 0.2-0.25% (calculated on size of the position and charged on opening and closing the position and including spreads and, for certain instruments, commissions), and
 - (b) no physical settlement of the underlying financial instrument and therefore no clearing, settlement and custody charges, no stock borrowing costs for short contract positions and no stamp duty (applicable in certain foreign jurisdictions, such as the United Kingdom).

To the extent that investors are able to obtain long or short positions in an underlying financial instrument, CFDs can also serve as a tool for hedging this direct exposure.

17. The ability to lever an investment is one of the principal features of CFDs. Leverage allows investors to magnify investment returns (or losses) by reducing the initial capital outlay required to achieve the same market exposure that would be obtained by investing directly in the underlying financial instrument. CFDs offered in Canada generally employ the same degree of leverage as traditional margin accounts for long and short positions in securities. However, the degree of leverage may be increased in accordance with IIROC rules in force from time to time.
18. CFDs are currently available to retail investors without a prospectus in OTC markets in the United Kingdom, Germany, Switzerland, Singapore, Australia and New Zealand. With the implementation of the European Markets in Financial Instruments Directive in November 2007, CFDs are now considered “core” investment services and activities that registered investment firms can offer throughout Europe (via a “passport system” of securities regulation).

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CFDs Distributed in Canada

19. Certain types of CFDs may be considered to be “securities” under the Legislation.
20. CFDs issued by the Filer are currently distributed through CMC Canada to accredited investors in the Jurisdictions on a private placement basis and are therefore not qualified by a prospectus.
21. CMC Canada and the Filer wish to offer CFDs to retail investors in all of the Jurisdictions. Subject to obtaining the Requested Relief, the Filer proposes to file a short form base shelf prospectus in accordance with NI 44-101 and National Instrument 44-102 *Shelf Distributions* (NI 44-102) containing the disclosure required of a short form prospectus prepared in accordance with Form 44-101F1 but which also includes additional disclosure required for a long form prospectus prepared in accordance with NI 41-101 and Form 41-101F1 to qualify CFDs issued by the Filer for distribution to retail investors in the Jurisdictions (the Base Shelf Prospectus).
22. The Filer will file pursuant to NI 44-102 one or more shelf prospectus supplements (the Supplements) to provide full, true and plain disclosure in respect of the CFDs offered by the Filer, including a description of the underlying financial instrument(s) eligible for CFDs.
23. The Filer proposes to meet the full, true and plain disclosure requirement by the combination of disclosure in the Base Shelf Prospectus and the Supplements in a similar manner to other prospectus offerings of derivatives, including prospectus offerings of “linked notes”. The Filer intends to follow the guidance in CSA Staff Notice 44-304 *Linked Notes Distributed Under Shelf Prospectus System*.
24. The Filer anticipates that it will file a Supplement for each type of CFD that IIROC has approved for distribution by CMC Canada to Canadian clients. Accordingly, the Filer intends to initially file a prospectus supplement for CFDs in respect of each of the following underlying instruments:
 - shares (Share CFDs) and other listed securities including exchange traded funds (ETF CFDs);
 - indices (Index CFDs);
 - commodities such as metals, oil, gas and others (Commodity CFDs);

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- treasuries (Treasury CFDs); and
- foreign exchange (FX CFDs).

The Filer has agreed that, notwithstanding the issuance of a final receipt for the Base Shelf Prospectus, it will pre-clear with the Decision Makers each of the initial Supplements described above.

Satisfaction of the registration requirement

25. Investors wishing to purchase CFDs must open an account with CMC Canada and complete a principal contract with CMC UK.
26. Investor's will purchase CFDs through the Filer's "MarketMaker" on-line trading platform. The Filer's on-line platform is similar to those developed for on-line brokerages and day-trading in that the investor trades without other communication with, or advice from, the dealer. The Filer's on-line trading platform is not a "marketplace" as defined in National Instrument 21-101 *Marketplace Operation* since a marketplace is any facility that brings together multiple buyers and sellers by matching orders in fungible contracts in an on-discretionary manner. The Filer's on-line trading platform does not bring together multiple buyers and sellers rather it is a market maker that quotes the buy and sell price of a CFD offered by the Filer to the investor.
27. The role of CMC Canada will be limited to acting as an execution-only dealer, as it currently does in connection with private placements of CFDs. In connection with its role as execution-only dealer, CMC Canada will, among other things, be responsible for marketing, trade execution, administration of account opening and investor approval (including know-your-client diligence and suitability confirmations) for all Canadian clients.
28. IIROC rules exempt member firms that provide execution-only services such as discount brokerage from the obligation to determine whether each trade is suitable for the client. However, IIROC has exercised its discretion to impose additional requirements on members proposing to issue CFDs and requires that:
 - (a) Applicable risk disclosure documents and client suitability waivers provided must be in a form acceptable to IIROC.

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- (b) The firm's policies and procedures, amongst other things, must assess the depth of investment knowledge and trading experience of the client to assess whether the CFD product itself is appropriate for the client before an account is approved to be opened. IIROC has also imposed its proficiency requirements for futures trading on CMC Canada's registered salespeople, who will conduct the know your client and initial product suitability analysis, as well as their supervisory trading officer.
 - (c) The relationship and responsibilities, including conflicts of interest between the issuer and dealer, must be fully disclosed to the client and acknowledged in writing.
 - (d) Cumulative loss limits for each client's account must be established (this is a measure normally used by IIROC in connection with futures trading accounts).
29. The CFDs offered under the Base Shelf Prospectus will be offered in compliance with the leverage (margin) rates approved by IIROC. IIROC has prescribed margin limits for CFDs based on IIROC methodologies and principles as applied to existing products offered in Canada (particularly Montreal Bourse single stock futures).
30. IIROC limits the underlying instruments in respect of which member firm may issue CFDs since only certain securities are eligible for reduced margin rates. For example, underlying equity securities must be listed or quoted on certain "recognized exchanges" (as that term is defined in IIROC rules) such as TSX or the NYSE. The purpose of these limits is to ensure that CFDs offered in Canada will only be available in respect of underlying instruments that are traded in well-regulated markets, in significant enough volumes and with adequate publicly available information, so that investors can form a sufficient understanding of the exposure represented by a given CFD.
31. Unlike recognized clearing organizations that act as a central counterparty and guarantee the performance and payment obligations of contract positions to all its participants, CMC Canada has no obligations in the event of credit default by CMC UK or the investor, except to manage the flow of money between the two parties to the principal contract.
32. The CFDs offered under the Base Shelf Prospectus will be the only securities issued by the Filer that are distributed to retail investors in the Jurisdictions.

FSA regulatory regime applicable to the Filer

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33. The Filer is authorized and regulated by the Financial Services Authority (the FSA) in the United Kingdom. The Filer is currently registered as a BIPRU 730k firm with the FSA. The Filer is licensed to act as principal to its clients in the products offered and may deal with all categories of clients, including directly with retail investors. Furthermore, CMC Markets plc (the ultimate parent company of the Filer) is regulated on a consolidated basis in the UK by the FSA.
34. In order for a firm to be authorized and regulated by the FSA, the FSA must be satisfied that the firm meets certain threshold conditions prescribed by the *Financial Services and Markets Act 2000*. In similar fashion to reviews conducted by securities regulatory authorities in each of the Jurisdictions, the FSA reviews the firm's legal status, location of offices, adequacy of resources and suitability. In order to remain authorized, a registered firm must demonstrate its continuing compliance with these conditions.
35. As an FSA-regulated firm, the Filer is required to comply with certain rules of the FSA (the FSA Rules). The FSA Rules seek to ensure that regulated firms satisfy certain minimum business standards. These minimum business standards include the requirement that the Filer maintain adequate financial resources at all times, so that the Filer is able to meet its liabilities as they fall due. The FSA requires the Filer to maintain capital resources equal to or in excess of its base capital requirement plus a firm specific variable capital requirement to address market, capital and operational risks. The Filer monitors its regulatory capital on a daily basis (or more frequently depending on market conditions).
36. The FSA also requires the Filer to
- (a) file financial reports on a monthly basis with the FSA;
 - (b) immediately notify the FSA of any breach of the capital adequacy requirement; and
 - (c) submit its audited financial statements within three months of the financial year end together with an annual return and reconciliation of the annual return to the audited financial statements.
37. The Filer is required to comply with the Capital Requirements Directive (the CRD) which implemented the revised Basel Framework. CRD is based on three "pillars" which collectively provide for an overall framework for prudential supervision of banks, credit institutions and investment firms throughout Europe. Pillar 1 revises existing minimum regulatory capital

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standards for three major components of risk that investment firms face: credit, market and operational risk. The Filer is required under CRD to assess the amount of internal capital that it considers adequate to cover all of the risks to which it is, or is likely to be, exposed. CRD will require, in future, that the Filer publish key information about its underlying risks, models, controls and capital positions.

38. Although securities issued by the Filer are distributed to investors in the United Kingdom and other foreign jurisdictions, the Filer does not qualify for relief available to “designated foreign issuers” under Part 5 of National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers* (NI 71-102) as it is not subject to “foreign disclosure requirements” (as defined under NI 71-102) due to the fact that its filings with the FSA are not publicly disclosed.

Rationale for the Requested Relief

Qualification Requirement

39. The Filer has determined that the most appropriate method to qualify the proposed Offering of CFDs to retail investors is by way of a base shelf prospectus because
- (a) CFDs are in continuous distribution,
 - (b) most CFDs are of short duration (positions are generally opened and closed on the same day and are in any event marked to market and cash settled daily), and
 - (c) there are frequent changes to the array of available underlying financial instruments.
40. The Filer could become a reporting issuer in one of the Jurisdictions by filing a non-offering long form prospectus or applying to be deemed a reporting issuer and would therefore not require the Qualification Relief requested in respect of section 2.2(b) of NI 44-101. However, given the need for Qualification Relief in respect of section 2.2(e) of NI 44-101 in order for the Filer to qualify to distribute securities under a short form prospectus and the fact that any disclosure provided in a non-offering prospectus or in connection with an application to become a reporting issuer would be repeated in the short form prospectus utilized by the Filer to qualify the distribution of CFDs, it would be unnecessarily burdensome to require the Filer to file a non-offering

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long form prospectus or otherwise become a reporting issuer in one of the Jurisdictions immediately prior to filing its short form prospectus.

41. The Filer submits that providing the disclosure contained in a short form prospectus prepared in accordance with Form 44-101F1 which includes the additional disclosure required for a long form prospectus, as applicable to the Offering, prepared in accordance with NI 41-101 and Form 41-101F1 and filing such prospectus as a short form base shelf prospectus in accordance with NI 44-101 and NI 44-102, would be an effective and efficient means of qualifying CFDs for distribution in the Jurisdictions.

Non-Fixed Price Offering Requirement

42. Due to the nature of CFDs, the price at which a CFD will be offered to investors will be reflective of the market price of the underlying financial instrument at the time of opening and closing positions, and CFDs cannot be offered at a fixed price. To the best of the Filer's knowledge, no approved rating organizations provide ratings for CFDs. The Filer is therefore unable to comply with the requirement under section 7.2(1) of NI 41-101 to distribute securities under a prospectus at a fixed price and is unable to rely on the exemption from the fixed price requirement under section 7.2(2) of NI 41-101.
43. The Filer submits that due to the nature of CFDs it would not be in the public interest to require that CFDs receive a rating from an approved rating organization. Such ratings are generally provided to give investors an indication of an issuer's ability to sustain interest, dividend or other distributions linked to the issue price of a security. In contrast CFDs are not issued with any promise or projection of a fixed return that is correlated with their issue price. The return on CFDs is correlated with the price movement of an underlying financial instrument over which the Filer, as the issuer of CFDs, exerts no control or influence. The value of the CFD depends on the covenant of the Filer, as issuer, to pay the amount, if any, payable under the CFD. The Filer would be required under the FSA Rules to cease issuing CFDs if the Filer fails to maintain adequate financial resources at all times. As discussed above, under the current FSA Rules, the Filer is required to maintain at all times capital resources equal to or in excess of its base capital requirement plus a firm specific variable capital requirement to address market, capital and operational risks (the Required Regulatory Capital). The Filer monitors its Required Regulatory Capital on a daily basis (or more frequently depending on market conditions). The Filer submits that due to the regulatory oversight imposed by the FSA, its financial position is constantly reviewed in a manner which should provide sufficient comfort to the Decision Makers and Canadian retail investors.

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44. Based on the foregoing and in the absence of any ratings by approved rating organizations for CFDs, it should not be prejudicial to the public interest to provide the requested relief from the Non-Fixed Price Offering Requirement.

Decision

Each of the Decision Makers is satisfied that the test contained in the Legislation that provides the Decision Maker with the jurisdiction to make the decision has been met.

The Decision of the Decision Makers under the Legislation is that the Requested Relief is granted provided that

- (a) the Filer creates a filer profile on SEDAR (as defined in National Instrument 13-101 – *System for Electronic Document Analysis and Retrieval* (NI 13-101)), and takes any other steps required to become an electronic filer under NI 13-101;
- (b) the preliminary Base Shelf Prospectus and the final Base Shelf Prospectus are prepared in accordance with the Legislation, including the short form prospectus requirements of NI 44-101 and the requirements set out in Form 44-101F1; the shelf prospectus requirements of NI 44-102 and the disclosure required for a long form prospectus prepared in accordance with NI 41-101 and the requirements set out in Form 41-101F1, as applicable, except as otherwise permitted by the securities regulatory authorities in each of the Jurisdictions;
- (c) the preliminary Base Shelf Prospectus and final Base Shelf Prospectus will include the audited annual financial statements and unaudited interim financial statements required to be included in a long form prospectus pursuant to Part 4 of NI 41-101 and Item 32 of Form 41-101F1;
- (d) the Filer files a certificate dated as of the date of the preliminary Base Shelf Prospectus, executed on behalf of the Filer by one of its executive officers, certifying that (a) the Filer has satisfied the criteria set out in s. 2.2(a) of NI 44-101, (b) the Filer is not a reporting issuer in any Jurisdiction and therefore is not required to file any periodic and timely disclosure documents, (c) the Filer has relied on the exemption from the criteria set out in s. 2.2(d) of NI 44-101, and (d) the Filer is exempt from the criteria set out in ss. 2.2(b) and (e) of NI 44-101 pursuant to the Decision of the Decision Makers;

and for so long as,

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- (e) the Filer complies with National Instrument 51-102 *Continuous Disclosure Obligations* and incorporates by reference into the Base Shelf Prospectus, by means of a statement to that effect, the documents set forth in item 11 of Form 44-101F1.

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