Canadian Securities Administrators

CSA Consultation Paper 91-407

Derivatives: Registration

Canadian Securities Administrators Derivatives Committee
April 18, 2013

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CSA Consultation Paper 91-407 – Derivatives: *Registration*

On November 2, 2010, the Canadian Securities Administrators ("CSA") Derivatives Committee published Consultation Paper 91-401 – *Over-the-Counter Derivatives Regulation in Canada* ("Consultation Paper 91-401").[1] That consultation paper set out high-level proposals for the regulation of over-the-counter derivatives. The Committee sought input from the public with respect to the proposals and eighteen comment letters were received from interested parties.

The Committee has continued to contribute to and follow international regulatory proposals and legislative developments, and collaborate with the Bank of Canada, the Office of the Superintendent of Financial Institutions, the Department of Finance Canada, market participants, as well as bodies such as the International Organization of Securities Commissions, the Financial Stability Board and the Over-the-Counter Derivatives Regulators' Forum. This public consultation paper is one in a series of eight papers that build on the regulatory proposals contained in Consultation Paper 91-401. It proposes a framework for the regulation of key derivatives market participants through a registration regime. It is hoped that this paper will generate necessary commentary and debate that will assist members of the CSA in selecting appropriate policies and rules that will be implemented in Canada.

The Committee continues to work with foreign regulators to develop international standards that will shape the rules that we develop, including those regarding CCP clearing. Although a significant market in Canada, the Canadian OTC derivatives market comprises a relatively small share of the global market, with a substantial portion of transactions involving Canadian market participants transacting with foreign counterparties. It is therefore crucial that rules be developed for the Canadian market that ensure that Canadian market participants have access to international markets and are regulated in accordance with international principles. The Committee will continue to monitor and contribute to the development of international standards.

[1] Report available on various CSA websites including:
http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/91-401/3672026-v1-CSA_Consultation_Paper_91-401.pdf
http://www.bcsc.bc.ca/uploadedFiles/securitieslaw/policy9/94-101_Consultation_Paper.pdf
http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa_20101102_91-401_cp-on-derivatives.pdf
http://www.lautorite.qc.ca/files//pdf/consultations/derives/2010nov02-91-401-doc-consultation-en.pdf

Executive Summary

This paper provides an overview of the Committee's proposal for the regulation of key derivatives market participants through the implementation of a registration regime.

Background

In developing this paper, the Committee considered rules and proposals specific to the regulation of key derivatives market participants in a number of foreign jurisdictions, particularly the United States ("U.S.") and Europe. In addition, the Committee considered the existing CSA registration regime for securities as well as existing regulatory requirements applicable to derivatives market participants in each CSA jurisdiction.

Categories of Registration

The registration regime would have three distinct registration categories: derivatives dealers, derivatives advisers and large derivative participants.

Derivatives Dealer

Persons carrying on the business of trading in derivatives or holding themselves out to be carrying on that business will be required to be registered as derivatives dealers in each Canadian province and territory where they conduct derivatives trading business.

Derivatives Adviser

Persons carrying on the business of advising others in relation to derivatives, or who hold themselves out to be in that business in any Canadian jurisdiction, will be required to be registered as a derivatives adviser in each Canadian province and territory where they conduct derivatives advising business.

Large Derivative Participant

Large derivative participants ("LDPs") would be required to register in this third category. Large derivatives participants will include entities, other than derivatives dealers, that have a substantial aggregate derivatives exposure. The Committee recommends that additional analysis be completed to establish registration thresholds for LDPs that are appropriate for Canadian financial markets.

For each of the above registration categories, the Committee recommends that an individual would register where the individual is:

- the ultimate designated person, chief compliance officer or chief risk officer of the registrant;
- involved in providing clients with advice relating to derivatives;
- involved in providing trading services to clients as an intermediary to a trade; or
- involved in a trade with a counterparty that is a non-qualified party[2] that is not represented by an independent derivatives adviser.[3]

The Committee recommends that individual registration requirements apply to both frontline staff that deal with clients and persons who manage or supervise such staff.

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[2] The term "non-qualified party" is defined in the introductory section of Part 6 of this paper.

[3] A discussion of the proposals on the regulation of transactions involving a derivatives dealer and a counterparty that is a non-qualified party are set out in part 7.2(b)(ii) of this paper.

Registration Requirements

The Committee recommends that all registrants be subject to the following registration requirements:

a) Proficiency – all individuals who are directors, partners, officers, employees or agents of a derivatives registrant who are involved in trading in or advising on derivatives should be subject to minimum proficiency requirements.

b) Financial and Solvency – all registrants should be subject to financial and solvency requirements, including the following:

- minimum Capital Requirements;
- margin Requirements;
- insurance Requirements; and
- maintenance of Financial Records and Periodic Financial Reporting.

c) Compliance Systems and Internal Business Conduct – all registrants should have adequate systems in place to ensure compliance with regulatory requirements and manage risks relating to derivatives positions.

d) Honest Dealing – all registrants should have an obligation to act honestly and in good faith when trading in or advising on derivatives.

e) Holding Client/Counterparty Assets - obligations relating to the care of collateral posted by clients or counterparties have been or will be addressed in other consultation papers issued by the Committee.[4]

Derivatives dealers and derivatives advisers will also be subject to the following additional registration requirements:

a) Gatekeeper – derivatives dealers and advisers should obtain sufficient information relating to their clients and, in the case of derivatives dealers, their counterparties, to allow them to act as a gatekeeper with the objective of ensuring market integrity and allowing the dealer to assess its counterparty risks.

b) Business Conduct – derivatives advisers and derivatives dealers advising or trading for clients should be subject to additional registration requirements. These requirements include:

- know your client/counterparties obligations;
- suitability obligations;
- conflict of interest identification and management; and
- fair dealing obligations.

The Committee is considering two alternatives for the regulation of derivatives dealers trading as principal with non-qualified parties:

[4] Consultation Paper 91-404 - *Derivatives: Segregation and Portability in OTC Derivatives Clearing* outlines the Committee's proposals relating to collateral posted in relation to trades cleared through a central counterparty. Proposed obligations applicable to posted collateral relating to bilaterally cleared trades will be described in a future consultation paper.

- that the non-qualified party obtain advice from an independent derivatives adviser before trading; or
- that the derivatives dealer inform the counterparty of a conflict of interest and provide details of the conflict in writing and advise the counterparty that it has the right to obtain independent advice. With this alternative, the derivatives dealer would be subject to the market conduct requirements described above.

Derivatives dealers trading for a client or trading as principal with a non-qualified party that is not represented by an independent derivatives adviser would be subject to the following additional requirements:

a) Pre-trade Reports - provide a pre-trade report to allow the client or counterparty to understand the terms of the proposed trade and the costs that it will incur to execute the trade.

b) Trade Confirmations – provide a confirmation of each trade describing the principal financial terms of the client or counterparty's trade.

c) Account Statements - deliver regular statements describing the client or counterparty's positions relating to trades executed with the derivatives dealer or on their behalf by the derivatives dealer.

Exemptions based on Equivalent Regulation

Registrants may be exempted from certain registration requirements in the following circumstances:

a) Regulated Persons – persons triggering registration as a derivatives dealer, a derivatives adviser or large derivatives participants who are subject to equivalent regulatory requirements that are appropriately monitored and enforced by an acceptable regulator in Canada, should be exempted from redundant registration requirements.

b) Foreign Derivatives Dealers and Advisers – foreign derivatives advisers and derivatives dealers should be exempted from specific regulatory requirements in Canada where they are subject to equivalent requirements in their home jurisdictions. These entities will be required to register in each Canadian jurisdiction where they carry on business.

c) Foreign LDPs – foreign entities triggering the obligation to register as a LDP should be required to register in each jurisdiction where their trading obligations exceed the prescribed thresholds; however, these entities should be exempted from specific registration requirements where they are subject to equivalent regulatory requirements in their home jurisdictions. These entities will be required to register in each Canadian jurisdiction where they carry on business.

Exemptions from Registration

The Committee recommends that the following parties be exempted from the requirement to register:

a) Dealers Providing Advice – a person registered as a derivatives dealer should be exempted from the obligation to register as a derivatives adviser when providing advice, where the provision of such advice is incidental to trading services.

b) Governments – Canadian federal, provincial and municipal governments should not be subject to an obligation to register or be subject to registration requirements in any circumstances. Federal and provincial crown corporations whose obligations are guaranteed by the federal and provincial government will not be required to register or be subject to registration requirements only when dealing with qualified parties and not intermediating any trades for clients.

c) Clearing Agencies – where a clearing agency has been recognized (or exempted from recognition) it should not be subject to a requirement to register as a derivatives dealer, derivatives adviser or a LDP where the obligation to register results solely from carrying on the ordinary business as a clearing agency.

d) Transactions with Affiliated Entities – persons that would be subject to registration as either a derivatives dealer or a derivatives adviser solely as a result of trading with or on behalf of or providing derivatives-related advice to a person that is their affiliate should be exempt from the requirement to register as a derivatives dealer or adviser.

Comments and Submissions

The Committee invites participants to provide input on the issues outlined in this public consultation paper. You may provide written comments in hard copy or electronic form. The comment period expires June 17, 2013.

The Committee will publish all responses received on the websites of the Autorité des marchés financiers (www.lautorite.qc.ca) and the Ontario Securities Commission (www.osc.gov.on.ca).

Please address your comments to each of the following:

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission

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

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1. Introduction

In Consultation Paper 91-401 the Committee outlined its proposals relating to the regulation of over-the-counter ("OTC") derivatives in Canada, including proposals to impose obligations on certain participants in the OTC derivatives market. To implement those regulatory proposals the Committee believes that it is necessary to impose registration requirements on key derivatives market participants (including participants that represent significant risks to the market because of their derivatives exposure and persons in the business of trading in derivatives or providing advice in relation to derivatives). These requirements, to the degree practical, should be harmonized across all CSA jurisdictions and impose requirements that will not result in an unnecessary regulatory burden.

The Committee believes that derivatives registrants should be subject to a number of regulatory requirements, including requirements relating to capital and collateral, reporting, internal controls, risk management and interactions with counterparties and clients[5]. These requirements are intended to:

- protect participants in the derivatives markets from unfair, improper and fraudulent practices;
- protect the soundness of our financial markets by ensuring that key market participants manage risks relating to their participation in derivatives markets, including counterparty risk;
- impose specific requirements on registrants when trading with counterparties and trading on behalf of clients; and
- reduce risks, including systemic risks, resulting from the derivatives activities of key market participants.

This consultation paper will outline the Committee's proposals relating to:

- the categories of registration for key derivative market participants;
- the type of activities that would trigger registration;
- the requirements that will apply to derivatives registrants; and
- exemptions from registration and registration requirements, including exemptions for entities that are subject to a regulatory regime that is comparable to the regime established by the CSA.

This Committee recommends that there be three categories of registration: derivatives dealers (entities or persons in the business of trading derivatives), derivatives advisers (entities or persons in the business of advising on derivatives) and large derivatives participants. Additional discussion relating to the types of activities that will trigger registration for each registrant category is set out in Part 6 of this paper.

While this paper discusses minimum registration requirements for each category of registration that will apply to all derivatives dealers, derivatives advisers and large derivatives participants, the Committee recommends that, where appropriate, the CSA consider relying on third-party regulators to carry out some or all of the regulatory functions. These regulators could include foreign regulators, regulating the registrant in its home jurisdiction, prudential regulators, including those responsible for regulating financial institutions in Canada, and self-regulatory

[5] The terms "client" and "counterparty" are used throughout this paper. A client will include any person or entity to which: (i) a registrant provides services, as an intermediary, in relation to derivatives trading; or (ii) a registrant provides advice in relation to derivatives. A counterparty will be a person or entity that is entering into a derivatives trade with a registrant. In many cases the same person could be both a client in relation to one transaction with a registrant and a counterparty to that same registrant in separate transactions.

organizations. Additional discussion regarding the provision of exemptions from compliance with registration requirements where alternative regulation regimes are in place is included in part 5.2 of this paper.

2. Background

In September 2009, Canada and other members of the G20 called for the improvement of the global financial market and committed themselves to reforming OTC derivatives markets and improving oversight of those markets. These reforms included specific commitments to improve transparency, mitigate systemic risk, and protect against market abuse.[6]

On November 2, 2010 the Committee published for comment Consultation Paper 91-401. Consultation Paper 91-401 outlined the Committee's high-level proposals relating to the regulation of OTC derivatives, including proposal relating to clearing, trade reporting, electronic trading, capital and collateral and end-user exemptions. Eighteen comment letters were received from interested parties.

Since the publication of Consultation Paper 91-401 and the receipt of the comment letters relating to that paper, the Committee has developed a plan to implement the regulatory framework proposed in that paper and has published five consultation papers.[7] This paper provides an overview of the Committee's proposal for the regulation of key derivatives market participants through the implementation of a registration regime. Requirements to report derivatives trades to a trade repository, clear derivatives trades utilizing a central counterparty or to execute derivatives trades on an electronic trading platform have been or will be described in other consultation papers issued by the Committee.

3. Foreign Regulation

3.1 United States Approach

The Dodd-Frank Wall Street Reform and Consumer Protection Act [8]("Dodd-Frank Act") requires both the U.S. Commodity Futures Trading Commission ("CFTC") and the U.S. Securities and Exchange Commission ("SEC") to make rules providing for the registration of certain derivatives market participants. The SEC rules provide for the registration of security-based swap dealers and security-based major swap participants. The CFTC rules provide for the registration of swap dealers and major swap participants.

The U.S. *Commodities Exchange Act*[9] establishes requirements relating to the registration of futures, commodity option and retail foreign exchange intermediaries. The CFTC has finalized additional rules requiring the registration of swap dealers and major swap participants.[10]

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[6] "Leaders' Statement: The Pittsburgh Summit" (September 24-25, 2009) available at http://www.g20.org/pub_communiques.aspx

[7] The Committee's published consultation papers deal with trade repositories, surveillance and enforcement, end-user exemptions, segregation and portability of collateral and central counterparty clearing.

[8] *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub.L.III-203, H.R. 4173, sec. 721(a)(47), online: http://frwebgate.access.gpo.gov/cgibin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4173enr.txt.pdf.

[9] U.S. *Commodities Exchange Act*, 7 UFC.Chapter 1, online: http://www.law.cornell.edu/uscode/text/7/chapter-1.

[10] The terms Swap Dealer and Major Swap Participant are defined in the regulations to the Dodd-Frank Act at 17 CFR 240, Release No. 34-66868, File No. S7-39-10 – Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant." dated May 23, 2012.

The CFTC's definition a "swap dealer" includes any person who:

- holds itself out as a dealer in swaps;
- makes a market in swaps;
- regularly enters into swaps in the ordinary course of business, for its own account; or
- engages in any activity causing it to be commonly known in the trade as a dealer or market-maker of swaps.

In addition, the CFTC indicates that '(T)he statutory definitions provide exceptions for a person that enters into swaps or security-based swaps for the person's own account, either individually or in a fiduciary capacity, but not as part of a "regular business."'.

The Dodd-Frank Act provides an exemption from dealer registration for persons who engage in a *de minimis* quantity of swap dealing activity with or on behalf of customers.[11] The CFTC has adopted rules to implement this exemption as an element of the swap dealer definition.[12] To qualify for the CFTC's exemption , an entity's aggregate gross notional exposure resulting from swaps entered into in connection with its dealing activity, over the previous twelve months (excluding exposure resulting from non-dealing activity such as transaction entered into by the entity to hedge its own business risks) can not exceed: (i) for all customers U.S. $3 billion (subject to a phase in level of $8 billion), and (ii) for its customers that are "special entities"[13] U.S. $25 million. [14]

The CFTC defines a "major swap participant" as a person, who is not a swap dealer and:

- that maintains a substantial position in any major category of swaps excluding (i) positions held to "hedge or mitigate commercial risk", and (ii) positions held by a "employee benefit plan" for the purposes of hedging risks directly associated with the operation of the plan;
- whose outstanding swaps create "substantial counterparty exposure" that could have serious adverse affects on the financial stability of the U.S. banking system or financial markets; or
- that is a "financial entity" that holds a substantial position in a major category of swaps, is highly leveraged when compared to the amount of capital it holds, and is not subject to capital requirements by a federal banking agency.

Swap dealers and major swap participants (together referred to as "swap registrants") will be subject to requirements, including:

- where the entity is not subject to prudential regulation by a federal banking regulator, requirements relating to capital adequacy, including margin requirements;

[11] In this part 3.1, "customers" references the term used in U.S. regulatory requirements. It is not equivalent to the term "client" described in footnote 5 of this paper.

[12] Federal Register / Vol. 77, No. 100 / Wednesday, May 23, 2012/Rules and Regulations, pp. 30626 to 30643.

[13] The term "special entities" includes entities such as federal, state or local governments or corporations owned by those governments, endowments and employee benefit plans.

[14] CFTC Regulation Sec. 1.3(ggg)(4).

- requirements relating to risk management including a requirement to establish and maintain a robust risk management process in relation to all of the firm's swap related activities;
- swap documentation requirements, including requirements to deliver trade confirmation to counterparties that are not swap registrants, conduct portfolio reconciliations and terminate offsetting swaps;
- record keeping and reporting requirements, including requirements to keep complete records in relation to each swap transaction and all swap positions held by the registrant;
- requirements to supervise all activities relating to its swap business;
- requirements to adopt and implement procedures to identify and manage conflicts of interest;
- requirements to provide access to records and information relating to its swap trading activity to the CFTC and prudential regulators; and
- business conduct standards applicable when dealing with counterparties that are US persons or non-US persons whose obligations are guaranteed by US persons, including:
    - preventing material confidential information about a counterparty from being misused;
    - making disclosure of material information to counterparties, other than other swap registrants. This information includes:
        - information to allow the counterparty to assess the material risks and characteristics of the swap and the incentives and conflicts of interest that the swap registrant may have relating to execution of the swap with that counterparty;
        - scenario analysis using a range of assumptions, including extreme downward stress scenarios, to allow the counterparty to assess its potential exposures with respect to the swap; and
        - provide counterparties a daily mark of the swap trades that are not centrally cleared;
    - communicating with the counterparty in a fair and balanced manner in accordance with the principles of fair dealing and good faith; and
    - advising a counterparty of its right to clear a swap that is not subject to mandated clearing and its right to select a derivatives clearing organization;

In addition to the requirements applicable to all swap registrants, swap dealers will be subject to:

- requirements to obtain sufficient facts relating to its counterparty to allow it to identify its counterparty and the persons controlling that counterparty and allow it to implement credit and operation risk management policies for transactions with that counterparty; and
- a requirement that a swap dealer use reasonable diligence to understand the risks and benefits of a proposed swap and to ensure that the swap is suitable for the counterparty to which it is providing advice related to derivatives trading.[15]

[15] These requirements are set out in a number of CFTC rules, particularly 17 CFR, Parts 1, 3, 4, and 23.

Under existing CFTC rules, swap dealers and major swap participants are required to become members of a registered futures association.[16] The National Futures Association ("NFA") is the registered futures association for swap dealers and major swap participants. Under NFA rules, intermediaries in the derivatives market are subject to a variety of requirements including:

- proficiency requirements;
- financial requirements, including prudential regulation;
- market integrity requirements;
- requirements relating to obligations owed to customers; and
- requirements to maintain risk management and compliance systems.

The SEC is proposing new rules under the U.S. *Securities Exchange Act of 1934*[17] that will require the registration of two new categories of entities, securities-based swap dealers ("SBS dealers") and major security-based swap participants ("major SBS participants" and together with SBS dealers "SBS entities").[18]

Under the SEC proposal SBS dealers that enter into security-based swaps with persons that do not qualify as "eligible contract participants"[19] must also be registered as broker-dealers, unless otherwise exempt from that requirement.

Key requirements applicable to all SBS entities under the proposed SEC registration regime obligations:

- to disclose material risks and characteristics of a securities-based swap to all counterparties[20] that are not registered as SBS entities before entering into the swap;
- to disclose material incentives and conflicts of interest that the SBS entity may have in relation to the swap before entering into the swap;
- to provide a daily mark of the security-based swap;[21]
- to disclose to its counterparties:
    - the clearing agencies to which the SBS entity is a clearing member; and
    - that the SBS entity has the sole right to select the clearing agency that will clear the swap, provided that the SBS entity is permitted to clear through that clearing agency;
- to communicate in a fair and balanced manner based on the principles of fair dealing;
- to know-their-counterparty so that the SBS entity can comply with applicable requirements, understand the risks they face in relation to the counterparty and ensure the authority of the person acting on behalf of the counterparty;

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[16] The requirement is in CFTC Regulation 170.16.

[17] The proposed new SEC Rules are Rules 15Fb1-1 through 15Fb6-1.

[18] 17 CFR Part 240 and 249, Release No. 34-65543; File No. S7-40-11 – Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, dated October 12, 2011.

[19] "Eligible Contract Participant is defined in the U.S. *Commodities Exchange Act* and includes a variety of parties including individual who has amounts invested on a discretionary basis, in excess of $10 million (or $5,000,000 if contracting to manage risks) and corporations with at least $10 million in assets or $1 million in net worth if contracting for risk management purposes.

[20] This disclosure does not appear to be the equivalent of prospectus disclosure under US requirements.

[21] This will not apply where the counterparty is an SBS or a swap registrant.

- when making a recommendation to a proposed counterparty (including a communication that may reasonably influence a decision to enter into a transaction) to ensure that the swap is suitable for that counterparty;
- to communicate with counterparties in a fair and balanced manner to provide the counterparty with a sound basis for evaluating the facts relating to a swap;
- to maintain and enforce systems to appropriately supervise their business involving security-based swaps; and
- to act in the best interest of a special entity such as a federal or state agency, and employee benefit plan or an endowment when advising such an entity on security-based swaps.[22]

3.2 European Union Approach

The European Union's Markets in Financial Instruments Directive ("MiFID")[23] provides for the regulation of investment firms trading, either as an agent or as a principal, or advising in relation to a wide range of derivatives.

The term "investment firm" is defined in MiFID as "… any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis".[24]

Investment services and activities include:

- execution of orders on behalf of clients;[25]
- dealing on their own account;
- portfolio management; and
- investment advice.

Investment firms operating in Europe are subject to a wide variety of requirements including those relating to:

- member state supervision;
- management of conflict of interests;
- obligations when providing services to clients, including the obligation to act in a client's best interest;
- market integrity requirements;
- a requirement to maintain compliance and risk management systems;
- record keeping obligations; and
- management of client assets they hold.

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[22] 17 CFR 240, Release No. 34-64766, File No. 87-25-11 – Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, dated June 29, 2011.

[23] Directive 2004/39/EC of the European Parliament and of the Council, of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC – http://ec.europa.eu/internal_market/securities/isd/mifid_en.htm

[24] MiFID Level 1 Directive, Article 4.

[25] The reference to "clients" in this part 3.2 references the term used in European regulatory requirements rather than term described in footnote 5 of this paper.

MiFID does provide exemptions from specific regulatory obligations when an investment firm conducts a transaction with an eligible counterparty.[26] In particular, an investment firm that transacts with eligible counterparties will be exempt from specific requirements relating to:

- acting honestly, fairly and professionally in accordance with the best interests of the client;
- providing fair, clear and non-misleading information about the investment firm, its services, investment strategies and costs;
- the assessment of suitability and appropriateness of financial instruments for the client;
- the duty to report on services provided and costs associated with these services; and
- the obligation to execute orders on terms most favourable to the client.

The proposed revisions to MiFID[27] ("MiFID II"), when implemented in 2014, will reduce the scope of exemptions applicable to investment firms when dealing with eligible counterparties. As a result of the proposed changes investment firms will be subject to:

- the obligation to act honestly, fairly and professionally and the obligation to be fair, clear and not misleading will apply even where counterparties are eligible counterparties;
- the requirement to provide eligible counterparties with information about the investment firm, its services, investment strategies and costs; and
- the requirement to report to eligible counterparties on services provided and costs associated with transactions and services.

4. IOSCO Standards

In June 2012, the Technical Committee of the International Organization of Securities Commissions ("IOSCO") released its final report relating to the regulation of derivative market intermediaries (DMIs")[28]. This report provides recommendations on:

- registration standards related to derivatives activity;
- capital standards and other financial resource requirements;
- business conduct standards related to derivatives activity;
- supervision standards for derivatives activities; and
- standards relating to recordkeeping in relation to derivatives activities.

4.1 Registration Standards

IOSCO's report recommends that DMIs should generally include persons in the business of dealing in derivatives, making a market in derivatives or intermediating derivatives transactions. The report recommends that DMIs should be subject to registration or licensing and substantive regulations. DMIs should not include end-users and other persons entering into derivatives transactions but that are not

[26] MiFID Level 1 Directive, Article 24.

[27] Proposal for a Directive of the European Parliament and of the Council on Market in Financial Instruments repealing Directive 2004/39/EC of the European Parliament and of the Council - http://ec.europa.eu/internal_market/securities/isd/mifid_en.htm.

[28] Internal Standards for Derivatives Market Intermediary Regulation, Final Report, Technical Committee of the International Organization of Securities Commissions, FR03/12 June 2012, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD381.pdf

engaged in the business of dealing, making a market or intermediating trades. The recommendations in the report are limited to the regulation of intermediaries and are not intended to address the regulation of participants in the derivatives market that, through their derivatives exposures, represent a systemic risk to derivatives markets or economies.

4.2 Capital and Financial Standards

The report recommends the adoption of adequate capital standards applicable to DMIs to protect against insolvency by addressing risks that the intermediaries' liabilities exceed the realizable value of their assets. These standards may include both minimum capital requirements as well as margin requirements. The report acknowledges that some entities are currently subject to appropriate prudential regulation requirements and therefore do not need to be subject to capital standards established by market regulators.

4.3 Business Conduct Standards

The report recommends the adoption of business conduct standards to prevent improper behaviour and foster confidence in derivatives markets. These would require intermediaries to observe high standards of integrity and fair dealing. The report recommends that appropriate regulatory protections must be established for participants based on nature of the party and the complexity and risk associated with an instrument or service. These standards should be appropriate for the derivatives markets and the participants in these markets and not merely the application of traditional standards applied to securities intermediaries.

These standards would include, among other things, prohibitions against fraud, misrepresentation, manipulation and other abusive practices. Business conduct requirements should be tailored, as appropriate, for the derivatives market, which could be based on the reasonable assessment of the nature of the party dealing with a DMI and the complexity and risk associated with a derivatives instrument or service.

4.4 Supervision Standards

The report recommends the adoption of regulatory requirements and internal advisory structures that facilitate the identification and monitoring of risks. In addition, internal supervisory structures adopted by DMIs must be adequate to recognize and monitor risk across all lines of business activity, including derivatives. This structure will include:

- an effective corporate governance framework;
- supervisory policies and procedures to manage their derivatives activities;
- risk management organizations and systems to identify and manage derivative related risk;
- compliance systems to monitor compliance with regulatory standards and the DMI's internal policies and procedures; and
- an effective business continuity plan appropriate for the DMI.

4.5 Recordkeeping Standards

The report recommends the adoption of requirements that DMIs keep detailed records relating to derivatives transactions, including records relating to communications with clients or counterparties, including:

- records that provide an audit trail for client or counterparty instructions and orders;
- records of the terms of derivatives transactions executed for clients or counterparties; and
- any agreements or communications with such parties.

The report also recommends that DMIs should be required to retain derivatives transaction records and be able to provide them in a timely, organized and readable manner for a specified period after derivative's termination, maturity or assignment.

4.6 Gaps and Overlap with Existing Regulatory Regimes

The report does not prescribe the type of regulator or combination of regulators that should be responsible for the regulation and oversight of DMIs in a particular jurisdiction but rather provides standards which could be used by each IOSCO member to assess whether the recommendations in the report have been implemented in its jurisdiction.

5. Current Regulation of Derivatives Markets in Canada

5.1 Regulation of Derivatives Market Participants

The *Derivatives Act* (Québec) (the "QDA")[29] establishes a legislative framework for regulation of key derivatives market participants by requiring that derivatives dealers and advisers be registered, and specifies the requirements applicable to them as regards the management of their business, their conduct and the conduct of their officers, representatives and employees.

The QDA defines a dealer as "a person who engages or purports to engage in the business of (1) derivatives trading on the person's own behalf or on behalf of others; or (2) any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of an activity described in paragraph 1", and an adviser as "a person who engages or purports to engage in the business of advising others as to derivatives or the buying or selling of derivatives, or in the business of managing derivatives portfolios". The QDA provides that the categories of registration, the conditions to be met by applicants, the duration of registration and the rules governing the business of dealers, advisers and representatives are determined by regulation.[30] Dealers and advisers that are registered in accordance with the *Securities Act* (Québec) ("QSA")[31] and meet the conditions imposed by the QDA for registration are deemed to be registered under the QDA.

Section 7 of the QDA provides that provisions dealing with registration and qualification do not apply where OTC derivatives activities or transactions involve only Accredited Counterparties.[32]

Other provinces also have existing regulatory requirements applicable to derivatives market participants.

Amendments to the *Securities Act* (Ontario) ("OSA")[33] and the *Securities Act* (Manitoba) ("MSA")[34] have been approved by the respective legislatures and include specific powers relating the regulation of

[29] *Derivatives Act*, R.S.Q., I-14.01.
[30] *Derivatives Act*, c. 1-14.01, r. 1.
[31] *Securities Act*, R.S.Q., V-1.1.
[32] "Accredited Counterparty" is defined in section 3 of the QDA.

derivative market participants, including powers relating to the registration of persons trading in or advising on derivatives. These amendments are not yet in force. Where instruments fall under the definition of "securities" in both the OSA and MSA, persons dealing in these instruments will be subject to registration under the securities regime.

The OSA includes an exemption from registration for specified financial institutions.[35]

Other provinces including British Columbia, Alberta, Saskatchewan, New Brunswick and Nova Scotia are in the process of developing or introducing legislative amendments to facilitate the registration of persons dealing in or advising on derivatives. Currently in British Columbia, Alberta, Saskatchewan and New Brunswick, instruments that will be considered to be derivatives can be either securities, exchange contracts or fall outside the regulation regime altogether. In these provinces, for the purpose of registration, persons trading in or advising on derivatives that are securities or exchange contracts will, unless otherwise exempted, be subject to securities dealer registration.

In addition, a number of jurisdictions have adopted exemptions from registration and prospectus requirements for trades of OTC derivatives where the client or counterparty to the transaction meets specified criteria. These criteria include a minimum net worth, for individuals, or minimum total assets, for non-individual entities.

5.2 Alternative Regulation of Derivatives Markets Participants

Some derivatives market participants, such as federally and provincially regulated financial institutions, insurance companies, investment dealers and foreign resident derivatives dealers and advisers, may be subject to existing supervision and regulatory requirements that are or that may be equivalent with some or all of the registration requirements that the Committee is proposing.[36] The Committee recommends that persons subject to equivalent requirements be exempted from the equivalent registration requirements. Additional information about these exemptions is set out in Part 8 of this paper.

6. Registration Requirement and Categories of Registration

The Committee believes that the most appropriate method to regulate key derivatives market participants is to impose standard registration requirements based on the activity conducted by the participants.

National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103") provides a comprehensive registration regime for persons in the business of trading in or advising on securities and for persons acting as investment fund managers. Many of the concepts relating to the registration of derivative market registrants have been developed through a review of the existing securities registration regime in Canada, however the factors that will trigger registration and the specific requirements applicable to derivatives registrants will, in some ways, be

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[33] *Securities Act*, RSO 1990, c. S.5.

[34] *The Securities Act*, CCSM, c S50.

[35] *Securities Act*, RSO 1990, c. S.5, section 35.1.

[36] Specific information relating to exemptions from a requirement to register as a derivatives dealer or derivatives adviser or from having to comply with some registration obligations are described in Part 8 of this paper.

substantially different from those applicable under the existing securities registration regime. These differences are necessary given:

- the differences in the purpose of trading, with securities typically being purchased for investment purposes and derivatives typically being contracts entered into for the transfer of risk;
- the element of leverage that exists in most categories of derivatives that amplifies market risk. The total risk exposure under a derivatives contract will often exceed the cost of entering into the derivative; and
- the complexity of many types of derivatives contracts.

As a result, derivatives markets operate in ways that are different from securities markets. The Committee recommends that the regulation of derivatives market participants involve derivatives-appropriate registration requirements. While the Committee did consider requiring persons dealing in or advising on derivatives that had securities as their underlying asset to be registered under the securities regime, the Committee believes that it is desirable to subject all types of derivatives to a consistent regime regardless of the nature of the underlying asset. The Committee believes that an exemption from registration under the derivatives regime for these categories of derivatives market participants would result in confusion and would result in different regulatory requirements for derivatives that have similar risks.

Where, however, the contract or instrument is used by an issuer or an affiliate of an issuer solely to compensate an employee or service provider or as a financing instrument and whose underlying interest is a share or stock of that issuer or its affiliate it will be considered to be a security for the purpose of registration. In such situations, the contract or instrument has a similar or the same economic effect as a security. The Committee believes it should be subject to the registration requirements that are applicable to securities. Persons trading these contracts or instruments will be subject to registration as securities dealers in accordance with NI 31-103 and, unless required because of other activities, will not be required to register as derivatives dealers.[37]

The Committee recommends that persons registered as securities dealers or securities advisers who are also subject to registration as derivatives dealers or derivatives advisers be subject to compliance with both regimes. The Committee also recommends that steps be taken to streamline the processes applicable to entities that register as both securities dealers and derivatives dealers to ensure that regulation is conducted in an efficient manner.

The Committee considered the application of derivatives registration requirements on investment funds. The Committee believes that investment fund managers should continue to be regulated under the securities registration regime regardless of the nature of the investment fund or the assets held by the fund.

An adviser to a fund that triggers the obligation to register as an adviser under part 6.2 of this paper will be subject to derivatives adviser registration requirements. An adviser that advises in relation to both

[37] The Committee intends this carve out to be consistent with section 5 of CSA Staff Consultation Paper 91-301 - Model Provincial Rules – Derivatives: Product Determination and Trade Repositories and Derivatives Data Reporting as well as paragraph 4 of section 6 of the QDA.

derivatives and securities may be subject to registration as both a securities adviser and a derivatives adviser.

The Committee also notes that some investment funds may conduct derivatives trading activity that could trigger registration requirements as a derivatives dealer. The Committee believes that the obligation to register as a derivatives dealer will apply to the fund itself rather than the fund's investment fund manager, however, based on the criteria used to define being in the business of trading derivatives, the Committee believes that most investment funds, particularly investment funds that are reporting issuers, will not trigger an obligation to register. By imposing the derivatives registration requirements on the fund, pertinent financial information relating to the fund and its derivatives exposures will be provided pursuant to trade reports and reports furnished under registration requirements. The Committee understands that, under their proposal, investment funds will often rely on their investment fund managers to fulfill the fund's registration requirements however the responsibility to meet registration requirements will remain with the fund.

The Committee understands that participants in the derivatives market include a variety of entities ranging from very large and sophisticated entities to individuals and small entities that may have little experience in trading derivatives. The Committee believes that participants that do not have the experience necessary to understand the obligations and risks related to a derivatives transaction or the resources necessary to easily meet their obligations may benefit from additional protection that is not appropriate for large, sophisticated participants.

In this paper we will refer to these sophisticated participants with adequate resources to absorb losses from derivatives trades as "qualified parties". A person would be a qualified party in respect of a derivatives trade if:

- they are a securities or derivatives registrant in any jurisdiction in Canada; or
- they have sufficient:
    - financial resources to ensure that:
        - losses resulting from a derivatives trade would not cause undue hardship; and
        - they can perform all of their obligations pursuant to a derivatives trade; and
    - experience and knowledge in trading derivatives so as to have an understanding of the risks and obligations relating to trades in derivatives; and
- they have not entered into a contract with the registered entity that requires the registered entity to provide the persons with the same types of protections that are adopted as registration requirements when trading with a non-qualified party.

A specific definition of a qualified party will be established in future regulations. The Committee recognizes that there are a number of options available to determine whether a person will be a qualified party, including:

- an *accredited investor* standard consistent with National Instrument 45-106 – *Prospectus and Registration Exemptions*;[38]

[38] National Instrument 45-106 – *Prospectus and Registration Exemptions*, section 1.1.

- a *permitted client* standard consistent with NI 31-103;[39]
- an *accredited counterparty* standard consistent with the QDA;[40] or
- another standard based on financial resources, proficiency requirements or experience in trading of the derivative.

Persons that do not meet the standards to be a qualified party will be referred to in this paper as "non-qualified parties".

Q1: Should investment funds be subject to the same registration triggers as other derivatives market participants? If not, what registration triggers should be applied to investment funds?

Q2: What is the appropriate standard for determining whether a person is a qualified party? Should the standard be based on the financial resources or the proficiency of the client or counterparty? If the standard is based on financial resources should it be based on the net assets of the client or counterparty, gross annual revenues of the client or counterparty, or some other factor or factors?

6.1 Derivatives Dealer

The Committee believes that persons carrying on the business of trading in derivatives or holding themselves out to be carrying on that business, should be regulated. The Committee recommends that these persons be required to be registered as derivatives dealers in each Canadian province and territory where they conduct derivatives trading business, unless an exemption is available. Subject to part 8.1 below, persons in the business of trading derivatives in Canada that are resident outside of Canada will still be subject to an obligation to register and be required to comply with registration requirements, even if that dealer does not have an office or other place of business in Canada.

The registration requirements applicable to a derivatives dealer will, in many ways, be comparable to the registration requirements applicable to derivatives dealers in the U.S. under both the CFTC and SEC regimes; however the Committee is not currently recommending a *de minimis* exemption comparable to that adopted by U.S. regulators. The Committee believes that participants in the derivatives market should be subject to the same protections regardless of the size or the total derivatives exposure of the dealer. While the Committee does not believe that a *de minimis* exemption is appropriate, it should be noted that a person that is not in the business of dealing or advising in the trading of derivatives will not be required to register as a derivatives dealer or adviser.

(a) Trading Derivatives

As described above, persons will only have to register as derivatives dealers where they are in the business of trading derivatives. This concept is similar to the trigger applicable to investment dealers under the securities registration regime however there will be substantial differences in the way the trigger is applied. By their nature, trades in derivatives are very different from trades in securities. Generally, securities trades involve an agreement to sell and purchase a specific security. The relationship between the buyer and seller is concluded once the transfer of the security is settled and the agreed upon consideration delivered. A derivatives trade results in the creation on an ongoing

[39] NI 31-103 – *Registration Requirement, Exemptions and Ongoing Registrant Obligations*, section 1.1.
[40] QDA, section 3.

contractual relationship between two counterparties that will last for the term of the contract. A derivatives trade will also be considered to occur when there is a material change to the terms of the derivatives contract. Subsection (b.1) and (b.2) of the definition of "trade" in the Ontario *Securities Act* make this clear:

> (b.1) entering into a derivative or making a material amendment to, terminating, assigning, selling, or otherwise acquiring or disposing of a derivative, or
> (b.2) a novation of a derivative, other than a novation with a clearing agency.

A number of other jurisdictions in Canada are considering or are in the process of developing legislative amendments to introduce a comparable concept of a trade of a derivative.

The Committee proposes that a variety of activities be considered to be a trade in a derivative, including:

- entering into a derivatives contract;
- material amendments to a derivatives contract;
- assignment of any or all rights under a derivatives contract;
- termination of a derivatives contract;
- novation of a derivatives contract, except where the novation is by a clearing agency; and
- other activities in furtherance of a trade.

The Committee notes that the definition of derivative is not consistent across the country. Certain jurisdictions have an independent regime for commodity futures contracts[41] and commodity futures options[42] while some jurisdictions include them as securities and others define them as derivatives. Recently the Committee published CSA Staff Consultation Paper 91-301[43] that provides the Committee's recommendations on the type of instruments that will be considered derivatives. While this instrument only relates to trade reporting, it does provide some insight into what types of instruments that the Committee may recommend to be considered derivatives for the purposes of triggering registration as a derivatives dealer.

A number of persons providing comments to Consultation Paper 91-401[44] discussed the scope of derivatives market regulation, particularly concerns that the CSA may regulate traditional banking activities. The discussion on business triggers below provides guidance on the types of activities that will result in a requirement to register as a derivatives dealer.

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[41] The Ontario *Commodity Futures Act* (R.S.O. 1990, c.C20) defines a commodity futures contract as "a contract to make or take delivery of a specified quantity and quality, grade or size of a commodity during a designated future month at a price agreed upon when the contract is entered into on a commodity futures exchange pursuant to standardized terms and conditions set forth in such exchange's by-laws, rules or regulations".

[42] The Ontario *Commodity Futures Act* defines a commodity futures option as "a right, acquired for a consideration, to assume a long or short position in relation to a commodity futures contract at a specified price and within a specified period of time and any other option of which the subject is a commodity futures contract".

[43] CSA Staff Consultation Paper 91-301 - Model Provincial Rules – Derivatives: Product Determination and Trade Repositories and Derivatives Data Reporting.

[44] Comment letters publicly available at http://www.osc.gov.on.ca/en/30430.htm and http://www.lautorite.qc.ca/en/regulation-derivatives-markets-qc.html

(b) Business Trigger for Trading

The Committee recommends that a variety of factors, including those described below, be considered when determining whether a person is in the business of trading derivatives. For the most part, these factors are from case law and regulatory decisions that have interpreted the business purpose test for securities matters. This is not a complete list. The existence of any one of these factors, on its own, is not determinative as to whether an individual or firm is in the business of trading or advising in derivatives but instead each should be considered as an element of a holistic analysis. In all cases, a potential registrant should consider whether they could benefit from the registration exemptions described in part 8 of this paper.

(i) *Intermediating trades* - In general, the provision of services relating to the intermediation of trades between counterparties to derivative contracts will be considered to be a trading business activity. This typically takes the form of the business commonly referred to as a broker.

(ii) *Acting as a market maker* - Making a market in derivatives is also generally considered to be trading for a business purpose. A person will generally be considered to be making a market for a derivative where it is taking or making an effort to take both a long and a short position in a derivative or category of derivatives.

(iii) *Trading with the intention of being remunerated or compensated* - Receiving, or expecting to receive, any form of compensation for carrying on derivatives trading activity, including whether the compensation is transaction or value based, indicates a business purpose. It does not matter if the individual or firm actually receives compensation or in what form.

(iv) *Directly or indirectly soliciting* - Contacting anyone to solicit derivatives trades will typically indicate a business purpose. Solicitation includes contacting someone by any means, including advertising that offers derivatives trading or participating in a derivatives trade, or that offers services for these purposes. This includes advertising on the internet with the intention of encouraging trading in derivatives by local residents.

(v) *Providing clearing services to third parties* – The provision of clearing services for derivatives trades to third parties, typically as a clearing member of a clearing agency, would also indicate that a person is in the business of trading derivatives[45].

(vi) *Trading with a counterparty that is a non-qualified party that is not represented by a derivatives dealer or adviser on a repetitive basis*[46] - If the second proposal outlined in part 7.2(b)(ii) is adopted, then a party entering into transactions with counterparties that are non-qualified parties will typically be considered to be in the business of trading derivatives unless that non-qualified party is represented by a derivatives dealer or adviser.

(vii) *Engaging in activities similar to a derivatives dealer* - If a person sets up a business to carry out any activities related to trading of derivatives, it is an indication that they could be in the business of trading derivatives and are derivatives dealers. For example, a person that is in the business of promoting a strategy for trading derivatives could be

[45] Clearing agencies may benefit from an exemption as described in part 8.2(c) of this paper.

[46] For further discussion on persons that would constitute a non-qualified party see section 7.2(b) of this paper.

considered to be in the business of trading derivatives if they are providing additional services to facilitate the trade.[47]

The proposed trigger may result in a variety of persons that do not carry out derivatives dealing activities as their primary business becoming subject to an obligation to register as a derivatives dealer.

(c) Jurisdiction

To determine whether a person will be considered to be carrying on business in a jurisdiction, a number of factors should be considered. The presence of any one of these factors would indicate that a person is carrying on business in a jurisdiction:

(i) it has an office or other place of business in a jurisdiction, even if that place of business is not permanent;
(ii) it intermediates a trade or trades on behalf of a resident of the jurisdiction;
(iii) it conducts trading activity with or on behalf of counterparties located in the jurisdiction on a regular or repetitive basis;[48]
(iv) it actively solicits or markets a derivatives trading business in that jurisdiction; or
(v) acts as a market maker to a resident in the jurisdiction.

(d) Registration of Derivatives Dealers Representatives

Information relating to the obligation to register individuals is discussed in part 6.4 below. The registration requirements applicable to derivatives dealer representatives will be discussed in Part 7 of this paper.

6.2 Derivatives Adviser

The Committee recommends that persons that carry on the business of advising others in relation to derivatives, or who hold themselves out to be in that business in any Canadian jurisdiction, be required to register as a derivatives adviser, unless an exemption is available. This would include persons that provide advice in relation to the management of a portfolio of derivatives.

(a) "Advising" in Relation to Derivatives

The concept of advising in relation to derivatives is very similar to the concept of advising about securities. A person would be considered to be "advising" in relation to derivatives where they provide another person with any advice or direction relating, either directly or indirectly, to trading derivatives, including the provision of advice in relation to:

- the management of a portfolio of derivatives;
- the use of derivatives as an investment strategy or part of an investment strategy; and
- the provision of advice in relation to hedging strategies.

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[47] Where an entity is only offering trading advice they will not be subject to registration as derivative dealers but instead will be subject to registration as derivatives advisers, as described below.

[48] A person will not be considered to be carrying on business in a jurisdiction due to repetitive trading activity with counterparties in a jurisdiction that is conducted through the facilities of a trading facility where the person is unaware of the identity of their counterparties.

Persons registered as derivatives dealers will be exempt from the requirement to register as derivatives advisers if they trigger registration as a derivatives adviser through the provision of advice that is solely incidental to a derivatives trade. The exemption is described more fully in part 8.2(a) of this paper.

(b) Business Trigger for Advising

Specific factors that should be considered when determining whether a person is "in the business" of providing derivatives advice include:

(i) *Directly or indirectly providing advice about derivatives trading activity with repetition, regularity or continuity* - Frequent or regular provision of advice in relation to derivatives transactions or in relation to the ongoing management of a portfolio of derivatives are common indicators that a person may be engaged in the business of advising in relation to derivatives. This activity does not have to be their sole or even primary endeavour for them to be in the business.
(ii) *Being, or expecting to be, remunerated or compensated* - Receiving, or expecting to receive, any form of compensation for providing advice about derivatives.
(iii) *Directly or indirectly soliciting* - Contacting anyone to solicit business relating to advising in derivatives trades. Solicitation includes contacting someone by any means, including advertising.
(iv) *Engaging in activities similar to a derivatives adviser* – Carrying on a business that is intended to provide persons with advice relating to derivatives trading activity, including promoting a trading strategy or offering software that provides a client with guidance relating to the purchase of derivatives,[49] will trigger registration as a derivatives adviser.

(c) Jurisdiction

The derivatives adviser would be subject to an obligation to be registered in each Canadian jurisdiction in which it is engaged in the business of providing advice in relation to derivatives, such as where it:

(i) has an office or other place of business in a jurisdiction, even if that place of business is not permanent;
(ii) provides advice on a trade to a resident of the jurisdiction;
(iii) carries on the business of providing advisory services or promotes itself as providing advisory services to a person or persons residing in the jurisdiction; or
(iv) actively solicits or markets a derivatives advising business in that jurisdiction.

(d) Registration of Derivatives Adviser Representatives

Information relating to the obligation to register individuals is discussed in part 6.4 below. The registration requirements applicable to derivatives adviser representatives are described in Part 7 of this paper.

6.3 Large Derivative Participant

As indicated earlier in this paper, U.S. regulators have developed a new registration category for major swap participants.[50] The Committee believes that, similar to the U.S., there may be entities, other than derivatives dealers, that may have positions in derivatives that represent or could represent a significant

[49] Where the entity is providing the advice and trading services the expectation is that they will only be registering as a derivatives dealer.
[50] See footnote 11.

systemic risk to Canadian markets or to the national or local economies. The registration of these entities would facilitate regulatory oversight that would assist in the management of systemic risk.

Recommendation

The Committee recommends that a third category of regulation, large derivative participant ("LDP") be established. Regulation as a LDP will not be subject to the same "business" trigger as dealers and advisers. Instead a market participant will be required to register as an LDP where:

- the entity is:
    - a Canadian resident entity that maintains a substantial position in a derivative or a category of derivatives; or
    - is a foreign resident entity that holds a substantial position in a derivative or category of derivatives with Canadian resident counterparties; and
- the entity's exposure in Canadian derivatives markets results in counterparty exposure that could pose a serious risk to Canadian financial markets or to the financial stability of Canada or a province or territory of Canada.

Entities can be categorized as LDPs, and subject to regulation regardless of whether their derivative trading activity is for hedging purposes or for speculative purposes. Where an entity is registered as a derivatives dealer under a CSA registration regime, they would not be expected to also register as a LDP.

The Committee further recommends that additional work be undertaken, in consultation with other Canadian authorities to establish the thresholds for registration as an LDP. The thresholds will be established in regulations that will be developed once the Committee has done sufficient analysis on trade repository data.

6.4 Registration of Individual Representatives of Derivatives Dealers and Derivative Advisers

NI 31-103 includes a requirement that securities registrants register individual employees including chief compliance officers, ultimate designated persons and representatives of securities dealers and securities advisers.

As previously discussed in part 6 of this paper, the derivatives market is very different from the securities markets. A sizable proportion of OTC derivatives activity involves transactions between qualified parties that have the resources necessary to protect their own interests. They do not rely on the expertise and advice of the counterparty to the transaction, and that counterparty's representatives, to protect their interests. The Committee does however recognize that there are participants in the derivatives market that will be relying on the expertise of derivatives dealers and derivatives advisers and persons representing those registered entities to ensure that their derivatives trade is suitable given the participant's objectives and risk tolerances.

Recommendation

The Committee recommends that individuals be registered:

- where they are the ultimate designated person, chief compliance officer and chief risk officer of a registrant;

- as a representative of a derivatives adviser where they provide clients with advice relating to derivatives, whether or not the client is a qualified party; and
- as a representative of a derivatives dealer where they provide services relating to trading to clients, whether or not the client is a qualified party, or, if the second alternative part 7.2(b)(ii) is implemented, where they deal with a counterparty[51] that is a non-qualified party[52] unless that counterparty is represented by an independent investment adviser. If first alternative in part 7.2(b)(ii) is implemented, representatives dealing with counterparties will not be required to be registered as all counterparties will either be qualified parties or will be represented by independent derivatives advisers.

Individuals that function as dealer representatives that do not trade on behalf of non-qualified parties will not be required to register.

The Committee believes that limiting registration of individual representatives to the situations described above balances the need to protect the interests of derivative market participants with the cost of having registrants register.

Q3: Should registration as a derivatives dealer be subject to a *de minimis* exemption similar to the exemption adopted by U.S. regulators? Please indicate why such an exemption is appropriate.

Q4: Are derivatives dealer, derivatives adviser and LDP the correct registration categories? Should the Committee consider recommending other or additional categories?

Q5: Are the factors listed the correct factors that should be considered in determining whether a person is in the business of trading derivatives? Please explain your answer.

Q6: The Committee is not proposing to include frequent derivatives trading activity as a factor that we will consider when determining whether a person triggers registration as a derivative dealer. Should frequent derivatives trading activity trigger an obligation to register where an entity is not otherwise subject to a requirement to register as a derivatives dealer or a LDP? Should entities that are carrying on frequent derivatives trading activity for speculative purposes be subject to a different registration trigger than entities trading primarily for the purpose of managing their business risks?

Q7: Is the proposal to impose derivatives dealer registration requirements on parties providing clearing services appropriate? Should an entity providing these clearing services only to qualified parties be exempt from regulation as a derivatives dealer?

Q8: Are the factors listed above the appropriate factors to consider in determining whether a person is in the business of advising on derivatives?

Q9: Are the factors listed for determining whether an entity is a LDP appropriate? If not what factors should be considered? What factors should the Committee consider in determining whether an entity, as a result of its derivatives market exposures, could represent a serious adverse risk to the financial stability of Canada or a province or territory of Canada?

[51] Footnote 5 describes how the terms client and counterparty are used in this paper.

[52] The terms "qualified party" and "non-qualified party" are defined in part 7.2(b) of this paper.

Q10: Is the Committee's proposal to only register derivative dealer representatives where they are dealing with clients or when dealing with counterparties that are non-qualified parties appropriate?

7. Registration Requirements

This part represents the Committee's view with respect to some of the key registration requirements that will apply to each category of registrant and the individual representatives of a registrant. A chart summarizing the proposed registration requirements for each category is included as Schedule A, at the end of this paper.

A discussion of exemptions from registration and from regulatory requirements will be discussed more fully in Part 8 of this paper.

Obligations related to derivatives trade reporting, mandatory clearing of derivatives trades through a clearing agency or requirements to trade derivatives on an electronic trading platform will not be discussed in this paper. Other consultation papers that have been or will be issued by the Committee will address these requirements.

This part is intended to describe key registration requirements that the Committee is recommending. Detailed registration requirements will be set out in draft rules that will be published for comment.

At present the Committee has not come to a recommendation that derivatives dealers or other categories of registrants be required to become members of a self-regulated organization ("SRO"), however the Committee will carry out additional analysis on the issue.

7.1 Requirements of Derivatives Dealers, Derivatives Advisers and LDPs

This part describes registration requirements that will, subject to exemptions, apply to all derivatives registrants. Additional requirements that will apply to derivatives dealers and derivatives advisers will be discussed in parts 7.2 and 7.3.

(a) Proficiency Requirements

The Committee believes that all individuals who are directors, partners, officers, employees or agents of a derivatives registrant who are involved in trading in or advising on derivatives, including persons responsible for the supervision or management of derivatives related activity, should be subject to minimum proficiency standards. These standards are intended to ensure that individuals representing registrants understand the fundamentals of the derivatives markets in which they trade or advise in and the regulatory requirements relevant to their activities. The Committee also believes that minimum proficiency requirements will have the effect of protecting the registered entities, their clients and counterparties and the broader derivatives market.

Recommendation

The Committee recommends that registered entities be required to develop minimum proficiency standards and have procedures to ensure that all of their directors, officers, employees or agents involved in trading or advising on derivatives, including supervisors and managers of those responsible for trading in or advising activity, have the appropriate

education, training and experience to carry out their responsibilities. The Committee believes that the proficiency requirements should, at least initially, be principle based. Registered entities will be responsible for ensuring that all directors, officers, employees and agents involved in trading or advising on derivatives are reasonably proficient to:

- perform the trading and advising functions that they carry out;
- understand the risks and obligations resulting from the derivatives trades; and
- be knowledgeable of the behaviour and dynamics of the derivatives markets in which they will be trading.

The Committee also recommends that proficiency requirements be established based on the specific classes or categories of derivatives that a representative is trading in or providing advice on. The Committee believes that markets for different classes and categories of derivatives are distinctive and that persons trading in, or advising in relation to, those markets should have specialized expertise to understand their market. Similarly, the Committee believes that it is inappropriate to require a derivative dealer's representative to have a broad range of proficiency related to derivatives markets that they do not trade in. So, for example, an individual trading foreign exchange based derivatives must have adequate knowledge and proficiency relating to trading those foreign exchange based contracts. They will not be required to become proficient in trading other types of contracts, such as commodity futures, and will not be able to trade those products. It should be noted that some elements of the proficiency requirements, such as familiarity with market conduct standards, will be common across all categories of derivatives classes.

At least initially, proficiency can be developed by taking educational courses or by passing relevant examinations recognised by the CSA members, or through work experience. Derivatives registrants that are also securities registrants will be required to ensure that their representatives meet proficiency requirements applicable to both securities registrants and derivatives registrants.

Q11: Is it appropriate to impose category or class-specific proficiency requirements?

Q12: Is the proposed approach to establishing proficiency requirements appropriate?

(b) Financial and Solvency Requirements

Clients of registrants rely on the dealer or adviser to have the resources to provide services and stand behind the services they provide. Clients that have counterparty risk from a registrant will be adversely impacted if the registrant defaults on its obligations under a derivatives contract. Such a default will often adversely impact the non-defaulting counterparty but may also impact the non-defaulting counterparty's ability to meet its obligations. The Committee believes that the imposition of financial and solvency requirements will help manage the risks to clients and counterparties of registrants.

Recommendation

(i) *Minimum Capital Requirements*

The Committee recommends that registrants be required to maintain minimum specified levels of capital. These requirements are intended to ensure the solvency of registrants, with the intention of reducing the likelihood that they cannot meet their ongoing obligations under

derivatives contracts. Presently many potential registrants are subject to capital regulation by a prudential regulator, such as the Office of the Superintendent of Financial Institutions or self-regulatory organizations such as IIROC. As stated in part 5.2 of this paper, where such requirements are substantially equivalent, those requirements will continue to apply and those entities will be exempt from the CSA's capital requirements.

The Committee recommends that registrants be required to calculate their minimum capital requirements on a regular basis and be required to adjust the amount of capital held, as appropriate. Registrants will be required to file periodic reports on minimum capital requirements and capital held.

The Committee will provide recommendations relating to minimum capital requirements in a future paper.

(ii) Margin Requirements

International working groups are considering standards relating to posting and collecting margin in relation to derivatives trades that are not cleared through a central counterparty.[53] The Committee recommends that margin standards be adopted that, at a minimum, are consistent with international standards. Typically, margin requirements will not apply to registered entities that are registered only as derivatives advisers where these entities are not holding positions as counterparties to derivatives trades.

The Committee will provide additional information relating to specific margin requirements and obligations with respect to holding collateral in a future paper.

(iii) *Insurance Requirements*

The Committee recommends that registrants be required to maintain insurance to protect against the loss of property with a view to protecting, where applicable:

- the assets of a counterparty to a transaction held as collateral;
- client and counterparty assets held by the entity; and
- the entity's own assets.

The insurance will, at a minimum cover:

- losses of property resulting from the dishonest or fraudulent actions of an employee, director, officer, partner or agent of the registrant;
- loss of property held or controlled by the registrant resulting from theft or fraud by a third-party; and
- loss of property held or controlled by the registrant as a result of a disaster including fire, flood, earthquake, physical damage to a storage or transportation facility or loss in transporting the property, as appropriate.

(iv) *Maintenance of Financial Records and Periodic Financial Reporting*

The Committee recommends that all registrants be required to maintain complete, up-to-date financial records including their financial statements, records of all derivatives positions held by the registrant on its own behalf or on behalf of third-parties. These records should be

[53] BCBS-IOSCO, Margin requirement for non-centrally-cleared derivatives, available at: http://www.bis.org/publ/bcbs242.pdf.

consistent with appropriate accounting standards. These records should include calculations of the value and risk exposure relating to each position and the value and exposure of the registrant's aggregate positions and specifics regarding collateral posted to or collected from its derivatives counterparties.

The Committee also recommends that these registrants be required to file these financial records on a quarterly basis. In addition, they would be required to file audited versions of their financial statements on an annual basis. The audit would need to be conducted by a fully qualified, independent auditor in compliance with appropriate audit standards and approved by the registrant's board of directors.[54]

(c) Compliance Systems and Internal Business Conduct Requirements

The Committee believes that all registrants should have adequate systems in place to ensure compliance with all regulatory requirements and to manage risks relating to derivatives positions.

Recommendations

(i) *Compliance and Risk Management Systems*

The Committee recommends that registrants be required to establish, maintain and apply systems, policies and procedures that establish robust compliance and risk management systems, appropriate for their derivatives business. These systems should:

- provide assurance that the registrant and individuals acting on its behalf comply with applicable derivatives legislation and regulation; and
- manage the risks associated with the registrant's business, including its derivatives business, in accordance with prudent business practices.

The Committee recommends that these compliance and risk management systems be required to have internal controls and monitoring systems to identify non-compliance with both regulatory requirements and internal policies and procedures and correct such non-compliance in a timely manner. The Committee expects that risk management systems would identify risks applicable to the registrant and ensure that appropriate steps are taken to manage such risks in a timely manner. These systems should be part of a firm-wide commitment to compliance and management of risk involving participation by directors, management and staff.

The Committee recommends that each registrant be obligated to implement compliance systems that are appropriate for their derivatives business, considering the size and scope of their operations, including the types of clients or counterparties that they do business with, types of derivatives traded, types of counterparties dealt with, risks and compensating controls, and any other relevant factors. The Committee also recommends that registrants be required to implement compliance and risk management systems that include:

- a firm-wide commitment to compliance;
- sufficient resources and training to operate effective compliance and risk management systems, including qualified staff;
- detailed policies and procedures that:

[54] When we refer to a registrant's board of directors in this paper we intend to reference to any person or groups of persons that control or provide direction over a registrant including sole proprietors, partners, or trustees.

    - ensure compliance with regulatory requirements and internal policies and procedures;
    - clearly outline who is expected to do what, when and how;
    - are readily accessible by everyone who is expected to know and follow them; and
    - are updated when regulatory requirements or the registrant's business practices change;
- internal controls that manage the risks that affect their business, including risks that may relate to:
    - safeguarding of firm, client and counterparty assets;
    - accuracy of books and records;
    - trading;
    - conflicts of interest;
    - money laundering;
    - business interruption
    - marketing and sales practices, and
    - the registrant's overall financial viability;
- monitoring and supervision of derivatives related activity and risk exposure including day-to-day monitoring as well as monitoring the effectiveness of the registrant's compliance and risk management systems; and
- business continuity and disaster recovery plans designed to ensure that the registrant is able to resume operations within a reasonable period with minimal disturbance to clients and counterparties.

In all cases, the Committee believes that these compliance and risk management systems should be approved by the registrant's board of directors. In addition, the systems should be appropriately documented and made reasonably available to directors, partners, trustees, officers and staff members of the registrant to allow them to understand the duties and obligations under the systems. The Committee recommends that registrants be required to regularly review both compliance and risk management systems to ensure that they continue to be appropriate for the organization and its ongoing derivatives trades and exposures. At least annually, each registrant will be required to prepare a report describing the registrant's derivatives activities, their derivatives compliance and risk management systems and issues related to derivatives compliance and risk management for presentation to the registrant's board. A copy of this report should be filed with the market regulators in each jurisdiction in which it is registered after it has been approved by the registrant's board.

While these requirements do apply to all categories of registrants, the Committee notes that the compliance and risk management systems that would be appropriate for derivatives dealers, derivatives advisers or LDPs may be very different because of the different registration requirements and the different risks that each category of registrant faces.

(ii) *Appointment of an Ultimate Designated Person, Chief Compliance Officer and Chief Risk Officer*

The Committee recommends that each registrant be required to appoint and register an ultimate designated person ("UDP") who will be the individual responsible for conduct and supervision of the derivative trading or advising operations of the entity. This individual will

typically be the senior staff member responsible for derivatives trading or advising activity at the registrant.

For organizations that have derivatives trading or advising as their primary business, the UDP will typically be the president, chief executive officer or someone holding a comparable position. For entities where derivatives trading or advising is merely one part of the organizations business, the UDP will typically be the individual responsible for the arm of the business that conducts derivatives trading or advising.

The Committee also recommends that each registrant be required to appoint and register a chief compliance officer ("CCO") for their derivatives related business. The CCO will be the main point of contact for regulators. This individual will be responsible for promoting a culture of compliance, developing and implementing appropriate compliance systems and overseeing the operation of the firm's compliance systems relating to OTC derivatives, including:

- overseeing the operation of the registrant's compliance systems;
- establishing and updating compliance policies and procedures;
- monitoring and supervising actions to resolve compliance issues;
- reporting material compliance issues to the registrant's board of directors; and
- providing the registrant's board of directors with a status report on compliance systems on at least an annual basis.

The Committee also recommends that each registrant be required to appoint and register a chief risk officer ("CRO") who will report to the risk committee of the registrant's board of directors. The securities registration regime does not require the appointment of a chief risk officer. The Committee believes that persons holding positions in derivatives must address risks that normally do not exist when holding a securities position[55] and that derivatives registrants should be subject to an obligation to monitor risks on a continuous basis. As such, the Committee believes that all derivatives registrants should be required to register a CRO that will be responsible for the development and ongoing operation of a risk management framework that can effectively identify, measure, monitor and manage derivatives-related risks, including appropriate supervisory policies and procedures, including:

- developing clear policies and procedures to implement the risk management framework;
- overseeing the operation of the registrant's risk framework's systems, including conducting regular reviews of the internal risk management framework;
- ensuring that appropriate risk management tools are employed to identify excessive or otherwise inappropriate risk taking;
- ensuring that derivatives activities are consistent with pre-determined objectives and strategies established by the registrant's board of directors;

[55] These risks stem from a variety of factors including, but not limited to, the risk resulting from leverage that exists in many types of derivatives contracts, counterparty risk related to trading counterparties and, in many cases, an inability to liquidate an OTC derivative position during the term of the derivatives contract. In this footnote leverage refers to the fact that a party's potential liability under a derivatives contract can exceed the original cost of entering into the contract, or the original exposure under the contract, by a significant amount due to changes in the market value of the derivative or in asset that underlies the derivative.

- monitoring compliance with risk management policies and procedures;
- reviewing, testing and, if necessary, updating risk management systems; and
- providing the registrant's senior management team and board of directors with regular reports, at least on a quarterly basis, relating to the risk management framework, risks related to OTC derivatives and the management of those risks.

The Committee recommends that individuals acting as CCO and CRO be subject to proficiency requirements to ensure that they have the expertise and experience in relation to both compliance and the derivatives market to perform their role. The Committee further recommends that no individual may simultaneously act as UDP, CCO and CRO however in certain situations, such as where the entity is very small in size, one individual may be allowed to fill more than one role. Entities that are registered as securities dealers or advisers may have the same individual registered as the UDP or CCO of both the securities registrant and the derivatives registrant.

(iii) *Record Keeping*

The Committee recommends that registrants be required to maintain an effective record keeping system in relation to their derivatives related business including records of all derivatives trades where the registrant:

- is the counterparty to the trade;
- acts as an intermediary on behalf of a client or has provided clearing services to a client or counterparty; or
- provides advice to a client.

In addition, registrants should be required to maintain adequate records to document the risks and exposures relating to derivatives trading activities that they have been involved in whether as a counterparty, intermediary or adviser. Records will be required in a durable and intelligible form, capable of being easily accessed and printed.

The Committee recommends that registrants be required to maintain, at a minimum:

- in the case of derivatives dealers or LDPs, transaction records that fully document all transactions entered into by the registrant as principal and, in the case of a derivatives dealer, transactions where the dealer acts as an intermediary on behalf of clients, including records relating to the current valuation of the transaction and exposures resulting from the transaction. These records would include:
    - for OTC derivatives trades and where appropriate for derivatives trades executed on a trading facility, information identifying the counterparty to each derivatives trade;
    - records of all communication with clients or counterparties relating to the terms and conditions of a derivatives contract, including a record of when such communications occurred;
    - documents describing the transaction including the contract and all documents referenced in that contract;
    - records of all reports made to a trade repository;
    - records of interactions with clearing agencies, clearing houses and central counterparties and with third-parties providing clearing services;

- records of all transactions where the registrant is facilitating the clearing of a derivatives trade on behalf of another person;
- records regarding all collateral requirements arising from transactions not cleared through a clearing agency, clearing house or central counterparty, including records of collateral requirements, records of collateral held and collateral delivered pursuant to a derivatives trade;
- records relating to collateral held at third-party custodians including the identity of the custodians, amount and types of collateral received or delivered, and information of the counterparties in which the custodian is holding the collateral for;
- records of all orders entered on a derivatives trading facility, including a facility operated by the derivatives dealer, and a record of all trades executed on or reported to such facility; and
- information used to monitor and assess the registrant's risk exposure or the risk exposure of a client or counterparty of the registrant;

- in the case of derivatives dealers and derivatives advisers, maintain records to:
  - create an audit trail for communications with clients or counterparties pertaining to:
    - client or counterparty instructions and orders; and
    - if applicable, the advice provided to clients or counterparties, including, where applicable suitability advice, relating to derivatives trades; and
  - records of complaints made by clients or counterparties.

(iv) *Complaint handling*

The Committee recommends that registrants be required to document and, in a manner that is fair and reasonable, respond to each complaint made by any client or counterparty in relation to any of the registrant's activities relating to derivatives trading. All responses should be approved by the registrant's UDP or CCO.

(d) Honest Dealing

Each Canadian jurisdiction requires securities registrants to deal with clients fairly, honestly and in good faith.[56] The CFTC has imposed fair dealing requirement on all registrants including both swap dealers and major swap participants to communicate in a fair and balanced manner based on principles of fair dealing and good faith. [57]

The Committee recognizes that the derivatives market is different than the securities market. Often derivatives trades are executed between two large and sophisticated counterparties that negotiate the terms of a derivatives trade in the same way they would negotiate any commercial contract. Imposing a fair dealing requirement on derivatives dealers and LDPs in such circumstances is unnecessary to protect the interests of the registrant's counterparties and would place the registered entity at a disadvantage.

[56] For example, see British Columbia's Securities Rules (B.C. Reg. 194/97 under the B.C. *Securities Act* and OSC Rule 31-505 – *Conditions of Registration.*

[57] 17 CFR 23, section 23.433.

However the Committee does believe that registrants should be subject to a basic obligation to act honestly and in good faith whenever they provide advising or trading services to clients or trade with counterparties.

Recommendation

The Committee recommends that all registrants be subject to an obligation to act honestly and in good faith when trading in or advising on derivatives. All derivatives registrants should be precluded from misleading clients or counterparties or making any misrepresentation, including through omission, to a counterparty relating to: (i) any materials terms of a derivatives trade; or (ii) any material matters related to the market for the derivative being traded. Derivatives registrants should avoid making incomplete, inaccurate or unwarranted claims, opinions or forecasts in their communications with clients and counterparties or potential clients and counterparties. This requirement is not intended to impact a derivatives dealer's ability to negotiate commercial terms of a derivatives contract that benefit it where the contract will be between the derivatives dealer and its counterparty.

Derivatives dealers acting as an intermediary or trading with counterparties that are non-qualified parties and derivatives advisers will be subject to additional business conduct requirements, including the requirement to deal fairly, honestly and in good faith. These business conduct requirement will be discussed in part 7.2(b) below.

Q13: Is the Committee's proposal to impose a requirement on registrants to "act honestly and in good faith" appropriate?

(e) Requirements Relating to Client/Counterparty Assets

In any situation where a registered entity holds client or counterparty assets, including collateral provided by the client or counterparty under a derivatives trade, there is a risk that such funds can be misappropriated or subject to claims by third-parties. The Committee outlined specific requirement relating to client or counterparty assets held by clearing agencies and clearing members of clearing agencies in the Committee's Consultation Paper 91-404 - *Derivatives: Segregation and Portability in OTC Derivatives Clearing*.[58] Specific requirements applicable to collateral posted by clients and counterparties in uncleared trades will be described in the future CSA paper dealing with capital and collateral requirements.

Q14: Are the requirements described appropriate registration requirements for derivatives dealers, derivatives advisers and LDPs? Are there any additional regulatory requirements that should apply to all categories of registrants? Please explain your answers.

[58] Report available on various CSA websites including:
http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/Canadian%20Securities%20Administrators%20Consultation%20Paper%2091-404%20Derivatives%20%e2%80%93%20Segregation%20and%20Portability%20in%20OTC%20Derivatives%20C/4100530-v1-CSA_Consult_Paper_91-404_Derivatives_-_Seg_and_Port_in_OTC_Der_Clrng.pdf
http://www.bcsc.bc.ca/uploadedFiles/securitieslaw/policy9/91-404_[CSAConsultationPaper].pdf
http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa_20120210_91-404_segregation-portability.pdf

7.2 Additional Regulatory Requirements Applicable only to Derivatives Dealers and Derivatives Advisers

(a) Gatekeeper Requirements

The Committee expects derivatives dealers to have sufficient knowledge of their clients and counterparties to allow them to assess the risks that these entities represent to the dealer or the capital markets. Derivatives advisers should have the same level of knowledge of their clients.

Recommendation

The Committee recommends that derivatives dealers and derivatives advisers be required to obtain sufficient information relating to their clients and, in the case of derivatives dealers their counterparties, to allow them to act as a gatekeeper with the objective of ensuring market integrity and allow the dealer to assess their counterparty risks. In particular they should be aware of:

- the identity of their client or counterparty and, if they are not an individual, the identities of the entities that either directly or indirectly control the client or counterparty;
- potential compliance issues that may relate to the client or counterparty (for example past regulatory issues that they or their staff may have had, their access to material non-public information relating to a derivative or the asset underlying the derivative); and
- other information necessary to apply anti-money laundering legislation or other comparable regulatory requirements.

(b) Registration Requirements to Protect Derivative Market Participants

(i) *Background*

The Committee believes that registered entities that have clients or counterparties that rely on their advice when conducting a derivatives trade should be subject to additional registration requirements to protect the interests of those clients and counterparties.[59] These additional registration requirements will apply where:

- a derivatives adviser is providing advice to clients;
- a derivatives dealer is providing trading related services to a clients and
- if the second alternative described below is implemented, a derivatives dealer is trading with a counterparty that is a non-qualified party unless that counterparty has retained the services of an independent, registered derivatives adviser.

(ii) *Alternative Proposals where a Derivatives Dealer trades with Non-Qualified Parties*

The Committee recognizes that a conflict of interest will exist where a derivatives dealer enters into a transaction with a counterparty that is a non-qualified party that relies on that derivative dealer for direction or advice in relation to the trade. The Committee is considering two alternatives for addressing this conflict of interest.

[59] An explanation of the usage of the terms “client” and “counterparty” is provided in footnote 5 to this paper.

First Alternative

The first alternative would preclude all derivatives dealers from entering into trades with counterparties that are non-qualified parties unless those counterparties receive advice from a registered derivatives adviser in relation to that transaction. The adviser should be independent from the derivatives dealer that will be the counterparty to the proposed transaction.

This alternative will effectively address the fundamental conflict of interest that will exist between a derivatives dealer and counterparties that are non-qualified parties. In each case the counterparty will be assured that it will receive unbiased advice. The Committee is, however, concerned that this alternative may result in extra costs that would discourage non-qualified parties from participating in the market, including discouraging them from hedging risks.

Second Alternative

The second alternative would require that the derivatives dealer inform counterparties that are non-qualified parties that there is a conflict of interest and provide details of the conflict in writing. In addition, the dealer would be required to advise the counterparty that they have the right to obtain independent advice before entering into the transaction. If the non-qualified party chooses not to have an adviser for that transaction, they would have to sign an acknowledgement indicating that they were electing not to obtain independent advice.

The Committee is concerned that the elements of the second proposal may not be effective in addressing the inherit conflict of interest with their counterparty.

(iii) *Business Conduct Requirements*

The Committee recommends that derivatives advisers, derivatives dealers acting as an intermediary on behalf of clients and, if the second alternative described in part 7.2(b)(ii) above is implemented, derivatives dealers trading with counterparties that are non-qualified parties[60] be subject to the additional requirements described below. The business conduct requirements described in this part are comparable to the obligations that swaps dealers owe to clients, including clients that are "special entities"[61] under U.S. regulations.[62]

The requirements described in this part 7.2(b)(iii) will not apply to a derivatives dealer where:

- the counterparty to the trade has a registered derivatives dealer trading on their behalf or is being advised on the trade by a registered derivatives adviser;

[60] The requirements will only apply to derivatives dealers trading with counterparties that are non-qualified parties if the second option described earlier in the paper is adopted. If the first option is chosen derivatives dealers will only be able to trade with counterparties that are non-qualified persons where that person has retained the services of an independent derivatives adviser. Where such an adviser has been retained, a derivatives dealer would not be subject to any of the obligations described in part 7.2(b).

[61] Under U.S. legislation, special entities include federal agencies, states, state agencies, cities and other political subdivisions of a state, employee benefit plans, governmental plans and endowments.

[62] The concept of special entities under U.S. regulations is very different from the concept of non-qualified party discussed above. The Committee is not recommending the adoption of a special entity concept. Canadian entities that would be comparable to U.S. "special entities" (as that term is defined in both the U.S. *Commodities Exchange Act* and *Securities Exchange Act of 1934*), may or may not be a qualified party to derivatives trades.

- the relationship between the derivatives dealer and the counterparty to a trade is solely the result of being counterparties to a derivatives trade executed through the facilities of a publicly accessible, multi-dealer trading platform; or
- the derivatives dealer's services in relation to a trade are limited to providing clearing services to a counterparty to the trade.

(A) *Know your client/counterparty*
The Committee recommends that, before (a) trading on behalf of a client when acting as an intermediary in relation to a trade, or (b) if the second alternative described in part 7.2(b)((ii) above is implemented, trading with a counterparty that is a non-qualified party, derivatives dealer and its representatives be required to take reasonable steps to know its client under (a) or counterparty under (b). Similarly a derivatives adviser and its representatives should be required to take reasonable steps to know each of its clients. Knowing a client or counterparty will include:

- understanding the person's financial circumstances and level of understanding of derivatives and the derivatives market;
- understanding the nature of the person's business activities and the types of derivatives trades the person intends to execute;
- understanding the person's general objectives for entering into derivatives trades, including whether their trades will generally be for speculative or hedging purposes;
- where the trade is for hedging purposes, understanding the risks that the person is seeking to manage; and
- understanding the person's risk tolerances.

The Committee recommends that derivatives dealers and derivatives advisers be required to take reasonable steps to update the information:

- on a periodic basis; and
- where the person takes steps to enter into a transaction that is inconsistent with the person's general objectives or is materially inconsistent with their past trading activity.

(B) *Suitability*
The Committee recommends that, before (a) trading on behalf of a client or when acting as an intermediary in relation to a trade or, (b) if the second alternative described in part 7.2(b)(ii) above is implemented, trading with a counterparty that is a non-qualified party, derivatives dealers and their representatives be required to determine that the derivative trade is suitable for their client under (a) or counterparty under (b). Derivatives advisers and their representatives will be subject to the same suitability obligation when advising a client. The registrant will meet this requirement by:

- determining whether a derivative is a suitable instrument for the person, considering their objectives and risk tolerances; and
- where the derivatives dealer or derivatives adviser determines that a derivatives trade is suitable, the derivatives dealer or derivatives adviser must determine the suitability of a specific derivatives instrument for that person. The dealer must have an adequate understanding of the features and risks of the specific derivative that they are trading

and must determine that these features and risks are suitable given the needs of the person.

When considering suitability the derivatives registrant must consider both the immediate impact of the trade as well as future risks resulting from the trade. Where a trade is for hedging purposes the derivatives registrant should determine whether existing trades are likely to remain suitable risk management tools in the future. Where the relationship between the registrant and its client or counterparty is ongoing, the registrant must, periodically, consider whether the outstanding positions of the client or counterparty continue to effectively achieve their objectives.

(C) *Conflicts of Interest*

The Committee recommends that registered derivatives dealers and their representatives, when (a) trading on behalf of a client or acting as an intermediary in relation to a trade or, (b) if the second alternative described in part 7.2(b)((ii) above is implemented, trading with a counterparty that is a non-qualified party, be subject to a requirement to take reasonable steps to identify:

- existing material conflicts of interest; and
- material conflicts of interest that reasonably would be expected to arise during the duration of a derivatives trade,

between themselves and each of those clients and counterparties. Derivatives advisers and their representatives will be subject to the same obligation when advising a client.

Where a representative identifies a material conflict of interest they would be subject to a requirement to report the conflict to the supervisor or other person with the authority to address conflict of interest issues. Where the derivatives dealer or derivatives adviser has identified a material conflict of interest, it would be required to:

- take reasonable steps to address the conflict of interest; or
- if the conflict can not be reasonably addressed, either:
    - disclose to each applicable client and counterparty that is a non-qualified party, in writing and in a timely manner:
        - the nature and extent of the conflict of interest and describe any actions the dealer will take to manage the conflict or interest; and
        - that the counterparty has the right to obtain third-party advice before entering into the trade; or
    - where disclosure is not an adequate method for addressing the conflict of interest, take steps to end the situations that result in conflicts of interest.

(D) *Fair Dealing*

In addition to the general obligation to act honestly when interacting with their clients or counterparties, as discussed in part 7.1(d), derivatives dealers and their representatives, when (a) trading on behalf of a client or acting as an intermediary in relation to a trade or, (b) if the second alternative described in part 7.2(b)((ii) above is implemented, trading with a counterparty that is a non-qualified party should be required to deal fairly, honestly and in good faith. Derivatives advisers and their representatives will be subject to the same obligation to act fairly, honestly and in good faith when advising a client. This will include:

- not making any incomplete, inaccurate or unwarranted claims, opinions or forecasts;
- providing information that gives the client or counterparty a sound basis to evaluate the facts of the derivatives trade;
- providing balanced information relating to the benefits, opportunities, costs and risks relating to a derivatives trade; and
- when trading with a non-qualified party as a counterparty, ensuring that the terms of the trade are fair, balancing the interests of the derivatives dealer and its counterparty.

The obligation to deal fairly, honestly and in good faith will also apply to the registered representatives of derivatives dealers and advisers.

7.3 Additional Regulatory Requirements Applicable only to Derivatives Dealers

The requirements described in this part apply regardless of whether the derivatives dealer's clients have retained the services of a derivatives adviser in relation to the trade.

(a) Pre-trade Reports

The Committee recommends that derivatives dealers acting on behalf of clients or, if the second alternative described in part 7.2(b)((ii) above is implemented, counterparties that are non-qualified parties be required to provide additional information to allow the client or counterparty to understand the terms of a trade and the costs that they will incur to execute the trade. These transaction reports should be delivered prior to the trade being executed. This information should include:

- disclosure of all fees payable by the client or counterparty in relation to the trade, including fees relating to the clearing and settlement of the trade;
- disclosure of all other compensation to be paid by the client or counterparty to the derivatives dealer in relation to the trade;[63] and
- a detailed description of the risks to and the rights and responsibilities of the client or counterparty under the terms of the trade.

(b) Post-trade Reports

The Committee recommends that derivatives dealers acting on behalf of clients or, if the second alternative described in part 7.2(b)((ii) above is implemented, counterparties that are non-qualified parties be required to provide a trade confirmation within a reasonable time after the conclusion of the derivatives trade.

The trade confirmation should describe the principal economic terms of the trade. Specific requirements relating to the trade confirmation will be described in the model provincial rule on registration.

[63] This requirement is intended to impose obligations to disclose compensation earned as a direct result of executing the derivatives trade and is not intended to impose a requirement that the registrant disclose compensation or profit resulting from subsequent transactions related to the derivatives trade or from changes in the value of the derivatives position.

(c) Account Statements

The Committee recommends that derivatives dealers be required to deliver regular statements to clients and counterparties that are non-qualified parties describing their outstanding positions relating to trades executed with the derivatives dealer or on their behalf by the derivatives dealer. In addition to describing each outstanding trade, the statements would include a variety of information, including:

- a description of all material amendments to outstanding derivatives contracts during the reporting period, including terminations, assignments, selling, or other acquisition or disposition of rights and obligations;
- the current market value of the derivative and a description of how it is calculated;
- the client's exposure resulting from the derivative contract; and
- types and current value of the collateral received from the client.

Q15: Should derivatives dealers dealing with qualified parties be subject to business conduct standards such as the ones described in part 7.2(b)(iii) above? If so, please explain what standards should apply.

Q16: Do you have a preference between the two proposals relating to the regulation of a derivatives dealer trading with counterparties that are non-qualified parties? Is there another option to address the conflict of interest that the Committee should consider? Please explain your answer.

Q17: Are the recommended requirements appropriate for registrants that are derivatives dealers? If not please explain. Are there any additional regulatory requirements that should apply to registered derivatives dealers?

Q18: Are the recommended requirements appropriate for registrants that are derivatives advisers? If not please explain. Are there any additional regulatory requirements that should apply to registered derivatives advisers?

8. Exemptions from Registration or Registration Requirements

8.1 Exemption from Registration Requirements

(a) Regulated Persons

Some persons triggering registration as a derivatives dealer, a derivatives adviser or large derivatives participants will be subject to regulation by other entities with regulatory responsibilities. Where such a regime provides for equivalent supervision and regulatory requirements that are monitored and enforced to the satisfaction of Canadian securities regulators, those persons should not be subject to redundant requirements.

Recommendation

The Committee recommends that Canadian securities regulators analyze existing regulatory regimes, including requirements, compliance monitoring and enforcement, imposed by other Canadian regulatory authorities to determine whether those regimes impose regulatory requirements that are, in

their outcome, equivalent to those that would be implemented by securities regulatory authorities. The Committee further recommends that exemptions from registration requirements be adopted where equivalent regulatory regimes are in place.

(b) Foreign Derivatives Dealers and Advisers

An entity that is resident outside of Canada may trigger registration as a derivatives adviser or as a derivatives dealer in a Canadian jurisdiction. If such an entity is regulated as a derivatives adviser or a derivatives dealer, as applicable, in their home jurisdiction, they will be subject to regulatory requirements at home and in Canada. These requirements may be overlapping and, in some cases, conflicting.

Recommendation

The Committee recommends that foreign derivatives advisers and derivatives dealers be exempted from specific regulatory requirements in Canada where they are subject to an equivalent regulatory regime in their home jurisdiction. In these circumstances the foreign entity will still be required to register in all Canadian jurisdictions where it carries on business.

Where an equivalent regime does exist in the foreign entity's home jurisdiction, exemptions may be provided for requirements that apply to the entity, including:

- financial and solvency requirements;
- requirements relating to entity-level controls including requirements related to compliance and risk management systems; and
- specific requirements relating to entity-level record keeping.

These entities will not be exempt from the registration requirements described in parts 7.2(iii) and 7.3, if applicable, when dealing with Canadian clients and counterparties.

To benefit from the exemption foreign derivatives dealers and advisers will be expected to provide the relevant Canadian authorities with adequate information to allow them to determine whether the regulatory regime in their home jurisdiction is substantially equivalent to Canadian requirements.

This recommendation will require foreign dealers trading with Canadian counterparties, including qualified parties, or for derivatives dealers or derivatives advisers that act for Canadian clients, to register in the Canadian jurisdiction where the client or counterparty resides before entering into the derivatives trade or providing advice. This registration requirement will apply in all circumstances, including where the Canadian counterparty or client has operations in the foreign derivative dealer's home jurisdiction and the trade is booked there.

(c) Foreign LDPs

The Committee understands that an entity that would trigger the obligation to register as a LDP in any Canadian jurisdiction, but is a foreign resident, may already be subject to regulation in their home jurisdiction. The imposition of equivalent requirements in Canada could lead to duplicate regulation and would be inefficient.

Recommendation

The Committee recommends that foreign entities triggering the obligation to register as a LDP be required to register in each jurisdiction where their trading obligations exceed the prescribed thresholds. The Committee also recommends that foreign LDPs be exempted from specific registration requirements where that entity is subject to equivalent regulatory requirements in its home jurisdiction.

To benefit from the exemption large derivatives participants will be expected to provide the relevant Canadian authorities with adequate information to allow them to determine whether the regulatory requirements in their home jurisdiction are substantially equivalent to the applicable Canadian requirements.

Q19: The Committee is recommending that foreign resident derivative dealers dealing with Canadian entities that are qualified parties be required to register but be exempt from a number of registration requirements. Is this recommendation appropriate? Please explain.

Q20: Is the Committee's recommendation to exempt foreign resident derivatives dealers from Canadian registration requirements where equivalent requirements apply in their home jurisdictions appropriate? Please explain.

Q21: Should foreign derivatives dealers or advisers not registered in Canada be exempt from registration requirements where such requirements solely result from such entities trading with the Canadian federal government, provincial governments or with the Bank of Canada?

8.2 Exemptions from the Requirement to Registration

(a) Dealers Providing Advice

Derivatives dealers will often provide clients or counterparties with advice as an element of trading services. Often this advice is in connection with a trade that the derivatives dealer could make on behalf of the client or counterparty and assists that client or counterparty in making trading decisions.

Recommendation

The Committee recommends that a person registered as a derivatives dealer be exempt from the obligation to register as a derivatives adviser where:

- the obligation to register as a derivatives adviser results solely from the provision of advice in relation to a derivatives trade;
- the advice is not in relation to an account over which that the derivatives dealer has discretionary trading authority;
- the derivatives dealer does not charge a fee for the provision of the advice; and
- the derivatives dealer has complied with all of the registration requirements applicable to a derivatives adviser as described in part 7 of this paper.

(b) Governments

In some cases municipal, provincial, territorial or federal governments, or crown corporations, may carry on activities that could trigger registration as a derivatives dealer, derivatives adviser or as a LDP.

Recommendation

The Committee recommends that Canadian federal, provincial, territorial and municipal governments not be subject to an obligation to register. The Committee also recommends that federal and provincial crown corporations whose obligations are fully guaranteed by the applicable government should be exempt from the requirement to register as a LDP or as a derivatives dealer where the entity's trading activity is restricted to trading as a counterparty with persons that are qualified parties. This exemption is appropriate as governments and crown corporations whose obligations are guaranteed represent little risk to the market as they can rely on government resources to satisfy their obligations. However, where these crown corporations are acting as a derivatives adviser or as a derivatives dealer intermediating trades or trading with non-qualified counterparties, the clients and counterparties of these entities should benefit from the same regulatory protections that they would receive when dealing with derivatives advisers or derivatives dealers that are not crown corporations.

A crown corporation would not be exempt from a requirement to register where it:

- triggers registration as a derivatives adviser by advising entities that are not governments or crown corporations;
- triggers registration as a derivatives dealer and intermediates trades on behalf of clients that are not governments or crown corporations; or
- triggers registration as a derivatives dealer and trades with counterparties that are non-qualified parties.

Where a crown corporation is subject to an obligation to register the Committee recommends that the corporation be exempted from complying with the regulatory requirements described in part 7.1 of this paper where that corporation is subject to equivalent regulatory or oversight requirements.

The Committee does not recommend an exemption from the requirement to register for or from registration requirements for:

- domestic crown corporations whose obligations are not guaranteed by the applicable government;
- corporations owned by municipal governments;
- foreign governments; or
- corporations owned or controlled by foreign governments.

Foreign governments and corporations owned by foreign governments may benefit from the exemption for foreign derivatives dealers and advisers set out in part 8.1(b) above where such an exemption is applicable.

Q22: Is the proposal to exempt crown corporations whose obligations are fully guaranteed by the applicable government from registration as a LDP and, in the circumstances described, as a derivatives dealer appropriate? Should entities such as crown corporations whose obligations are not fully guaranteed, foreign governments or corporation owned or controlled by foreign governments benefit from comparable exemptions? Please provide an explanation for your answer.

(c) Clearing Agencies

Clearing agencies,[64] particularly central counterparties, may carry out a variety of activities which may cause them to carrying on the business of trading derivatives. The Committee recommends that, where a clearing agency has been recognized (or exempt from recognition) not be subject to a requirement to register as a derivatives dealer, derivatives adviser or a LDP where the obligation to register results solely from carrying on the ordinary business as a clearing agency.

(d) Transactions with Affiliated Entities

The CFTC in its final rule defining "swap dealer" has indicated that transaction between majority owned affiliates be excluded from swap dealer determination. The CFTC noted that swaps "between persons under common control may not involve interaction with unaffiliated persons that we believe is the hallmark of the elements that refer to holding oneself out as a dealer or being commonly known as a dealer".[65]

The Committee takes a similar view. Interaction between affiliated entities would not be activity that would typically be considered to be the business of trading.

Recommendation

The Committee recommends that persons that would be subject to registration as either a derivatives dealer or a derivatives adviser solely as a result of trading with or on behalf of or providing derivatives-related advice to a person that is their affiliate be exempt from the requirement to register as a derivatives dealer or derivatives adviser.

For the purposes of this part, two entities will be considered to be affiliated if:

- one is controlled, either directly or indirectly, by the other;
- both are controlled, either directly or indirectly, by a common entity.

Q23: Are the proposed registration exemptions appropriate? Are there additional exemptions from the obligation to register or from registration requirements that should be considered but that have not been listed?

9. Questions for public comment

Q1: Should investment funds be subject to the same registration triggers as other derivatives market participants? If not, what registration triggers should be applied to investment funds?

Q2: What is the appropriate standard for determining whether a person is a qualified party? Should the standard be based on the financial resources or the proficiency of the client or counterparty? If the standard is based on financial resources should it be based on the net assets of the client or counterparty, gross annual revenues of the client or counterparty, or some other factor or factors?

[64] In some jurisdictions clearing agencies are referred to as clearing houses. All references to clearing agencies in this paper are intended to also refer to clearing houses.

[65] Federal Register Volume 77, Issue 100\340\.

Q3: Should registration as a derivatives dealer be subject to a *de minimis* exemption similar to the exemption adopted by U.S. regulators? Please indicate why such an exemption is appropriate.

Q4: Are derivatives dealer, derivatives adviser and LDP the correct registration categories? Should the Committee consider recommending other or additional categories?

Q5: Are the factors listed the correct factors that should be considered in determining whether a person is in the business of trading derivatives? Please explain your answer.

Q6: The Committee is not proposing to include frequent derivatives trading activity as a factor that we will consider when determining whether a person triggers registration as a derivative dealer. Should frequent derivatives trading activity trigger an obligation to register where an entity is not otherwise subject to a requirement to register as a derivatives dealer or a LDP? Should entities that are carrying on frequent derivatives trading activity for speculative purposes be subject to a different registration trigger than entities trading primarily for the purpose of managing their business risks?

Q7: Is the proposal to impose derivatives dealer registration requirements on parties providing clearing services appropriate? Should an entity providing these clearing services only to qualified parties be exempt from regulation as a derivatives dealer?

Q8: Are the factors listed the correct factors that should be considered in determining whether a person is in the business of advising on derivatives?

Q9: Are the factors listed for determining whether an entity is a LDP appropriate? If not what factors should be considered? What factors should the Committee consider in determining whether an entity, as a result of its derivatives market exposures, could represent a serious adverse risk to the financial stability of Canada or a province or territory of Canada?

Q10: Is the Committee's proposal to only register derivative dealer representatives where they are dealing with clients or when dealing with counterparties that are non-qualified parties appropriate?

Q11: Is it appropriate to impose category or class specific proficiency requirements?

Q12: Is the proposed approach to establishing proficiency requirements appropriate?

Q13: Is the Committee's proposal to impose a requirement on registrants to "act honestly and in good faith" appropriate?

Q14: Are the requirements described appropriate registration requirements for derivatives dealers, derivatives advisers and LDPs? Are there any additional regulatory requirements that should apply to all categories of registrants? Please explain your answers.

Q15: Should derivatives dealers dealing with qualified parties be subject to business conduct standards such as the ones described in part 7.2(b)(iii) above? If so, please explain what standards should apply.

Q16: Do you have a preference between the two proposals relating to the regulation of a derivatives dealer trading with counterparties that are non-qualified parties? Is there

another option to address the conflict of interest that the Committee should consider? Please explain your answer.

Q17: Are the recommended requirements appropriate for registrants that are derivatives dealers? If not please explain. Are there any additional regulatory requirements that should apply to registered derivatives dealers?

Q18: Are the recommended requirements appropriate for registrants that are derivatives advisers? If not please explain. Are there any additional regulatory requirements that should apply to registered derivatives advisers?

Q19: The Committee is recommending that foreign resident derivative dealers dealing with Canadian entities that are qualified parties be required to register but be exempt from a number of registration requirements. Is this recommendation appropriate? Please explain.

Q20: Is the Committee's recommendation to exempt foreign resident derivatives dealers from Canadian registration requirements where equivalent requirements apply in their home jurisdictions appropriate? Please explain.

Q21: Should foreign derivatives dealers or advisers not registered in Canada be exempt from the obligation to register where such requirements solely result from such entities trading with the Canadian federal government or provincial governments or with the Bank of Canada?

Q22: Is the proposal to exempt crown corporations whose obligations are fully guaranteed by the applicable government from registration as a LDP and, in the circumstances described, as a derivatives dealer appropriate? Should entities such as crown corporations whose obligations are not fully guaranteed, foreign governments or corporation owned or controlled by foreign governments benefit from comparable exemptions? Please provide an explanation for your answer.

Q23: Are the proposed registration exemptions appropriate? Are there additional exemptions from the obligation to register or from registration requirements that should be considered but that have not been listed?

Schedule A

Registration Requirement	Derivative Dealers	Derivative Advisers	Large Derivative Participants	Individual Registrants
Proficiency requirements for staff (7.1(a))	X	X	X	
Minimum capital requirements (7.1(b)(i))	X	X	X	
Margin requirements (7.1(b)(ii))	X		X	
Insurance requirements (7.1(b)(iii))	X	X	X	
Financial records and reporting (7.1(b)(iv))	X	X	X	
Compliance and Risk Management Systems (7.1(c)(i))	X	X	X	X
Appointment of UDP, CCO and CRO (7.1(c)(ii))	X	X	X	
Record keeping (7.1(c)(iii))	X	X	X	
Complaint handling (7.1(c)(iv))	X	X	X	
Honest Dealing (7.1(d))	X	X	X	
Client/counterparty assets (7.1(e))	X		X	
Gatekeeper obligation (7.2(a))	X	X		
Know your client/counterparty (7.2(b)(iii)(A))	X*	X		X*
Suitability (7.2(b)(iii)(B))	X*	X		X*
Conflicts of interest (7.2(b)(iii)(C))	X*	X		X*
Fair dealing (7.2(b)(iii)(D))	X*	X		X*
Pre-trade reports (7.3(a))	X*			
Post-trade reports (7.3(b))	X*			
Client account statements (7.3(c))	X*			

* These requirements only apply to dealers and their representatives when trading for clients or with counterparties that are non-qualified parties.