COMPANION POLICY 91-501CP (BC)
TO BLANKET ORDER 91-501 (BC)

OVER-THE-COUNTER DERIVATIVES

PART 1 BACKGROUND AND PURPOSE

1.1 **Background -** The definition of "security" in the *Securities Act* includes "an instrument that is a futures contract or an option but is not an exchange contract". The Act also contains a definition of "futures contract", which was amended in June 1999. This aspect of the definition of "security" includes derivative instruments traded over-the-counter rather than on exchanges.

1.2 **Purpose -** The purpose of Blanket Order 91-501 (BC) is to enable certain parties to enter into OTC derivatives in British Columbia without being subject to the registration and prospectus requirements of the Act. This exemption is being provided on the basis that Qualified Parties, as defined in BOR#91-501 (BC), will be able to determine for themselves, without assistance from a registrant or any mandated disclosure under the Act, whether entering into an OTC derivative is appropriate in the circumstances. Similarly, it is assumed that Qualified Parties can assess the creditworthiness of their counterparties and the risks inherent in entering into OTC derivatives.

PART 2 INTERPRETATION

2.1 **Interpretation of "OTC derivative" -** "OTC derivative" is defined in BOR#91-501 (BC). This definition is intended to encompass forward contracts, commodity contracts, contracts for differences, options on those contracts, and any other type of contract, option or instrument commonly considered to be an OTC derivative.

2.2 **Interpretation of paragraph (p) of the definition of "Qualified Party"**

(1) Paragraph (p) of the definition of "Qualified Party" in section 1.1 of BOR#91-501 (BC) is intended to apply to a person that deals in a commodity and enters into an OTC derivative where a material component of the underlying interest is, directly or indirectly, the commodity in which the party deals, or a related, affecting or correlating commodity, security or variable. The Commission's

intention is to provide an exemption for persons that enter into OTC derivatives for the purpose of commercial hedging.

(2) Paragraph (p) provides for hedging by way of OTC derivatives based on a variety of underlying interests. For example, a producer of apples could enter into OTC derivatives based on:

- apples (sub-paragraph (i) of the definition),
- apple juice (sub-paragraph (ii) - a related commodity),
- the weather in apple growing regions (sub-paragraph (iii) - a variable that affects the production of apples),
- farm income in apple-growing regions (sub-paragraph (iv) - a variable having a high degree of correlation with the price of apples), or
- another OTC derivative based on any of the above.

(3) Similarly, a gold producer could enter into OTC derivatives based on gold (sub-paragraph (i)) or gold producer shares (sub-paragraphs (ii) or (iv)). A ski hill operator could enter into OTC derivatives based on average temperatures or snowfall in a geographic area (sub-paragraph (iii)).

(4) These examples are provided for illustration only. The parties to an OTC derivative must determine in their particular circumstances whether the definition applies and, if so, must decide whether entering into the OTC derivative is an appropriate hedging strategy.