

2010 BCSECCOM 320

Headnote

A foreign issuer wants to offer over-the-counter contracts for difference and foreign exchange contracts to retail investors in British Columbia without a prospectus - The issuer is a UK company regulated by the FSA; the securities will be offered through a registered Canadian dealer affiliate that is a member of IIROC; the prospectus regime is not well suited for an offer of over-the-counter contracts for difference and foreign exchange contracts; retail investors will receive a plain language risk disclosure document and will be required to positively acknowledge that they have read and understood the risk disclosure document

Exemption Order

**CMC Markets UK Plc
and
CMC Markets Canada Inc.**

Section 76 of the *Securities Act*, R.S.B.C. 1996, c. 418

Background

- ¶ 1 CMC Markets UK plc (CMC UK) and CMC Markets Canada Inc. (CMC Canada) (together, the Filers) have applied for an exemption from the requirements to file and obtain receipts for a preliminary prospectus and prospectus in section 61 of the Act (Prospectus Requirement) in respect of the distribution of contracts for difference and over-the-counter (OTC) foreign exchange contracts (collectively, CFDs) to investors resident in British Columbia (the Requested Relief).

Representations

- ¶ 2 The Filers represent that:
1. CMC Markets Plc, the ultimate parent company of both CMC UK and CMC Canada, is a privately held company controlled directly by its principal founder, Mr. Peter Cruddas;
 2. founded in 1989, CMC UK is an established international on-line trading company which, with its affiliates, offers CFDs to a broad range of clients in many countries;

2010 BCSECCOM 320

3. CMC UK is a privately-held company organized under the laws of England and Wales with its principal office in London, United Kingdom;
4. CMC Markets plc has established a Canadian dealer affiliate, CMC Canada, to act as a dealer for CFDs offered by CMC UK to Canadian clients;
5. CMC Canada is a corporation amalgamated under the laws of Canada with its principal office in Toronto, Ontario and is an affiliate of CMC UK;
6. CMC UK is authorized and regulated by the Financial Services Authority (the FSA) in the United Kingdom; CMC UK is licensed in the United Kingdom, among other things, to act as principal to its clients in the products it offers and may deal with all categories of clients, including directly with retail clients;
7. CMC UK is a “regulated entity” as defined in the rules and regulations (the IIROC Rules) of the Investment Industry Regulatory Organization of Canada (IIROC);
8. CMC UK is not a reporting issuer in any jurisdiction in Canada;
9. CMC UK currently offers CFDs to “accredited investors” (as defined in National Instrument 45-106 *Prospectus and Registration Exemptions*) (NI 45-106) in Canada, other than in the provinces of Ontario and Québec, on a private placement basis through CMC Canada as dealer and predominantly through CMC UK’s *Marketmaker®* on-line trading platform;
10. CMC UK is not, to the best of its knowledge, in default of any requirements of securities legislation in any jurisdiction of Canada or similar legislation in the United Kingdom;
11. in Québec, the Filers currently offer CFDs to both accredited and non-accredited investors (referred to herein as retail investors), pursuant to the provisions of the *Derivatives Act* (Québec) (the QDA) and the conditions contained in the Order dated June 16, 2009 issued by the *Autorité des marchés financiers* (the AMF) (the AMF Order); the AMF Order exempts CMC UK from the qualifying requirement set forth in section 82 of the QDA relating to the creation or marketing of CFDs offered to the public, subject to certain terms and conditions;
12. in Ontario, the Filers currently offer CFDs to retail investors pursuant to an order made by the Ontario Securities Commission (the OSC) under Section 74

2010 BCSECCOM 320

of the *Securities Act* (Ontario) (the OSA) dated October 8, 2009 (the OSC Order); the OSC Order exempts the Filers from the prospectus requirements in Section 53 of the OSA, subject to the terms and conditions set forth in the OSC Order;

13. CMC UK wishes to offer CFDs to investors, including retail investors, in British Columbia on a similar basis as in Ontario and Québec and on substantially the same terms and conditions as articulated in the QDA, the AMF Order and the OSC Order; for the Interim Period (defined below), both CMC UK and CMC Canada are seeking the Requested Relief in connection with this proposed offering in British Columbia;
14. none of CMC UK nor any of its affiliates have any securities listed or quoted on an exchange or marketplace in any jurisdiction inside or outside of Canada;
15. CMC Canada is registered in the category of investment dealer in all provinces and territories except Alberta and is a member of IIROC;
16. CMC Canada is not, to the best of its knowledge, in default of any requirements of securities legislation in jurisdiction of Canada;
17. CMC Canada as an IIROC member is required to have specified minimum capital which includes having any additional capital IIROC requires for margin requirements and to address other risks;
18. as a member of IIROC, CMC Canada is only permitted to distribute CFDs pursuant to IIROC Rules; CMC Canada is not, to the best of its knowledge, in default of any IIROC Rules;
19. IIROC has published certain additional expectations as to acceptable business practices for members proposing to issue CFDs and foreign exchange contracts (IIROC acceptable practices) in the publication titled "Regulatory Analysis of Contracts for Differences (CFDs)" published by IIROC on June 6, 2007, as amended on September 12, 2007;
20. to the best of its knowledge, CMC Canada is in compliance with IIROC acceptable practices for its offerings of CFDs;
21. a CFD is a derivative product that allows clients to obtain economic exposure to the price movement of an underlying instrument, such as a share, index, market sector, foreign currency, treasury, or commodity, without the need for ownership and physical settlement of the underlying instrument;

2010 BCSECCOM 320

22. a CFD is an agreement between a counterparty and a client to exchange the difference between the opening price of a CFD position and the price of the CFD at the closing of the position; the value of the CFD is generally reflective of the movement in prices at which the underlying instrument is traded at the time of opening and closing the position in the CFD;
23. in the case of CFDs offered by CMC UK in respect of which the underlying interest is a security, the CFDs do not confer the right or obligation to acquire or deliver the underlying security, and do not confer any other rights of holders of the underlying security, such as voting rights;
24. in the case of CFDs offered by CMC UK to investors in British Columbia in reliance on the Requested Relief, CMC UK will act as the sole counterparty and such CFDs will be offered exclusively through CMC Canada as dealer;
25. the ability to leverage an investment has traditionally been one of the principal features of CFDs, allowing clients to magnify potential investment returns or losses by reducing the initial capital outlay required to achieve the same market exposure that would be obtained by investing directly in the underlying instrument;
26. IIROC Rules and IIROC acceptable practices set out detailed requirements and expectations relating to leverage and margin for offerings of CFDs; consequently, CFDs offered in Canada in accordance with IIROC Rules and IIROC acceptable practices will generally employ the same degree of leverage as traditional margin accounts for long and short positions in securities; however, the degree of leverage may be amended in accordance with IIROC Rules and IIROC acceptable practices as may be established from time to time;
27. in British Columbia, CFDs and similar OTC derivative contracts, including OTC foreign exchange contracts not contemplated by the exemption provided in Blanket Order 91-502 *Short Term Foreign Exchange Contracts*, are “securities” under the Act;
28. investors wishing to purchase CFDs must open an account with CMC Canada and complete a principal contract with CMC UK;
29. prior to a client’s first CFD trade and as part of the account opening process, CMC Canada and CMC UK will provide the client with a separate risk disclosure document that clearly explains, in plain language, the product and the risks associated with an investment in the product (the risk disclosure

2010 BCSECCOM 320

document) and other documents as required by the FSA including a risk warning notice and execution policy summary;

30. the risk disclosure document includes the required risk disclosure in Schedule A to the Regulations to the QDA, leverage risk disclosure required under IIROC Rules, and also contains disclosure that is substantially similar to the risk disclosure statement required for exchange contracts in BC Form 91-903F Risk Disclosure Statement (Exchange Contracts);
31. prior to the client's first CFD trade and as part of the account opening process, the Filers will obtain a written or electronic acknowledgement from the client confirming that the client has received, read, and understood the risk disclosure document; such acknowledgment will take the form of a positive act by the client, and be separate and prominent from other acknowledgements provided by the client as part of the account opening process;
32. investors purchase CFDs through CMC Markets' on-line trading platform, *Marketmaker®*; CMC UK's on-line platform is similar to those developed for on-line brokerages and day-trading in that the investor trades without other communication with, or advice from, the dealer;
33. the *Marketmaker®* is not a "marketplace" as defined in National Instrument 21-101 *Marketplace Operation*; the *Marketmaker®* does not bring together multiple buyers and sellers; rather it is a market maker that quotes the buy and sell price of a CFD offered by CMC UK to the investor on a principal basis;
34. the role of CMC Canada is limited to acting as an execution-only dealer; in connection with its role as execution-only dealer, CMC Canada is, among other things, responsible for marketing, trade execution, administration of account opening and investor approval (including know-your-client diligence and suitability confirmations) for all Canadian clients;
35. IIROC Rules exempt member firms that provide execution-only services such as discount brokerage from the obligation to determine whether each trade is suitable for the client; however, IIROC has exercised its discretion to impose additional requirements on members proposing to issue CFDs and requires that:
 - (a) applicable risk disclosure documents and client suitability waivers provided must be in a form acceptable to IIROC;
 - (b) the firm's policies and procedures, amongst other things, must enable the firm to assess the depth of investment knowledge, financial position, and

2010 BCSECCOM 320

trading experience of the client to assess whether the CFD product itself is appropriate for the client before an account is approved to be opened;

- (c) CMC Canada's registered salespeople who conduct the know your client and initial product suitability analysis, as well as their supervisory trading officer, meet proficiency requirements for futures trading;
 - (d) the relationship and responsibilities, including conflicts of interest between the issuer and dealer, must be fully disclosed to the client and acknowledged in writing; and
 - (e) cumulative loss limits for each client's account must be established;
36. CFDs offered by CMC UK in Canada are offered in compliance with the margin rates approved by IIROC and in compliance with IIROC Rules and IIROC acceptable practices;
37. IIROC limits the underlying instruments in respect of which a member firm may issue CFDs since only certain securities are eligible for reduced margin rates; for example, underlying equity securities must be listed or quoted on certain "recognized exchanges" (as that term is defined in IIROC rules) such as TSX or the NYSE; the purpose of these limits is to ensure that CFDs offered in Canada will only be available in respect of underlying instruments that are traded in well-regulated markets, in significant enough volumes and with adequate publicly available information, so that investors can form a sufficient understanding of the exposure represented by a given CFD;
38. unlike recognized clearing organizations that act as a central counterparty and guarantee the performance and payment obligations of contract positions to all its participants, CMC Canada has no obligations in the event of credit default by CMC UK or the investor, except to manage the flow of money between the two parties to the CFD;
39. as an FSA-regulated firm, CMC UK is required to comply with certain rules of the FSA (the FSA Rules);
40. the FSA Rules seek to ensure, among other things, that regulated firms satisfy certain minimum standards including the requirement that CMC UK maintain adequate financial resources at all times, so that CMC UK is able to meet its liabilities as they fall due;

2010 BCSECCOM 320

41. the FSA requires CMC UK to maintain capital resources equal to or in excess of its base capital requirement plus a firm specific variable capital requirement to address market, capital, and operational risks;
42. CMC UK monitors its regulatory capital on a daily basis (or more frequently depending on market conditions);
43. the FSA also requires CMC UK to:
 - (a) file financial reports on a monthly basis with the FSA;
 - (b) immediately notify the FSA of any breach of the capital adequacy requirement; and
 - (c) submit its audited financial statements within three months of the financial year end together with an annual return and reconciliation of the annual return to the audited financial statements;
44. CMC UK has furnished to the Commission the name and principal occupation of its officers or directors, together with either the personal information form and authorization of indirect collection, use and disclosure of personal information provided for in National Instrument 41-101 *General Prospectus Requirements* or the registration information form for an individual provided for in Form 33-109F4 of National Instrument 33-109 *Registration Information Requirements* completed by any officer or director.

Order

¶ 3 Considering that it is not prejudicial to the public interest, the Commission orders that the Filers are exempt from the Prospectus Requirement for trades of CFDs provided that:

1. CMC UK remains registered with the FSA and in compliance in all material respects with FSA Rules;
2. all CFDs offered by CMC UK to clients resident in British Columbia are distributed through CMC Canada;
3. CMC Canada remains registered as a dealer in the category of investment dealer with the Commission and a member of IIROC;
4. all distributions of CFDs by CMC Canada to clients resident in British Columbia be conducted pursuant to IIROC Rules imposed on members

2010 BCSECCOM 320

seeking to distribute CFDs and in accordance with IIROC acceptable practices, as amended from time to time;

5. all distributions of CFDs by CMC Canada to clients resident in British Columbia be conducted pursuant to the rules and regulations of the QDA and the AMF and OSC Notice 91-702 - Offerings of Contracts for Difference and Foreign Exchange Contracts to Investors (OSC Notice 91-702) and the OSC Order, as amended from time to time, unless and to the extent there is a conflict between i) the rules and regulations of the QDA and the AMF or OSC Notice 91-702 or the OSC Order and ii) the requirements of British Columbia securities law, the IIROC Rules and IIROC acceptable practices, in which case the latter will prevail;
6. prior to a client's first CFD trade, the Filers have provided to the client the risk disclosure document described in paragraph 29 and 30;
7. prior to the client's first CFD trade and as part of the account opening process, the Filers have obtained a written or electronic acknowledgement from the client, as described in paragraph 31, confirming that the client has received, read, and understood the risk disclosure document;
8. CMC UK will promptly inform the Commission in writing of any material change affecting CMC UK, being any change in the business, activities, operations or financial results or condition of CMC UK that may reasonably be perceived by a counterparty to a derivative to be material;
9. CMC UK and/or CMC Canada will promptly inform the Commission in writing if any self-regulatory organization or any regulatory authority or organization initiates proceedings or renders a judgment related to disciplinary matters against CMC UK or CMC Canada respectively concerning the conduct of activities with respect to CFDs;
10. within 90 days following the end of its financial year, CMC UK will submit to the Commission the audited annual financial statements of CMC Markets Plc and a statement presenting the number of contracts concluded with British Columbia residents for any CFDs offered to the public during the most recent financial year;
11. the Requested Relief will immediately expire upon the earliest of:
 - (a) four years from the date that this Order is issued;

2010 BCSECCOM 320

- (b) the issuance of an order or decision by a court, the FSA, the AMF, the OSC or other similar regulatory body that suspends or terminates the ability of CMC UK to offer CFDs to clients in the UK or the ability of the Filers to offer CFDs to clients in Quebec and Ontario; and
- (c) the coming into force in British Columbia of legislation or a rule regarding the distribution of OTC derivatives to investors in British Columbia.

¶ 4 May 14, 2010

Brent Aitken
Vice-Chair, Corporate Finance
British Columbia Securities Commission