

DERIVATIVES REGISTRATION

...in a nutshell

Overview

The Canadian Securities Administrators (CSA) – including the Ontario Securities Commission (OSC) – are developing rules to regulate over-the-counter (OTC) derivatives markets in Canada. In April 2013, the CSA published Consultation Paper 91-407 *Derivatives: Registration* (the Consultation Paper)¹, which outlined the CSA's proposal for the registration of derivatives market participants. Although the proposed derivatives registration regime appears similar to the current securities registration regime, some important differences are noted below.

Who will this impact?

Nearly every market participant “in the business” of trading or advising clients in OTC derivative instruments will need to be registered in the jurisdictions in which they carry on business. This may include investment funds, fund managers, portfolio managers, advisers, dealers and commodities markets participants.

If a firm or individual is registered under the securities registration regime, and is trading or advising clients in derivative instruments, they may also be required to register under the derivatives registration regime. Unlike the United States derivatives regime, the Consultation Paper does not contemplate an exemption for persons who engage in a *de minimis* quantity of dealing in derivatives.

There are three proposed categories of firm registration: derivatives dealer, derivatives adviser, and large derivatives participant². A firm will need to conduct a fact-based analysis to determine whether it is “in the business”, taking the following factors into account:

FIRMS	
Derivatives Dealer (trading in derivative instruments)	Derivatives Adviser (advising clients in derivative instruments)
<ul style="list-style-type: none"> • intermediating trades • acting as a market maker • trading with the intention of being remunerated or compensated (commissions) • directly or indirectly soliciting (contacting or advertising trading services) • providing clearing services to third parties (as a member of a clearing agency) • trading on a repetitive basis with a counterparty that is a non-qualified³ party that is not represented by a derivatives dealer or adviser • engaging in activities similar to a dealer 	<ul style="list-style-type: none"> • directly or indirectly providing advice about derivatives trading activity with repetition, regularity, or continuity • being, or expecting to be, remunerated or compensated • directly or indirectly soliciting • engaging in activities similar to a derivatives adviser

The following individuals may be required to register:

- ultimate designated person (UDP), chief compliance officer (CCO), and chief risk officer (CRO)⁴;
- representatives of a derivatives adviser that provide clients with advice relating to derivatives; and
- representatives of a derivatives dealer that provide services relating to trading, or, depending on the CSA's proposed rules, where they deal with non-qualified counterparties⁵.

¹ Securities legislation in certain provinces contemplate exchange-traded futures contracts as “securities”. It is expected that the final rules to regulate derivatives will clarify whether the proposed regime will include such contracts.

² The category of registration for large derivatives participants applies to those whose positions are so substantial that they pose a systemic risk to Canadian financial markets or economic stability. This new category is modeled after the Major Swap Participant Category in the equivalent regime in the United States. At this early stage, the CSA has not publicly identified any parties that fit within this category that are not also exempt from registration, nor does it provide thresholds for registration in this category.

³ The proposed definition of “non-qualified” has not been confirmed.

⁴ Chief risk officer (CRO) is a new category of registration. The CRO will be responsible for the development and operation of a risk management framework that identifies, measures and supervises derivatives-related risks.

⁵ The Consultation Paper considers two alternatives for individual dealing representatives who trade with non-qualified parties: (i) derivatives dealers would be required to receive independent advice from a registered derivatives adviser regarding each proposed transaction; or (ii) counterparties would be permitted to waive independent advice after being informed of all conflicts of interest in writing.

What will be required of registrants?

Registrant Requirement	Derivatives Dealers	Derivatives Advisers	Individual Representatives
Proficiency requirements for staff	✓	✓	
Minimum capital requirements	✓	✓	
Margin requirements	✓	✓	
Insurance requirements	✓	✓	
Financial records and periodic financial reporting	✓	✓	
Compliance and Risk Management systems (developing and maintaining policies and procedures, internal controls on trading and/or advising)	✓	✓	✓
Appointment of UDP, CCO, and CRO	✓	✓	
Record keeping	✓	✓	
Complaint handling	✓	✓	
Honest Dealing	✓	✓	
Client/counterparty assets (see Consultation Paper 91-404 <i>Derivatives: Segregation and Portability in OTC Derivatives Clearing</i>)	✓		
Gatekeeper obligation (including anti-money laundering and client identity)	✓	✓	
Know your client/counterparty	✓*	✓†	✓*
Suitability	✓*	✓†	✓*
Conflicts of interest	✓*	✓†	✓*
Fair dealing	✓*	✓†	✓*
Pre-trade reporting	✓*		
Post-trade reporting	✓*		
Client account statements	✓*		

* Applies only to derivatives dealers and their representatives who trade with clients or counterparties that are non-qualified parties.
†These requirements will apply to derivatives advisers irrespective of whether their clients or counterparties are qualified parties.

Will there be exemptions from the registration requirement?

The Consultation Paper contemplates that certain entities may be exempt from registration. For example, a person registered as a derivatives dealer may be exempt from registration where it provides advice solely related to a derivatives trade, and other conditions are met. In addition, a firm trading or advising in derivatives transactions with an affiliate may also be exempt. The Consultation Paper suggests that this regime will be as comprehensive as National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*; accordingly, we anticipate that considerable preparation will be required by firms and individuals to meet the obligations.

Next steps?

Although the CSA has not communicated a specific timeline, we anticipate rules being published for comment early in 2014. If you have any questions or would like to discuss further, please contact any one of the following at AUM Law:

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