

CSA MI 93-101 Derivatives: Business Conduct

Regulation Overview and Requirements Summary

Rule Overview

On September 28, 2023 the CSA published the final version of Multilateral Instrument (MI) & Companion Policy (CP) 93-101 Derivatives: Business Conduct. The Instrument aims to protect participants in the OTC derivatives markets from unfair, improper or fraudulent practices, reduce risks, improve transparency, increase accountability and promote responsible business conduct in the OTC derivatives markets. The Instrument will be adopted by the CSA regulatory authorities of all Canadian Provinces and Territories except for B.C. who intends to adopt similar rules at a later date.

Derivatives Firms and Activities Covered

- The Instrument applies to federally regulated Canadian financial institutions that are in the business of trading (“derivatives dealer”) or advising (“derivatives advisor”) in OTC derivatives;
- All transactions in OTC derivatives, including commodity derivatives are covered. Specific provisions also apply to short-term foreign exchange contracts for derivatives dealers that have gross notional amounts of outstanding derivatives exceeding \$500 billion;
- Those in the business of trading in OTC derivatives in a Participating Jurisdiction may be exempt from the requirements of the Instrument if they qualify for an exemption available in the MI.

Timelines

- The Instrument comes into force on September 28, 2024;
- Transactions entered into before September 28, 2024 will not apply to the Instrument, other than the Fair Dealing requirements;
- There is a transition period until September 28, 2029 to assist derivatives firms transition to the new regulatory framework which during this period there will be additional types of sophisticated parties that can qualify as a “eligible derivatives party”;
- Derivatives firms have until September 28, 2025 to obtain waivers for certain individuals and eligible commercial hedgers to exempt from the additional obligations covered in Sections 14 to 29.

Structure of the Instrument

The Instrument takes a principles-based, two-tiered approach to regulating the conduct of derivatives firms:

- ① Obligations applying in all cases when a derivatives firm is dealing with or advising a derivatives party, regardless of the level of sophistication or financial resources of the derivatives party
- ② Additional obligations to further protect “retail” customers or investors that are less sophisticated and do not have the financial resources to purchase professional advice:
 - i Apply when the derivatives firm is dealing with a derivatives party that is not an “eligible derivatives party”
 - ii Apply but may be waived if the derivatives firm is dealing with a derivatives party that is an “eligible derivatives party” that is an individual or specified commercial hedger.

The Instrument covers requirements related to each of the following:

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| <ul style="list-style-type: none">• Fair Dealing• Conflicts of Interest• Know your Derivatives Party• Suitability• Pre-Transaction Disclosure | <ul style="list-style-type: none">• Reporting of Non-Compliance• Compliance• Senior Management Duties• Recordkeeping• Treatment of Derivatives Party Assets |
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Requirements for Investor/Customer Protection

NI 93-101 takes a two-tiered approach to investor/customer protection where there are (i) certain obligations that apply when dealing with any derivatives party, and (ii) additional obligations that apply when dealing with derivatives parties that are less sophisticated or have fewer financial resources.

The following are the general obligations towards all derivatives parties:

Fair Dealing	Requirements	A derivatives firm must act fairly, honestly and in good faith with a derivatives party.
Conflicts of Interest		A derivatives firm must establish, maintain and apply reasonable policies and procedures to identify existing and potential material conflicts of interest between the derivatives firm and a derivatives party, and disclose, in a timely manner, the nature and extent of the conflict of interest to the derivatives party.
Know your Derivatives Party		Collect information such as the identify of a derivatives party and the nature of its business, and whether it is an insider to non-public information of the underlying.
Handing Complaints		Document and, in a manner that a reasonable person would consider fair and effective, promptly respond to each complaint made to the derivatives firm about any product or service offered.
Tied Selling		A derivatives firm must not impose undue pressure on or coerce a person to obtain a derivatives-related product or service as a condition of obtaining another product or service from the derivatives firm.

The following are additional obligations that apply when a derivatives firm is dealing with (i) a non-eligible derivatives party, or (ii) an eligible derivatives party who is either an individual or eligible commercial hedger that has not waived these protections:

Derivatives Party Needs, Objectives, and Suitability	Additional Requirements	Before making a recommendation to or accepting an instruction from a derivatives party to transact in a derivative, the derivatives firm must take reasonable steps to understand the derivatives party's needs, objectives, financial circumstances, risk tolerance, and ensure the transaction is suitable.
Permitted Referral Arrangements		A derivatives firm must not participate in a referral arrangement unless the arrangement terms and fees are first disclosed in writing to the derivatives party and the qualifications of the firm receiving the referral have been verified.
Disclosure to Derivatives Parties		Before transacting with a derivatives party for the first time, a derivatives firm must disclose all information about the arrangement such as fees, derivatives and services offered, and reporting
Derivatives Party Assets		A derivatives firm must segregate derivatives party assets, hold initial margin at a permitted depository, and not use or invest initial margin without receiving written consent from the derivatives party.
Reporting to Derivatives Parties		A derivatives firm must provide the following reporting to its derivatives parties: <ul style="list-style-type: none"> - Written confirmation following each transaction showing details of the trade - Daily valuations available to the derivatives party for each derivative it has transacted with - Quarterly valuation statements, unless the derivatives party opts for monthly statements

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Additional Compliance Requirements and Available Exemptions

Additional Requirements of Compliance and Recordkeeping

A derivatives firm must establish, maintain and apply policies and procedures that establish a system of controls and supervision to ensure the following:

- 1 The derivatives firm complies with securities legislation relating to trading and advising in derivatives
- 2 The risks relating to its derivatives activities are managed in accordance with its risk management policies and procedures
- 3 The individuals performing transactions or advice in a derivative are well qualified to understand the nature of the product and its risks, and act with integrity

If any non-compliance creates a risk of material harm to a derivatives party, capital markets, or is part of a pattern of material non-compliance the derivatives dealer is to report the circumstance to the regulator.

A derivatives dealer must designate an individual as a senior derivatives manager for each derivatives business unit who will:

- 1 Supervise the derivatives-related activities conducted in the derivatives business unit
- 2 Respond by addressing, in a timely manner, any material non-compliance with this regulation, including reporting to the chief compliance officer.
- 3 Every calendar year, prepare a report that is to be submitted to the board of directors containing (i) each incident of material non-compliance, (ii) the steps taken to respond to each incidence of material non-compliance, (iii) state whether the business unit is in material compliance of the NI.

Records to be maintained as part of this Instrument are to be maintained for 7 years (or 8 years in Manitoba) from the record creation date.

Exemptions

The following are exemptions from the entire instrument:

Exemptions Available	Conditions Required to Meet Exemption
Foreign Liquidity Providers – Transacting with Derivatives Dealers	(i) Transactions are made with either an investment dealer or derivatives dealer that is transacting as principal for its own account (ii) Head office & principal place of business is outside Canada and is not a Canadian financial institution
Certain Derivatives End-Users	(i) Does not deal with a non-eligible derivatives party (NEDP) (ii) Is not market-making, does not intermediate transactions for another person, & does not facilitate clearing
Foreign Derivatives Dealers	(i) Head office & principal place of business is outside Canada and is not a Canadian financial institution (ii) Business is performed in the location of its head office or principal place of business (iii) Dealing only with eligible derivatives parties (EDP)

There are also exemptions available to specific provisions in the instrument:

- Derivatives transacted on a derivatives trading facility where the identity of the derivatives party is unknown (*Exempted: Section 9, 19, Part 5*)
- Does not deal with a NEDP & gross notional amount of outstanding derivatives does not exceed \$250 million (*Exempted: Section 9, 10, 28*)
- Does not deal with a NEDP, only deals in commodity derivatives & gross amount of outstanding commodity derivatives does not exceed \$10 billion (*Exempted: Section 9, 10, 28*)
- Investment Dealer Members of CIRO (*Exempted: Appendix D*)

There are also exemptions available for derivatives advisors advising generally, foreign derivatives advisors and sub-advisors, & registered advisors of futures legislation.

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