

Registration Reform

IN CANADA
The Finish Line is Here

Section N of Stikeman Elliott's Report on Canada's New Registration Regime
JULY 2009

Quebec's Derivatives Act



Quebec's Derivatives Act

On July 17, 2009, the Canadian Securities Administrators (the CSA) published their final proposal for National Instrument 31-103 - *Registration Requirements and Exemptions* (31-103). Subject to governmental and other local approval requirements, 31-103 will come into force on September 28, 2009 (the Implementation Date).

The adoption of 31-103 in Quebec can be expected to accelerate the further implementation of the Quebec *Derivatives Act* (QDA) which came into force in Quebec on February 1, 2009 and governs trading and advisory activities relating to all forms of derivatives.

Highlights of QDA

Overview

The QDA is comprehensive stand alone derivatives legislation which regulates both over-the-counter (OTC) and exchange-traded derivatives, subject to certain carve outs for OTC derivatives activities involving “accredited counterparties” and in other cases to be specified by regulation. A series of client updates published in connection with the adoption of the QDA can be found at Stikeman Elliott's securities blog, www.canadiansecuritieslaw.com, as a [January 21, 2009 posting](#) and a [January 30, 2009 posting](#).

Key Requirements

The QDA imposes a requirement to register as a derivatives dealer or adviser for any person that engages in those activities in Quebec. The QDA also sets out a recognition requirement for “regulated entities” (including exchanges, alternative trading systems not registered as derivatives dealers or other published markets, clearing houses, information processors and self-regulatory organizations) which carry on derivatives activities in Quebec. The QDA further requires that any person other than a “recognized regulated entity” that seeks to “create or market” a derivative be qualified by the *Autorité des marchés*

financiers (AMF), Quebec's financial services regulator (the derivatives qualification requirement) and that the derivative be approved by the AMF (the derivatives approval requirement). The QDA also contains rules for the purposes of determining whether so-called "hybrid products" are to be regulated as derivatives under the QDA or as securities under Quebec securities legislation.

Derivatives Regulation and Interaction with 31-103

The QDA is formulated as principles-based legislation and its key provisions cross-reference regulations which (for the most part) have yet to be published. The current *Derivatives Regulation* covers a limited range of matters, including the minimum asset requirement for self-certified "accredited counterparties" (discussed below), the rules for self-certification of operating rules of "recognized regulated entities", and the prescribed information document to be delivered to by derivatives dealers.

The AMF is expected to publish a more comprehensive Derivatives Regulation following the adoption in Quebec of 31-103. This regulation is expected to incorporate by reference a number of provisions of 31-103 governing individual and firm registration with respect to derivatives dealers and advisers registered under the QDA. The regulation would also likely cross-reference detailed provisions of 31-103 governing the business operations and client relationships of registered firms.

OTC Derivatives – Section 7 of the QDA sets out an important blanket exemption for OTC derivatives "involving accredited counterparties only or in any other cases specified by regulation" from the application of certain specified provisions, including the derivatives dealer and adviser registration requirements, the derivatives qualification and approval requirements, and certain limited procedural and enforcement-related provisions, except in the case of market manipulation and fraud (the OTC Derivatives Exemption). The list of "accredited counterparties" includes most of the leading Quebec institutional investors, as well as accredited persons meeting certain subjective (knowledge and experience) and objective (minimum financial assets) tests and qualified "hedgers".

Exchange-Traded Derivatives – Significantly, the QDA does not contain any exemption for exchange-traded derivatives activities that is equivalent to the OTC Derivatives Exemption. With the coming into force of the QDA on February 1, 2009, this marked a significant departure from the existing "accredited investor" exemptions under Quebec securities legislation on the basis of which many Canadian, U.S. and other foreign dealers had historically engaged in exchange-traded derivatives activities outside of Quebec for Quebec-resident institutional investors.

It remains unclear whether the application of the international dealer and international adviser exemptions under 31-103 to qualified non-Canadian dealers and advisers will be extended to the QDA. See the discussion under topics

Impact on International Dealers and Non-Canadians Trading in the Exempt Market and Impact on International Advisers.

What seems more likely is that the AMF will develop a specially tailored exemption regime that is generally analogous to those exemptions but which incorporates appropriate exemptions from the derivatives dealer/adviser registration requirements, and the derivatives qualification and approval requirements.

The AMF Blanket Decision – In the interim, the AMF has responded to the above concerns in part by issuing a blanket decision (the AMF Blanket Decision) that sets out an exemption from the derivatives dealer and adviser registration requirements and the derivatives qualification rules under the QDA for specified derivatives activities carried out solely with accredited investors as defined under the soon to be revised National Instrument 45-106 *Prospectus and Registration Exemptions* (45-106).

The AMF Blanket Decision will continue to apply for an unspecified temporary period and is subject to the following conditions:

- the derivatives activities must be carried out solely with accredited investors as defined under NI 45-106 and in accordance with the conditions set forth in that instrument (including the filing of a report under Part 6); and
- the activities must relate only to the following categories of derivatives (the Specified Categories) which were regulated under the *Securities Act* (Quebec) prior to the coming into force of the QDA:
 - an option or a negotiable futures contract pertaining to securities, or a Treasury bond futures contract;
 - an option on a commodity futures contract or financial instrument futures contract;
 - commodities futures contracts, financial futures contracts, currencies futures contracts and stock indices futures contracts.

The notices published by the AMF in conjunction with the coming-into-force of the QDA (the QDA Implementation Documents) include ancillary statements that would appear to imply that the relief under the AMF Blanket Decision is restricted to OTC derivatives. There is in fact no such restriction in the decision which we understand is intended to cover both OTC and exchange-traded derivatives of a type covered by the Specified Categories. All other derivatives are subject to the QDA.

Other QDA Transitional Relief – In addition to the AMF Blanket Decision, the QDA Implementation Documents contain other important transitional relief, namely:

- The postponement of the coming into force of provisions dealing with derivatives dealer and adviser registration categories and procedures to permit the incorporation of registration-related requirements under 31-103 and related instruments;

- The postponement of the coming into force of the derivatives approval requirement (outlined above). The stated intention of this measure is to “*permit the [Canadian Securities Administrators] to complete harmonization initiatives with respect to derivatives offered to the public*”; and
- A six-month window (to August 1, 2009) to enable financial sector participants to phase in the implementation of derivatives-related compliance measures to address new requirements under the QDA. This window has enabled, in particular, participants in the OTC derivatives industry seeking to rely on the OTC Derivatives Exemption to qualify current OTC counterparties as “accredited counterparties” for new transactions (and, depending on the terms, potentially for re-couponing), obtain appropriate counterparty representations and make the required amendments to ISDA and other documentation.

Industry participants that engage in derivatives trading or advisory activities in Quebec not covered by the OTC Derivatives Exemption, the AMF Blanket Decision and the other transitional relief described above will have to apply to the AMF for specific exemptive relief.

Registration Reform in Canada:

The Finish Line is Here

Canada's new registration rule was published by the Canadian securities administrators in final form on July 17, 2009.

The new regime is expected to be in force September 28, 2009 with transition periods for implementation of aspects varying. The new regime, which has been several years in the making, is intended to harmonize, streamline and modernize registration requirements and exemptions across all Canadian jurisdictions. It regulates dealers and advisers, effectively eliminating the dealer registration exemption for trading in the exempt market in Canada, and imposes a new registration requirement for investment fund managers.

The new regime has significant implications for Canadian and non-Canadian market participants, particularly those now doing business on an unregistered or exempt basis.

This document is one part in a series that details the regime and its impact on particular types of market participants and their business activities. The complete document includes the following sections:

- A** Overview of Canada's New Registration Regime
- B** Impact on Limited Market Dealers and Unregistered Dealers Trading in the Exempt Market
- C** Impact on Investment Fund Managers
- D** Impact on Portfolio Managers and Investment Counsel
- E** Impact on International Dealers and Non-Canadian Dealers Trading in the Exempt Market
- F** Impact on International Advisers
- G** Impact on Investment Dealers and Mutual Fund Dealers
- H** Impact on Issuers Generally
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- J** Impact on Private Equity and Venture Capital Funds
- K** Impact on Non-Canadian Investment Funds Privately Placing Securities in Canada
- L** New Compliance Requirements for Registrants
- M** Registering in Multiple Jurisdictions
- N** Quebec's *Derivatives Act*
- O** Trading or Advising in Commodity Futures
- P** Useful Links

If you would like a copy of any of the other sections, in electronic or print format, please contact your Stikeman Elliott representative, email us at info@stikeman.com or visit our website at www.stikeman.com

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