

January 13, 2012

**In the Matter of
the Securities Legislation of
Manitoba and Ontario
(the Jurisdictions)**

and

**In the Matter of
the Process for Exemptive Relief Applications in Multiple Jurisdictions**

and

**In the Matter of
R.J. O'Brien & Associates Canada Inc.
(the Filer)**

DECISION

Background

The securities regulatory authority or regulator in each of the Jurisdictions (Decision Maker) has received an application (the **Application**) from the Filer for a decision under the securities legislation of the Jurisdictions (the **Legislation**) that the Filer and its respective officers, directors and representatives be exempt from the 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 Canada (the **Requested Relief**) subject to the terms and conditions below.

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a dual application):

- (a) Then Manitoba Securities Commission is the principal regulator for this application,
- (b) the Filer has provided notice that section 4.7(1) of Multilateral Instrument 11-102 *Passport System* (MI 11-102) is intended to be relied upon in British Columbia, Saskatchewan, New Brunswick, Newfoundland and Labrador, Nova Scotia, and Prince Edward Island, (together with the Jurisdictions, the "Applicable Jurisdictions").
- (c) the decision is the decision of the principal regulator and evidences the decision of the securities regulatory authority or regulator in Ontario.

Interpretation

Terms defined in National Instrument 14-101 *Definitions* and MI 11-102 have the same meaning if used in this decision, unless otherwise defined.

Representations

This decision is based on the following facts represented by the Filer:

The Filer

1. The Filer is a corporation existing under the *Canada Business Corporations Act*, with offices in Winnipeg, Manitoba and Toronto, Ontario.
2. The Filer is registered as a dealer in the category of investment dealer in each of the provinces of Canada, and is a member of the Investment Industry Regulatory Organization of Canada (**IIROC**).
3. The Filer does not have any securities listed or quoted on an exchange or marketplace in any jurisdiction inside or outside of Canada.
4. The Filer is not, to the best of its knowledge, in default of any requirements of securities legislation in Canada or IIROC Rules or IIROC Acceptable Practices (as defined below).
5. The Filer currently offers OTC derivatives in which the underlying interests consist entirely of currencies (**OTC foreign exchange contracts**) to "accredited investors" (as defined in National Instrument 45-106 *Prospectus and Registration Exemptions*) (**NI 45-106**) in Alberta, British Columbia, Saskatchewan, Manitoba and Ontario.
6. The Filer wishes to offer OTC foreign exchange contracts and other types of CFDs to investors in the Applicable Jurisdictions on the terms and conditions described in this Decision. For the Interim Period (as defined below), the Filer is seeking the Requested Relief in connection with this proposed offering of CFDs in Manitoba and intends to rely on this Decision and the "Passport System" described in MI 11-102 (the **Passport System**) to offer CFDs in the Non-Principal Jurisdictions.
7. In Québec, the Filer has applied for an order from the *Autorité des marchés financiers* (the **AMF**) to offer CFDs to both accredited and retail investors pursuant to the provisions of the *Derivatives Act* (Québec) (the **QDA**). The final AMF Order will, if granted, exempt the Filer 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.
8. As a member of IIROC, the Filer is only permitted to enter into CFDs pursuant to the rules and regulations of IIROC (the **IIROC Rules**).
9. In addition, IIROC has communicated to its members certain additional expectations as to acceptable business practices (**IIROC Acceptable Practices**) as articulated in IIROC's "Regulatory Analysis of Contracts for Differences (CFDs)" published by IIROC on June 6, 2007, as amended on September 12, 2007 (the **IIROC CFD Paper**), for any IIROC member proposing to offer OTC foreign exchange contracts or other types of CFDs to investors. To the best of its knowledge, the Filer is in compliance with IIROC Acceptable Practices in offering CFDs. The Filer will continue to offer CFDs in accordance with IIROC Acceptable Practices as may be established from time to time.
10. The Filer is required by IIROC to maintain a certain level of capital to address the business risks associated with its activities. The capital reporting required by IIROC (as per the calculation in the Joint Regulatory Financial Questionnaire (the **JRFQ**) and the Monthly Financial Reports to IIROC) is based predominantly on the generation of

financial statements and calculations as to ensure capital adequacy. The Filer, as an IIROC member, is required to have a specified minimum capital which includes having any additional capital required with regards to margin requirements and other risks. This risk calculation is summarized as a risk adjusted capital calculation which is submitted in the firm's JRFQ and required to be kept positive at all times.

Online Trading Platform

11. In addition to a full service offering, the Filer also intends to establish an execution-only division to offer CFDs whereby clients would trade CFDs through an on-line trading platform (the **Trading Platform**).
12. The Trading Platform is a key component in a comprehensive risk management strategy which will help the Filer's clients and the Filer to manage the risk associated with leveraged products. This risk management system has evolved over many years with the objective of meeting the mutual interests of all relevant parties (including, in particular, clients). These attributes and services are described in more detail below:
 - (a) *Real-time client reporting.* Clients are provided with a real-time view of their account status. This includes how tick-by-tick price movements affect their account balances and required margins. Clients can view this information throughout the trading day by including it on their trading screen.
 - (b) *Fully automated risk management system.* Clients are instructed that they must maintain the required margin against their position(s). If a client's funds drop below the required margin, margin calls are regularly issued via email (as frequently as hourly), alerting the client to the fact that the client is required to either deposit more funds to maintain the position or close/reduce it voluntarily. Where possible, daily telephone margin calls are provided as a supporting communication for clients. However, if a client fails to deposit more funds, where possible, the client's position is automatically liquidated. This liquidation procedure is intended to act as a mechanism to help reduce the risk of losses being greater than the amount deposited. This functionality also ensures that the Filer will not incur any credit risk *vis-à-vis* its customers in respect of CFD transactions.
 - (c) *Wide range of order types.* The Trading Platform also provides risk management tools such as stops, limits, and contingent orders. Although not available on all products, these tools are designed to help reduce the risk of losses being greater than the amount deposited by a client.
13. The Trading Platform will be similar to those developed for on-line brokerages in that the client trades without other communication with, or advice from, the dealer. The Trading Platform is not a "marketplace" as defined in National Instrument 21-101 *Marketplace Operation* since a marketplace is any facility that brings together multiple buyers and sellers by matching orders in fungible contracts in a nondiscretionary manner. The Trading Platform does not bring together multiple buyers and sellers; rather it offers clients direct access to the underlying market and interbank prices.
14. The Filer will be the counterparty to its clients' CFD trades; it will not act as an intermediary, broker or trustee in respect of the CFD transactions. The Filer does not

manage any discretionary accounts, nor does it provide any trading advice or recommendations regarding CFD transactions.

15. The Filer manages the risk in its client positions by simultaneously placing the identical CFD on a back-to-back basis with an "acceptable counterparty" or a "regulated entity" (as those terms are defined in the JRFQ) (the **Acceptable/Regulated Counterparty**). The Applicant does not have an inherent conflict of interest with its clients, since it does not profit on a position if the client losses on that position, and vice versa. The Applicant is compensated by the "spread" between the bid and ask prices it offers. Any additional charges shall be fully disclosed to the client prior to trading.
16. The CFDs are OTC contracts and are not transferable.
17. The ability to lever an investment is one of the principal features of CFDs. Leverage allows clients to magnify 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 currency or instrument.
18. IIROC Rules and IIROC Acceptable Practices set out detailed requirements and expectations relating to leverage and margin for offerings of CFDs. The degree of leverage may be amended in accordance with IIROC Rules and IIROC Acceptable Practices as may be established from time to time.
19. Pursuant to section 13.12 *Restriction on lending to clients* of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, only those firms that are registered as investment dealers (a condition of which is to be a member of IIROC) may lend money, extend credit or provide margin to a client.

Structure of CFDs

20. 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, currency pair, treasury or commodity, without the need for ownership and physical settlement of the underlying instrument. Unlike certain OTC derivatives, such as forward contracts, CFDs do not require or oblige either the principal counterparty (being the Filer for the purposes of the Requested Relief) nor any agent (also being the Filer for the purposes of the Requested Relief) to deliver the underlying instrument.
21. CFDs to be offered by the Filer will not confer the right or obligation to acquire or deliver the underlying security or instrument itself, and will not confer any other rights of shareholders of the underlying security or instrument, such as voting rights. Rather, a CFD is a derivative instrument which is represented by 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.
22. CFDs allow clients to take a long or short position on an underlying instrument, but unlike futures contracts they have no fixed expiry date or standard contract size or an obligation for physical delivery of the underlying instrument.

23. CFDs allow clients to obtain exposure to markets and instruments that may not be available directly, or may not be available in a cost-effective manner.

CFDs Distributed in the Applicable Jurisdictions

24. Certain types of CFDs, such as CFDs where the underlying instrument is a security, may be considered to be "securities" under the securities legislation of the Applicable Jurisdictions.
25. Investors wishing to enter into CFD transactions must open an account with the Filer.
26. Prior to a client's first CFD transaction and as part of the account opening process, the Filer will provide the client with a separate risk disclosure document that clearly explains, in plain language, the transaction and the risks associated with the transaction (the **risk disclosure document**). The risk disclosure document includes the required risk disclosure set forth in Schedule A to the Regulations to the QDA and leverage risk disclosure required under IIROC Rules. The risk disclosure document contains disclosure that is substantially similar to the risk disclosure statement required for recognized options in OSC Rule 91-502 *Trades in Recognized Options* (which provides both registration and prospectus exemptions) (**OSC Rule 91-502**) and the regime for OTC derivatives contemplated by OSC SN 91-702 (as defined below) and proposed OSC Rule 91-504 *OTC Derivatives* (which was not adopted) (**Proposed Rule 91-504**). The Filer will ensure that, prior to a client's first trade in a CFD transaction, a complete copy of the risk disclosure document provided to that client has been delivered, or has previously been delivered, to the Principal Regulator.
27. Prior to the client's first CFD transaction and as part of the account opening process, the Filer will obtain a written or electronic acknowledgement from the client confirming that the client has received, read and understood the risk disclosure document. Such acknowledgement will be separate and prominent from other acknowledgements provided by the client as part of the account opening process.
28. As customary in the industry, and due to the fact that this information is subject to factors beyond the control of the Filer (such as changes in IIROC Rules), information such as the underlying instrument listing and associated margin rates would not be disclosed in the risk disclosure document but will be part of a client's account opening package and will be available on both the Filer's website and the Trading Platform.

Satisfaction of the Registration Requirement

29. The role of the Filer as it relates to the CFD offering (other than it being the principal under the CFDs) will be limited to acting as an execution-only dealer. In this role, the Filer will, among other things, be responsible to approve all marketing, for holding of clients funds, and for client approval (including the review of know-your-client (KYC) due diligence and account opening suitability assessments).
30. 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 trade in CFDs (the **IIROC CFD Requirements**) and requires, among other things, that:

- (a) applicable risk disclosure documents and client suitability waivers provided be in a form acceptable to IIROC;
 - (b) the firm's policies and procedures, amongst other things, require the Filer to assess whether CFD trading is appropriate for a client before an account is approved to be opened. This account opening suitability process includes an assessment of the client's investment knowledge and trading experience;
 - (c) the Filer's registered salespeople who will conduct the KYC and initial product suitability analysis, as well as their supervisory trading officer will meet proficiency requirements for futures trading, and will be registered with IIROC as Investment Representative (Retail) and Investment Futures Contract Representative Options (Retail) (**IR**); and
 - (d) cumulative loss limits for each client's account be established (this is a measure normally used by IIROC in connection with futures trading accounts).
31. The CFDs offered in Canada will be offered in compliance with applicable IIROC Rules and other IIROC Acceptable Practices.
 32. IIROC limits the underlying instruments in respect which member firm may offer 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 the Toronto Stock Exchange or the New York Stock Exchange. 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 clients can form a sufficient understanding of the exposure represented by a given CFD.
 33. IIROC Rules prohibit the margining of CFDs where the underlying instrument is a synthetic product (single U.S. sector or "mini-indices"). For example, Sector CFDs (i.e., basket of equities for the financial institutions industry) may be offered to non-Canadian clients; however, this is not permissible under IIROC Rules.
 34. IIROC members seeking to trade CFDs are generally precluded, by virtue of the nature of the contracts, from distributing CFDs that confer the right or obligation to acquire or deliver the underlying security or instrument itself (convertible CFDs), or that confer any other rights of shareholders of the underlying security or instrument, such as voting rights.
 35. The Requested Relief, if granted, would substantially harmonize the position of the regulators in the Applicable Jurisdictions (together, the **Commissions**) on the offering of CFDs to investors in the Applicable Jurisdictions with how those products are offered to investors in Québec under the QDA. The QDA provides a legislative framework to govern derivatives activities within the province. Among other things, the QDA requires such products to be offered to investors through an IIROC member and the distribution

of a standardized risk disclosure document rather than a prospectus in order to distribute such contracts to investors resident in Québec.

36. The Requested Relief, if granted, would be consistent with the guidelines articulated by Staff of the Principal Regulator in OSC Staff Notice 91-702 *Offerings of Contracts for Difference and Foreign Exchange Contracts to Investors (OSC SN 91-702)*. OSC SN 91-702 provides guidance with regards to the distributions of CFDs, foreign exchange contracts (forex or FX contracts) and similar OTC derivative products to investors in the Jurisdiction.
37. The Principal Regulator has previously recognized that the prospectus requirement may not be well suited for the distribution of certain derivative products to investors in the Jurisdiction, and that alternative requirements, including requirements based on clear and plain language risk disclosure, may be better suited for certain derivatives.
38. In Ontario, both OSC Rule 91-502 and OSC Rule 91-503 *Trades in Commodity Futures Contracts and Commodity Futures Options Entered into on Commodity Futures Exchanges Situate Outside of Ontario (OSC Rule 91-503)* provide for a prospectus exemption for the trading of derivative products to clients. The Requested Relief is consistent with the principles and requirements of OSC Rule 91-502, OSC Rule 91-503 and Proposed Rule 91-504.
39. The Filer has also submitted that the Requested Relief, if granted, would harmonize the Principal Regulator's position on the offering of CFDs with certain other foreign jurisdictions that have concluded that a clear, plain language risk disclosure document is appropriate for retail clients seeking to trade in foreign exchange contracts.
40. The Filer is of the view that requiring compliance with the prospectus requirement in order to enter into CFDs with retail clients would not be appropriate since the disclosure of a great deal of the information required under a prospectus and under the reporting issuer regime is not material to a client seeking to enter into a CFD transaction. The information to be given to such a client should principally focus on enhancing the client's appreciation of product risk including counterparty risk. In addition, most CFD transactions are of short duration (positions are generally opened and closed on the same day and are in any event marked to market and cash settled daily).
41. The Filer is regulated by IIROC, which has a robust compliance regime including specific requirements to address market, capital and operational risks.
42. The Filer has submitted that the regulatory regimes developed by the AMF and IIROC for CFDs adequately address issues relating to the potential risk to the clients of the Filer acting as counterparty. In view of these regulatory regimes, investors would receive little or no additional benefit from requiring the Filer to also comply with the prospectus requirement.
43. The Requested Relief in respect of each Applicable Jurisdiction is conditional on the Filer being registered as an investment dealer with the Commission in such Applicable Jurisdiction and maintaining its membership with IIROC and that all CFD transactions be conducted pursuant to IIROC Rules and in accordance with IIROC Acceptable Practices.

Decision

Each of the Decision Makers is satisfied that the decision meets the test set out in the Legislation for the Decision Makers to make the decision.

The Decision of the Decision Makers under the Legislation is that the Requested Relief is granted provided that:

- (a) all CFDs traded with residents in the Applicable Jurisdictions shall be executed through the Filer;
- (b) with respect to residents of an Applicable Jurisdiction, the Filer remains registered as a dealer in the category of investment dealer with the Principal Regulator and the Commission in such Applicable Jurisdiction and a member of IIROC;
- (c) all CFD transactions with clients resident in the Applicable Jurisdictions shall be conducted pursuant to IIROC Rules imposed on members seeking to trade in CFDs and in accordance with IIROC Acceptable Practices, as amended from time to time;
- (d) all CFD transactions with clients resident in the Applicable Jurisdictions be conducted pursuant to the rules and regulations of the QDA and the AMF, 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, and ii) the requirements of the securities laws of the Applicable Jurisdictions, the IIROC Rules and IIROC Acceptable Practices, in which case the latter shall prevail;
- (e) prior to a client first entering into a CFD transaction, the Filer has provided to the client the risk disclosure document described in paragraph 26 and have delivered, or have previously delivered, a copy of the risk disclosure document provided to that client to the Principal Regulator;
- (f) prior to the client's first CFD transaction and as part of the account opening process, the Filer has obtained a written or electronic acknowledgement from the client, as described in paragraph 27, confirming that the client has received, read and understood the risk disclosure document;
- (g) the Filer has furnished to the Principal Regulator 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;
- (h) the Filer shall promptly inform the Principal Regulator in writing of any material change affecting the Filer, being any change in the business, activities, operations or financial results or condition of the Filer that may reasonably be perceived by a counterparty to a derivative to be material;

- (i) the Filer shall promptly inform the Principal Regulator in writing if a self-regulatory organization or any other regulatory authority or organization initiates proceedings or renders a judgment related to disciplinary matters against the Filer concerning the conduct of activities with respect to CFDs;
- (j) within 90 days following the end of its financial year, the Filer shall submit to the Principal Regulator the audited annual financial statements of the Filer; and
- (k) the Requested Relief shall immediately expire upon the earliest of:
 - (i) four years from the date that this Decision is issued;
 - (ii) in respect of a subject Applicable Jurisdiction or Québec, the issuance of an order or decision by a court, the Commission in such Applicable Jurisdiction, the AMF (in respect of Québec) or other similar regulatory body that suspends or terminates the ability of the Filer to offer CFDs to clients in such Applicable Jurisdiction or Québec; and
 - (iii) with respect to an Applicable Jurisdiction, the coming into force of legislation or a rule by its Commission regarding the distribution of OTC derivatives to investors in such Applicable Jurisdiction

(the Interim Period).



Deputy Director
The Manitoba Securities Commission