

IIROC NOTICE

Rules Notice Notice of Approval/Implementation

Dealer Member Rules

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Over-the-counter securities fair pricing rule and confirmation disclosure requirements

I. Introduction

This Rules Notice provides notice of approval by the applicable securities regulatory authorities of amendments to the Dealer Member Rules concerning the fair pricing of over-the-counter securities (the “OTC fair pricing rule”) and confirmation disclosure requirements (collectively, the “amendments”). The OTC fair pricing rule will take effect on October 3, 2011; and the confirmation disclosure requirements will take effect in one year’s time on September 4, 2012.

The new OTC fair pricing rule will be known as Dealer Member Rule 3300 – *Fair Pricing of Over-the-Counter Securities*. A copy of Dealer Member Rule 3300 is enclosed as “Attachment A”, and a copy of Dealer Member Rule 200.1(h) regarding confirmation requirements is



enclosed as “Attachment B”. A black-lined copy of Dealer Member Rule 200.1(h) reflecting the amendments to the confirmation requirements is enclosed as “Attachment C”.

II. Objectives of the amendments

The amendments are intended to achieve the following objectives:

- (1) to ensure that clients, in particular retail clients, are being provided bid and offer prices for OTC securities that are fair and reasonable in relation to prevailing market conditions;
- (2) to ensure that clients are provided sufficient disclosure regarding the security at issue that will enable them, as well as the clients’ Registered Representative, to confirm through other market sources that the price being offered is a reasonable one in relation to prevailing market conditions;
- (3) to underscore the principle that compliance activities are as important for OTC securities transactions as they are for listed securities transactions;
- (4) to ensure that Dealer Members focus policies, procedures, supervisory and compliance efforts towards the OTC markets, in addition to the current focus on securities traded in organized markets, and provide Dealer Members’ compliance departments with regulatory support for their compliance activities with respect to OTC business; and
- (5) to acknowledge and highlight that the OTC markets differ in form and structure from the more formalized nature of the markets for listed securities, and to regulate the OTC markets taking these idiosyncrasies into account.

By placing an obligation for fair pricing of OTC traded securities squarely on the Dealer Member, IIROC is ensuring that the Dealer Member has in place, and supervises and enforces, policies and procedures that are directed at the price paid or received by the end client being a fair and reasonable one, taking into account the surrounding contextual factors, including the price prevailing in the market at that time for that security and similar or comparable securities.

Investors should also have enough information to enable them to determine if they are in fact paying, or receiving, a fair price for that product. The yield disclosure requirement is intended to provide investors with that information in the case of debt instruments. Investors will be able to compare the yield disclosure to published yields of the security at issue and other comparable securities to assist such investors in determining whether a certain price is fair and reasonable, given all the surrounding contextual factors.



III. Summary of the amendments

The amendments encompass the following interrelated rules:

1. Over-the-counter traded securities fair pricing rule

The OTC fair pricing rule is a principles-based rule that requires Dealer Members to provide or procure fair and reasonable prices for OTC securities transactions where such securities are purchased from or sold to either retail or institutional clients.

As the primary focus of this rule is to ensure the fair pricing of OTC products traded in the secondary market, the scope of the OTC fair pricing rule excludes: (1) primary market transactions; and (2) OTC derivatives with non-standardized contract terms that are customized to the needs of a particular client and for which there is no secondary market (“OTC derivatives”). Such OTC derivatives have been excluded in recognition of the fact that transactions in these products are primarily entered into by institutional clients on a bilateral basis with Dealer Members or their affiliates, and the unique nature of the pricing of such transactions. Primary market transactions are also excluded from the OTC fair pricing rule in recognition of the fact that there is already in existence a well established process which imposes a pricing discipline upon primary market transactions.

Aside from the exclusions noted above, any transaction in securities that is not executed through a marketplace will be covered by the OTC fair pricing rule. Contracts for difference (“CFDs”) and foreign exchange contracts are not exempt from the OTC fair pricing rule under the exclusion for primary market transactions. References within the OTC fair pricing rule and its related Guidance Note to “over-the-counter securities”, “OTC securities”, “OTC-traded securities”, and any other similar derivations of such terms, are intended to refer to securities where the purchase or sale of such securities is not executed through a marketplace.

Section 2 of the OTC fair pricing rule establishes a general duty to use “reasonable efforts” to obtain a price that is fair and reasonable in relation to prevailing market conditions. As an example, this provision will be particularly relevant in the context of an illiquid market for a specific OTC security where a Dealer Member may be required to canvass various parties to source the availability and the price of the specific security.

Mark-ups and mark-downs in the case of principal transactions, and commissions or service charges in the case of agency transactions, are an important factor in arriving at an aggregate fair price for a client. Section 3 of the OTC fair pricing rule addresses these issues. The fair pricing requirement will apply to all types of transactions in which a Dealer Member undertakes a purchase or sale of a relevant security for a client, whether the Dealer Member is engaging in the transaction as an agent or as a principal to the trade.



National Instrument 23-101 – *Trading Rules* sets out a dealer’s obligation to make reasonable efforts to achieve best execution when acting for a client. The approved rule does not in any way establish a lesser threshold to the best execution requirements.

A copy of the OTC fair pricing rule is enclosed as “Attachment A”.

Guidance Note

IIROC is also issuing concurrently with this Rules Notice guidance intended to assist Dealer Members in determining fair and reasonable prices, and which transactions may require pricing documentation. Please refer to Rules Notice [11-0257](#) for the guidance associated with the OTC fair pricing rule.

2. Fixed income security yield disclosure to clients

This rule requires the disclosure on trade confirmations of the yield to maturity for fixed income securities. The yield must be calculated based on the aggregate price to the client, according to market conventions for that particular security. Future guidance as to appropriate market conventions may be issued, if necessary. It may become necessary to issue such guidance if IIROC determines that there are significant discrepancies from market conventions in the calculation of yields, or if yield calculations are unreasonable.

The rule also requires confirmations to include notations for callable and variable rate securities. In the case of debt securities that are callable prior to maturity through any means, a notation of “callable” must be included on the confirmation. For debt securities carrying a variable rate coupon, a notation must be included on the confirmation as follows: “The coupon rate may vary”.

The yield disclosure rule is an amendment to Dealer Member Rule 200.1(h) regarding confirmation requirements. The yield disclosure requirements relating to stripped coupons and residual debt instruments already contained in Dealer Member Rule 200.1(h) will remain in place.

A copy of Dealer Member Rule 200.1(h) regarding the confirmation requirements that will take effect on September 4, 2012 is enclosed as “Attachment B”. A black-lined copy of Dealer Member Rule 200.1(h) reflecting the amendments is enclosed as “Attachment C”.

3. Remuneration disclosure statement to retail clients

This rule requires Dealer Members to disclose on confirmations for all OTC transactions for retail clients the following statement: “The investment dealer’s remuneration on this transaction has been added to the price in the case of a purchase or deducted from the price in the case of a sale.” The rule applies to all OTC securities transactions where the amount of



any mark-up or mark-down, or any other service charges, is not disclosed on the trade confirmation sent to retail clients.

Where fee-based accounts are concerned, the statement is required on confirmations for OTC transactions if in fact there is a mark-up or mark-down, or other service charge, relating to the transaction specifically.

In the case of introducing brokers, the remuneration statement will have to be disclosed unless the amount of any and all mark-ups or mark-downs, or other service charges associated with a transaction are disclosed on the confirmation, including any such form of remuneration with respect to a transaction on the part of the carrying broker.

The requirement for a remuneration disclosure statement is an amendment to Dealer Member Rule 200.1(h) regarding confirmation requirements. A copy of Dealer Member Rule 200.1(h) regarding the confirmation requirements that will take effect on September 4, 2012 is enclosed as “Attachment B”. A black-lined copy of Dealer Member Rule 200.1(h) reflecting the amendments is enclosed as “Attachment C”.

4. Corollary amendments to IIROC Dealer Member Rule 29

As a result of the amendments regarding the fair pricing of OTC securities, some corollary amendments must be made. Dealer Member Rule 29 currently includes Rules 29.9 and 29.10 concerning valuation of debt securities taken in trade. In light of the OTC fair pricing rule, Rules 29.9 and 29.10 will be repealed to avoid redundancy or conflict with the new rule.

IV. Publication for comment and summary of written comments

The amendments were republished for comment with IIROC Rules Notice 10-0163 on June 4, 2010. IIROC staff has considered all of the comments received and thank all of the commenters. A summary of the comments received and IIROC staff’s response to the comments is enclosed as “Attachment E”.

The scope of the OTC fair pricing rule remains the same as the proposed amendments that were published for comment in June, 2010. IIROC has made some minor revisions to the OTC fair pricing rule to make it clearer that the scope of the rule includes CFDs and foreign exchange contracts. None of the revisions are substantive in nature. Therefore, the revisions have not been republished for a further comment period.

V. Summary of changes

In response to CSA and public comments received, the amendments reflect some minor revisions IIROC has made to the OTC fair pricing rule and the requirement of a remuneration



disclosure statement. A black-lined copy of the revisions made since the publication for comment of proposed amendments in June, 2010 is enclosed as “Attachment D”.

Noteworthy changes made since the publication in June, 2010, are as follows:

OTC fair pricing rule

Wording was added to the OTC fair pricing rule to make it clearer that the rule applies to transactions in CFDs and foreign exchange contracts.

In regards to OTC derivatives and the use of the phrase “non-standardized contracts” in order to describe the OTC derivatives excluded from application of the OTC fair pricing rule, we have made a minor revision to the relevant clause in order to better reflect that the phrase “non-standardized contracts” was intended to refer to the *terms* of a derivatives transaction. To clarify this point, we have revised the language in the relevant clause to read “non-standardized contract terms”.

Guidance relating to OTC fair pricing

The Guidance Note was revised to include pricing and documentation guidance relating to OTC securities other than debt securities, including structured products, CFDs and foreign exchange contracts.

Remuneration disclosure statement to retail clients

The language of the remuneration disclosure statement requirement in Dealer Member Rule 200.1(h) was revised in order to align the scope of the requirement with the scope of the OTC fair pricing rule.

VI. Implementation plan

OTC fair pricing rule

The OTC fair pricing rule will be implemented on October 3, 2011.

The new rule will be known as Dealer Member Rule 3300 – *Fair Pricing of Over-the-Counter Securities*. A copy of Dealer Member Rule 3300 is enclosed as “Attachment A”.

IIROC is issuing guidance relating to the new rule concurrently with this Rules Notice. Please refer to Rules Notice [11-0257](#) for the guidance associated with the OTC fair pricing rule.

Surveillance of fixed income market activity will provide the tools to monitor for patterns and trends in prices and will allow regulators to more effectively identify price outliers. IIROC plans to implement a system to monitor OTC securities trading by Dealer Members which



would allow IIROC to identify circumstances where trade prices do not correspond with the prevailing market at that time.

Confirmation disclosure requirements

The confirmation disclosure requirements relating to yield disclosure and the remuneration disclosure statement to retail clients will be implemented on September 4, 2012.

A copy of Dealer Member Rule 200.1(h) regarding the confirmation requirements that will take effect on September 4, 2012 is enclosed as “Attachment B”. A black-lined copy of Dealer Member Rule 200.1(h) reflecting the amendments to the confirmation disclosure requirements is enclosed as “Attachment C”.

Attachments

[Attachment A](#) - Dealer Member Rule 3300 – Fair Pricing of Over-the-Counter Securities

[Attachment B](#) - Dealer Member Rule 200.1(h) regarding confirmation requirements

[Attachment C](#) - Black-lined copy reflecting amendments to existing Dealer Member Rule 200.1(h) and corollary amendments to Dealer Member Rule 29, sections 29.9 and 29.10

[Attachment D](#) - Black-lined copy of amendments compared to proposed amendments published for comment in June, 2010

[Attachment E](#) - Summary of comments received and IIROC staff response to comments