



Appendix 1 - Draft Guidance Note - Applying and interpreting the definitions of “hedger” and “institutional client”



IIROC NOTICE

Rules Notice
Guidance Note
IIROC Rules

Please distribute internally to:
Credit
Institutional
Internal Audit
Legal and Compliance
Operations
Registration
Regulatory Accounting
Retail
Senior Management
Trading Desk
Training

Contact:

Member Regulation Policy
e-mail: memberpolicymailbox@iiroc.ca

GN-1200-2X-0XX
Effective Date: **XXXX XX, 202X**

Applying and interpreting the definitions of “hedger” and “institutional client”

This guidance relates to the definitions of the terms “*hedger*” and “*institutional client*” set out in IIROC Rule subsection 1201(2). Pursuant to paragraph (vii) of the “*institutional client*” definition, a “*hedger*” can be classified as an institutional client for accounts with qualifying hedging activities and hedge positions if it requests and consents to being classified as an institutional client.

We are publishing this notice to describe the requirements that apply and to outline our expectations when determining:

- whether a client qualifies as a hedger,
- the circumstances under which a qualifying hedger can be classified as an institutional client.



1. Applicable rules

IIROC Rules this Guidance Note relates to:

- section 1201

2. Previous guidance notes

This Guidance Note replaces the following:

- N/A

3. Related documents

This Guidance Note was published under Notice 22-0055.

4. Appendices

Appendix A- Applying and interpreting the definitions of “hedger” and “institutional client”



Appendix A- Applying and interpreting the definitions of “hedger” and “institutional client”

Concept of hedger

The concept of “hedger” is meant to apply to a non-individual, generally a business, that enters into a derivative transaction for the purpose of managing risk inherent in its business activities. It is not intended to apply to speculators.

Qualifying a client as a hedger

To qualify as a hedger, a non-individual must be exposed to one or more risks as a necessary part of its business activities and seek to hedge that risk by engaging in ~~securities or~~ derivatives transactions where the underlying interest is the same as or materially related to the underlying interest for the risk. Such risks could include supply, credit, exchange and environmental risks as well as risks related to fluctuations in the market value of an asset, liability or position.

The underlying interest of the ~~securities or~~ derivatives used must be the same as or materially related to the risks to which the hedger is exposed as a necessary part of its business activities. As such, cross-hedging could be considered hedging as a ~~securities or~~ derivative may not exist in the precise underlying interest that the hedger may deal in. However, to be materially related the underlying interest of the ~~securities or~~ derivatives should show a historical and commercial price relationship with the hedger’s underlying business activities and have a reasonable level of basis risk.

To hedge, it is necessary for the hedger to intend to forgo the opportunity to realize the full effect of price level changes in its business~~primary~~ activities. Alternatively, a hedger may intend to substitute a risk to one currency for a risk to another currency provided the substitution does not increase its original exposure. ~~A significant feature of hedging is its severely restricted investment motive. However, a hedger could actually sustain a profit or loss from its hedging transactions.~~

Since the intended effect of the transaction is to eliminate or reduce risk, it is possible to hedge only part of an underlying interest or position and still have the transaction regarded as a hedge. However, the transaction should no more than offset price risks incidental to the hedger’s exposure as a necessary part of its business activities.

Finally, a hedger who requests and consents to being categorized as an institutional client is such only as to qualifying hedging activities and hedge positions.

Categorizing a qualifying hedger as an “institutional client”

Dealer Members should have reasonable basis to classify a hedger as an “*institutional client*”. For example, a Dealer Member should review with the client the nature and extent of the risk that is sought to be hedged and ~~to~~ confirm that the transactions are primarily for hedging purposes and not also for speculative purposes. This could include obtaining the hedging strategy/program from the client and being able to establish in a conclusive and verifiable manner that the requisite conditions to be categorized as a hedger have been met.

A Dealer Member’s books and records should clearly identify all steps taken and documents obtained that are necessary to demonstrate how the Dealer Member determined the client~~customer~~ was a hedger.



Dealer Members should periodically verify that a client's trading activities are consistent with the requisite conditions to qualify as a hedger.

Disclosure by Dealer Members

A hedger who requests and consents to being classified as an institutional client, should be clearly explained that the Dealer Member's obligations under the IIROC Rules ~~disclosure, suitability and supervision obligations~~ are different for institutional clients.

Dealer Members should provide clients with a full list of the obligation and requirements, and also provide clear examples of information they do not have to provide institutional clients (e.g. relationship disclosures and pre-trade disclosure of charges).

The following list examples of requirements²⁵ which are either different from those applicable to a retail client or not applicable to an institutional client:

- Know you client and suitability requirements: IIROC Rule clause 3208(1)(iv), IIROC Rule section 3403,
- Relationship disclosure: IIROC Rule subsection 3216(1),
- Fee schedule disclosure: IIROC Rule subsection 3504(1),
- Client complaints handling: IIROC Rule section 3715,
- Trade confirmation: IIROC Rule subclauses 3816(2)(v)(b), 3816(2)(vi)(c) and 3816(2)(vii),
- Client account statements: IIROC Rule clauses 3808(3)(vi) and 3808(3)(viii),
- Performance report: IIROC Rule subsection 3810(1),
- Fee/charge report: IIROC Rule subsection 3811(1), and
- Supervision of account: IIROC Rule sections 3950 to 3951.

²⁵ These examples do not constitute an exhaustive list of requirements applicable to retail clients or institutional clients.