

The Ontario Securities Commission

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The Ontario Securities Commission administers the *Securities Act* of Ontario (R.S.O. 1990, c. S.5) and the *Commodity Futures Act* of Ontario (R.S.O. 1990, c. C.20)

**The Ontario Securities Commission**

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# Chapter 1

## Notices

### 1.1. Notices

#### 1.1.1 CSA Staff Notice 11-339 Notice of Local Changes in Alberta



### CSA Staff Notice 11-339 Notice of Local Changes in Alberta

November 1, 2018

From time to time, a local jurisdiction may amend a national or multilateral instrument or change a policy or companion policy that affects activity only in that jurisdiction. The CSA recognize that such a local amendment or change may nonetheless be of interest or importance beyond the local jurisdiction and CSA staff are issuing this notice to identify changes implemented in Alberta. For public convenience, CSA members in other jurisdictions will update the text of the applicable material on their websites to reflect these local changes.

The local changes referred to in this notice comprise those shown in Annex A of this notice from Alberta to:

- Companion Policy 45-102 *Resale of Securities*

The text of this policy consolidation on the websites of CSA members will be updated as necessary to reflect these local changes. For further background on Annex A, see ASC Notice of Repeal and Replacement of Alberta Securities Commission Rule 72-501 Distributions to Purchasers Outside Alberta dated August 10, 2018. You may direct questions regarding this notice to:

Samir Sabharwal  
Alberta Securities Commission  
Tel: 403-297-7389  
[samir.sabharwal@asc.ca](mailto:samir.sabharwal@asc.ca)

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**Notices**

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ANNEX A

CHANGES TO  
COMPANION POLICY 45-102 RESALE OF SECURITIES

1. ***Companion Policy 45-102 Resale of Securities is changed by this Document.***
2. ***Subsection 1.1(3) is changed by replacing the words “Alberta Securities Commission Blanket Order 45-519 Prospectus Exemptions for Resale Outside Canada” with the words “sections 10 and 11 of Alberta Securities Commission Rule 72-501 Distributions to Purchasers Outside Alberta”.***
3. These changes became effective on August 31, 2018.

1.1.2 Donald Mason

File No.: 2018-1

**IN THE MATTER OF  
THE SECURITIES ACT,  
R.S.O. 1990, S.5, AS AMENDED**

**AND**

**IN THE MATTER OF  
DONALD MASON**

**NOTICE OF WITHDRAWAL**

The Applicant, Donald Mason, withdraws the Application.

**DATED** this 30th day of October, 2018.

**AFFLECK GREENE McMURTRY LLP**  
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Toronto, Ontario M5H 2V1

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Counsel for the Applicant, Donald Mason

1.4 Notices from the Office of the Secretary

1.4.1 Donald Mason

**FOR IMMEDIATE RELEASE  
October 31, 2018**

**DONALD MASON,  
File No. 2018-1**

**TORONTO** – The Commission issued an Order in the above named matter.

A copy of the Order dated October 31, 2018 and Notice of Withdrawal dated October 30, 2018 are available at <http://www.osc.gov.on.ca>.

OFFICE OF THE SECRETARY  
GRACE KNAKOWSKI  
SECRETARY TO THE COMMISSION

For media inquiries:

[media\\_inquiries@osc.gov.on.ca](mailto:media_inquiries@osc.gov.on.ca)

For investor inquiries:

OSC Contact Centre  
416-593-8314  
1-877-785-1555 (Toll Free)

**1.4.2 Michael Pearson and LeadFX Inc.**

**FOR IMMEDIATE RELEASE**  
October 31, 2018

**MICHAEL PEARSON and  
LEADFX INC.,  
File No. 2018-53**

**TORONTO** – The Commission issued its Reasons for Decision in the above named matter.

A copy of the Reasons for Decision dated October 31, 2018 is available at <http://www.osc.gov.on.ca>.

OFFICE OF THE SECRETARY  
GRACE KNAKOWSKI  
SECRETARY TO THE COMMISSION

For media inquiries:

[media\\_inquiries@osc.gov.on.ca](mailto:media_inquiries@osc.gov.on.ca)

For investor inquiries:

OSC Contact Centre  
416-593-8314  
1-877-785-1555 (Toll Free)

**1.4.3 Money Gate Mortgage Investment Corporation et al.**

**FOR IMMEDIATE RELEASE**  
November 6, 2018

**MONEY GATE MORTGAGE  
INVESTMENT CORPORATION,  
MONEY GATE CORP.,  
MORTEZA KATEBIAN and  
PAYAM KATEBIAN,  
File No. 2017-79**

**TORONTO** – The Commission issued an Order in the above named matter.

A copy of the Order dated November 6, 2018 and the Amended Statement of Allegations dated October 31, 2018 are available at <http://www.osc.gov.on.ca>.

OFFICE OF THE SECRETARY  
GRACE KNAKOWSKI  
SECRETARY TO THE COMMISSION

For media inquiries:

[media\\_inquiries@osc.gov.on.ca](mailto:media_inquiries@osc.gov.on.ca)

For investor inquiries:

OSC Contact Centre  
416-593-8314  
1-877-785-1555 (Toll Free)

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## Chapter 2

# Decisions, Orders and Rulings

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### 2.1 Decisions

#### 2.1.1 Brompton Funds Limited

##### Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – Relief granted from subsection 2.1(1) and paragraphs 2.2(1)(a), 2.5(2)(a), (c) and (e) of National Instrument 81-102 Investment Funds to allow mutual funds to invest in ETFs listed on a Canadian exchange, and to allow the top funds to pay brokerage commissions for the purchase and sale of the securities of related underlying ETFs – Underlying ETFs are subject to NI 81-102 – Relief subject to terms and conditions based on investment restrictions of NI 81-102 such that top funds cannot do indirectly via investment in underlying ETFs what they cannot do directly under NI 81-102.

##### Applicable Legislative Provisions

National Instrument 81-102 Investment Funds, ss. 2.1(1), 2.2(1)(a), 2.5(2)(a), 2.5(2)(e), 19.1.

October 9, 2018

IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
ONTARIO (the Jurisdiction)

AND

IN THE MATTER OF  
THE PROCESS FOR EXEMPTIVE RELIEF APPLICATIONS  
IN MULTIPLE JURISDICTIONS

AND

IN THE MATTER OF  
BROMPTON FUNDS LIMITED  
(Brompton)

DECISION

##### Background

The principal regulator in the Jurisdiction has received an application from Brompton, on behalf of the existing and future mutual funds, that are, or will be managed by the Filer (as defined below) (the **Funds**), for a decision (the **Exemption Sought**) under the securities legislation of the principal regulator (the **Legislation**) exempting each Fund from the following provisions of National Instrument 81-102 – *Investment Funds (NI 81-102)* in order to permit the Funds to invest in securities of exchange-traded funds that are not index participation units (the **Underlying ETFs**):

- (a) subsection 2.1(1) (the **Concentration Restriction**) to permit each Fund to purchase securities of an Underlying ETF or enter into a specified derivatives transaction with respect to an Underlying ETF even though, immediately after the transaction, more than 10% of the net asset value (**NAV**) of the Fund would be invested, directly or indirectly, in securities of the Underlying ETF (the **Concentration Relief**);
- (b) paragraph 2.2(1)(a) (the **Control Restriction**) to permit each Fund to purchase securities of an Underlying ETF even though, immediately after the purchase, the Fund would hold securities representing more than 10% of: (i) the votes attaching to the outstanding voting securities of the Underlying ETF; or (ii) the outstanding equity securities of the Underlying ETF (the **Control Relief**);

- (c) paragraph 2.5(2)(a) to permit each Fund to invest in securities of Underlying ETFs that do not offer securities under a simplified prospectus in accordance with National Instrument 81-101 – *Mutual Fund Prospectus Disclosure (NI 81-101)*; and
- (d) paragraph 2.5(2)(e) of NI 81-102 to permit each Fund to pay brokerage fees in relation to its purchase and sale of securities of Related Underlying ETFs (as defined below) (the **Brokerage Fee Relief**).

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

- (a) the Ontario Securities Commission is the principal regulator for the application; and
- (b) Brompton has provided notice that subsection 4.7(1) of Multilateral Instrument 11-102 – *Passport System (MI 11-102)* is intended to be relied upon in all of the provinces and territories of Canada other than the Jurisdiction (together with the Jurisdiction, the **Jurisdictions**).

### **Interpretation**

Terms defined in National Instrument 14-101 – *Definitions*, MI 11-102 and NI 81-102 have the same meaning if used in this decision, unless otherwise defined. In addition, the following terms as used in this decision have the following meanings:

**Filer** means Brompton or an affiliate or associate of Brompton

**Related Underlying ETF** means an Underlying ETF that is managed by the Filer.

### **Representations**

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

#### ***Brompton***

1. Brompton is a corporation incorporated under the laws of the Province of Ontario, with its head office located at Suite 2930, Bay Wellington Tower, Brookfield Place, 181 Bay Street, Toronto, Ontario, M5J 2T3.
2. Brompton is, or will be, the promoter and manager of the Funds and is registered in the categories of: (a) investment fund manager in the Provinces of Newfoundland and Labrador, Ontario and Quebec and (b) commodity trading manager, exempt market dealer and portfolio manager in the Province of Ontario.
3. Brompton and the existing Funds are not in default of securities legislation in any of the Jurisdictions.

#### ***The Funds***

4. Each Fund is, or will be, a mutual fund organized and governed by the laws of a Jurisdiction of Canada.
5. Each Fund distributes, or will distribute, some or all of its securities pursuant to a long form prospectus prepared pursuant to National Instrument 41-101 – *General Prospectus Requirements (NI 41-101)* and Form 41-101F2 – *Information Required in an Investment Fund Prospectus (Form 41-101F2)* and is or will be governed by the applicable provisions of NI 81-102, subject to any exemptions therefrom that have been, or may in the future be, granted by the securities regulatory authorities.
6. Each Fund is, or will be, a reporting issuer in one or more Jurisdictions.
7. Each Fund is, or will be, subject to National Instrument 81-107 – *Independent Review Committee for Investment Funds (NI 81-107)*.
8. A Fund may, from time to time, wish to invest up to 100% of its net asset value in any one or more Underlying ETFs in accordance with its investment objectives.

#### ***The Underlying ETFs***

9. Each Underlying ETF is, or will be, an open-ended mutual fund subject to NI 81-102, subject to any exemption therefrom that may be granted by the securities regulatory authorities.

## Decisions, Orders and Rulings

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10. Securities of each Underlying ETF are, or will be:
  - (a) distributed pursuant to a long form prospectus prepared pursuant to NI 41-101 and Form 41-101F2; and
  - (b) listed on the Toronto Stock Exchange or another “recognized exchange” in Canada, as that term is defined in the Legislation.
11. Each Underlying ETF is, or will be, a reporting issuer in one or more of the Jurisdictions.
12. Each Underlying ETF is, or will be, subject to NI 81-107 in respect of conflict of interest matters to which NI 81-107 applies.
13. The securities of an Underlying ETF will not meet the definition of index participation unit (**IPU**) in NI 81-102 because the purpose of the Underlying ETF will not be to:
  - (a) hold the securities that are included in a specified widely quoted market index in substantially the same proportion as those securities are reflected in that index; or
  - (b) invest in a manner that causes the Underlying ETF to replicate the performance of that index.
14. The securities of an Underlying ETF are, or will be, listed on a recognized exchange in Canada and the market for them is, or will be, liquid because it is, or will be, supported by a designated broker and dealers. As a result, the Filer expects a Fund to be able to dispose of such securities through market facilities in order to raise cash, including to fund the redemption requests of its securityholders.
15. No Underlying ETF will hold more than 10% of its NAV in securities of another investment fund unless: (a) the Underlying ETF is a clone fund, as defined in NI 81-102, (b) the other investment fund is a money market fund, as defined in NI 81-102; or (c) securities of the other investment fund are IPUs.
16. No Fund will pay management or incentive fees which, to a reasonable person, would duplicate a fee payable by an Underlying ETF for the same service.
17. Absent the Exemption Sought, an investment by a Fund in an Underlying ETF would be prohibited by paragraph 2.5(2)(a) of NI 81-102 because the Underlying ETFs do not offer securities under a simplified prospectus in accordance with NI 81-101. An investment by a Fund in an Underlying ETF would not qualify for the exception in paragraph 2.5(3)(a) of NI 81-102 because the securities of the Underlying ETF are not IPUs.

### ***The Concentration Relief and Control Relief***

18. An investment in an Underlying ETF by a Fund is an efficient and cost effective alternative to administering one or more investment strategies similar to that of the Underlying ETF and will represent the business judgement of responsible persons uninfluenced by considerations other than the best interests of the Fund.
19. An investment in an Underlying ETF by a Fund should pose limited investment risk to the Fund because each Underlying ETF will be subject to NI 81-102, subject to any exemption therefrom that may in the future be granted by the securities regulatory authorities.
20. Due to the potential size disparity between the Funds and the Underlying ETFs, it is possible that a relatively small investment, on a percentage of NAV basis, by a relatively larger Fund in securities of an Underlying ETF could result in such Fund holding securities representing more than 10% of: (i) the votes attaching to the outstanding voting securities of the Underlying ETF; or (ii) the outstanding equity securities of that Underlying ETF, contrary to the Control Restriction.
21. An investment by a Fund in securities of an Underlying ETF will not qualify for the exemptions set out in:
  - (a) paragraph 2.1(2)(d) of NI 81-102 from the Concentration Restriction; and
  - (b) paragraph 2.2(1.1)(b) of NI 81-102 from the Control Restriction, because securities of the Underlying ETFs are not IPUs.
22. The material difference between the securities of an Underlying ETF and the securities of a conventional mutual fund is the method of distribution and disposition.

***The Brokerage Fee Relief***

23. The trades conducted by a Fund may not be of the size necessary for the Fund to be eligible to purchase or exchange securities of a Related Underlying ETF directly from the Related Underlying ETF at its NAV per security. Trades in securities of a Related Underlying ETF are therefore likely to be conducted by a Fund in the secondary market through the facilities of a recognized exchange. Absent the Brokerage Fee Relief, paragraph 2.5(2)(e) of NI 81-102 would not permit a Fund to pay brokerage fees incurred in connection with a Related Underlying ETF.
24. All brokerage fees related to trades in securities of Related Underlying ETFs will be borne by the Funds in the same manner as any other portfolio transactions made on an exchange.
25. If a Fund trades in securities of a Related Underlying ETF with or through the Filer acting as dealer, the Filer will comply with its obligations under NI 81-107 in respect of any proposed related party transactions. These related party transactions will be disclosed to securityholders of the applicable Fund in its management report of fund performance.

**Decision**

The principal regulator is satisfied that the decision meets the test set out in the Legislation for the principal regulator to make the decision.

The decision of the principal regulator under the Legislation is that the Exemption Sought is granted, provided that:

- (a) the investment by a Fund in securities of an Underlying ETF is in accordance with the investment objectives of the Fund;
- (b) a Fund does not short sell securities of an Underlying ETF;
- (c) an Underlying ETF is not a commodity pool as defined in National Instrument 81104 – *Commodity Pools*;
- (d) the Underlying ETF does not rely on exemptive relief from the requirements of:
  - (i) section 2.3 of NI 81-102 regarding the purchase of physical commodities;
  - (ii) sections 2.7 and 2.8 of NI 81-102 regarding the purchase, sale or use of specified derivatives; or
  - (iii) paragraphs 2.6(a) and 2.6(b) of NI 81-102 with respect to the use of leverage;
- (e) securities of each Underlying ETF are listed on a recognized exchange in Canada; and
- (f) the prospectus of each Fund discloses, or will disclose in the next renewal of its prospectus following the date of this decision, in the investment strategy section, the fact that the Fund has obtained the Exemption Sought to permit investments in Underlying ETFs on the terms described in this decision.

“Darren McCall”  
Manager – Investment Funds & Structured Products  
Ontario Securities Commission

## 2.1.2 Mackenzie Financial Corporation and London Life Pathways Global Core Plus Bond Fund

### Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – exemption from section 2.1(1) of National Instrument 81-102 Investment Funds to permit a global fixed income fund to invest more than 10 percent of net assets in debt securities issued by a foreign government or supranational agency, subject to conditions.

### Applicable Legislative Provisions

National Instrument 81-102 Investment Funds, ss. 2.1(1), 19.1.

October 12, 2018

IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
ONTARIO  
(the Jurisdiction)

AND

IN THE MATTER OF  
THE PROCESS FOR EXEMPTIVE RELIEF APPLICATIONS  
IN MULTIPLE JURISDICTIONS

AND

IN THE MATTER OF  
MACKENZIE FINANCIAL CORPORATION  
(the Filer)

AND

IN THE MATTER OF  
LONDON LIFE PATHWAYS GLOBAL CORE PLUS BOND FUND  
(the Fund)

DECISION

### Background

The principal regulator in the Jurisdiction has received an application from the Filer on behalf of the Fund for a decision under the securities legislation of the Jurisdiction of the principal regulator (the **Legislation**) for an exemption pursuant to section 19.1 of National Instrument 81-102 *Investment Funds* (**NI 81-102**) from subsection 2.1(1) of NI 81-102 (the **Concentration Restriction**) to permit the Fund to invest up to:

- (a) 20% of the Fund's net asset value at the time of the transaction in evidences of indebtedness of any one issuer if those evidences of indebtedness are issued, or guaranteed fully as to principal and interest, by supranational agencies or governments other than the government of Canada, the government of a jurisdiction in Canada or the government of the United States of America and are rated "AA" by S&P Global Ratings Canada (**S&P**) or its DRO affiliate (as defined in NI 81-102), or have an equivalent rating by one or more other designated rating organizations or their DRO affiliates; and
- (b) 35% of the Fund's net asset value at the time of the transaction in evidences of indebtedness of any one issuer if those evidences of indebtedness are issued, or guaranteed fully as to principal and interest, by supranational agencies or governments other than the government of Canada, the government of a jurisdiction in Canada, or the government of the United States of America and are rated "AAA" by S&P or its DRO affiliate, or have an equivalent rating by one or more other designated rating organizations or their DRO affiliates

(collectively, the **Requested Relief**).

The evidences of indebtedness described above are collectively referred to as **Foreign Government Securities**.

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

- (a) the Ontario Securities Commission is the principal regulator for this application; and
- (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, Alberta, Saskatchewan, Manitoba, Québec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, the Northwest Territories, Nunavut and Yukon (the **Other Jurisdictions**).

### **Interpretation**

Terms defined in NI 81-102, 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:

1. The Filer is a corporation amalgamated under the laws of Ontario with its head office in Toronto, Ontario.
2. The Filer is registered as an investment fund manager, portfolio manager, exempt market dealer and commodity trading manager in Ontario. The Filer is also registered as a portfolio manager and exempt market dealer in all other Canadian provinces and territories and as an investment fund manager in Newfoundland and Labrador and Québec.
3. The Filer is the manager, trustee and portfolio manager of the Fund.
4. The Fund will be an open-ended mutual fund trust established under the laws of Ontario.
5. Securities of the Fund will be offered by simplified prospectus filed in all of the provinces and territories in Canada and, accordingly the Fund will be a reporting issuer in the Jurisdiction and the Other Jurisdictions. A preliminary simplified prospectus was filed for the Fund via SEDAR in all the provinces and territories on August 24, 2018 (the **Simplified Prospectus**).
6. The Filer and the Fund are not in default of securities legislation in any jurisdiction of Canada.
7. The Fund's investment objective is expected to be substantially as follows: "The Fund aims to generate income by investing primarily in a diversified portfolio of fixed-income securities issued by companies or governments of any size, anywhere in the world. The Fund also seeks to achieve long-term capital growth by investing in fixed-income securities and other investments. The Fund will employ a flexible approach, allocating assets across credit quality, structures, sectors, currencies and countries."
8. To achieve the investment objective of the Fund, it is expected that the investment team will employ a flexible approach, allocating assets across credit quality, structures, sectors, currencies and countries. The Fund can invest in all types of fixed-income securities from around the world.
9. Although the Fund aims to invest primarily in a diversified portfolio of fixed-income securities, depending on market conditions, the Fund's portfolio managers seek the discretion to gain exposure to any one issuer of Foreign Government Securities in excess of the Concentration Restriction.
10. The portfolio managers of the Fund will follow a value investment style, maximizing the relative value for risk around the world. The Fund will invest across all fixed-income credit qualities and in a wide variety of assets from anywhere in the world, including government bonds, high yield bonds and loans. This flexibility extends across structures, sectors, currencies and countries. In following this style, in conjunction with fundamental investment analysis, there may be periods where the portfolio managers believe that Foreign Government Securities are better suited to the Fund's investment objectives.
11. Allowing the Fund to hold highly rated Foreign Government Securities will enable the Fund to preserve capital in foreign markets during adverse market conditions, to have access to assets with minimal credit risk and will enable the portfolio manager to assess its views on interest rates and duration.

## Decisions, Orders and Rulings

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12. The increased flexibility to hold Foreign Government Securities may also yield higher returns than Canadian or U.S. shorter term government fixed-income alternatives.
13. Section 2.1(1) of NI 81-102 prohibits the Funds from purchasing a security of an issuer, other than a “government security” as defined in NI 81-102, if immediately after the purchase more than 10% of the net asset value of the fund, taken at market value at the time of the purchase, would be invested in securities of the issuer.
14. The Foreign Government Securities are not within the meaning of “government securities” as such term is defined in NI 81-102.
15. The Filer believes that the ability to purchase Foreign Government Securities in excess of the limit in subsection 2.1(1) of NI 81-102 will better enable the Fund to achieve its fundamental investment objectives, thereby benefitting the Fund’s investors.
16. The Fund seeks the Requested Relief to enhance its ability to pursue and achieve its investment objectives.

### Decision

The principal regulator is satisfied that the decision meets the test set out in the Legislation for the principal regulator to make the decision.

The decision of the principal regulator under the Legislation is that the Requested Relief is granted provided that:

1. paragraphs (a) and (b) of the Requested Relief cannot be combined for any one issuer;
2. any security that may be purchased under the Requested Relief is traded on a mature and liquid market;
3. the acquisition of the securities purchased pursuant to this decision is consistent with the fundamental investment objectives of the Fund;
4. the Simplified Prospectus of the Fund discloses the additional risks associated with the concentration of the net asset value of the Fund in securities of fewer issuers, such as the potential additional exposure to the risk of default of the issuer in which the Fund has so invested and the risks, including foreign exchange risks, of investing in the country in which the issuer is located; and
5. the Simplified Prospectus of the Fund discloses, in the investment strategies section, a summary of the nature and terms of the Requested Relief, along with the conditions imposed and the type of securities covered by this decision.

“Stephen Paglia”  
Manager, Investment Funds and Structured Products Branch  
Ontario Securities Commission

### 2.1.3 Nova Gas Transmission Ltd.

#### Headnote

Multilateral Instrument 11-102 Passport System and National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – National Instrument 52-107 Acceptable Accounting Principles and Auditing Standards (NI 52-107), s. 5.1 – the Filer requests relief from the requirements under section 3.2 of NI 52-107 that financial statements be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises to permit the Filer to prepare its financial statements in accordance with U.S. GAAP.

#### Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am.

**Citation:** Re Nova Gas Transmission Ltd., 2018 ABASC 166

October 25, 2018

IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
ALBERTA AND ONTARIO  
(the Jurisdictions)

AND

IN THE MATTER OF  
THE PROCESS FOR EXEMPTIVE RELIEF APPLICATIONS  
IN MULTIPLE JURISDICTIONS

AND

IN THE MATTER OF  
NOVA GAS TRANSMISSION LTD.  
(the Filer)

DECISION

#### Background

The securities regulatory authority or regulator in each of the Jurisdictions (each a **Decision Maker**) has received an application from the Filer for a decision under the securities legislation (the **Legislation**) of the Jurisdictions exempting the Filer (the **Exemption Sought**) from the requirements of section 3.2 of National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards (NI 52-107)* that financial statements (a) be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises and (b) disclose an unreserved statement of compliance with IFRS in the case of annual financial statements and an unreserved statement of compliance with IAS 34 *Interim Financial Reporting* in the case of an interim financial report.

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

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

### Interpretation

In this decision:

- (a) unless otherwise defined herein, terms defined in National Instrument 14-101 *Definitions*, MI 11-102 or NI 52-107 have the same meaning; and
- (b) "activities subject to rate regulation" has the meaning ascribed in the Handbook.

### Representations

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

1. The Filer was incorporated under the *NOVA Corporation Act of Alberta* on April 8, 1954 and was continued under the *Business Corporations Act* (Alberta) on September 1, 1987. The head office of the Filer is in Calgary, Alberta.
2. The Filer is an indirect wholly-owned subsidiary of TransCanada Corporation (**TransCanada**) by virtue of TransCanada's 100% ownership interest in TransCanada PipeLines Limited (**TCPL**). TCPL owns a direct 100% interest in the Filer.
3. The Filer is a reporting issuer in the Jurisdictions and each of the Passport Jurisdictions and is not in default of securities legislation in any jurisdiction in Canada.
4. The Filer has activities subject to rate regulation.
5. The Filer is not an SEC issuer.
6. TransCanada and TCPL file financial statements prepared in accordance with U.S. GAAP, as permitted by section 3.7 of NI 52-107. The financial statements of the Filer are consolidated into the financial statements of TransCanada and TCPL.
7. Were the Filer an SEC issuer, it would be permitted by section 3.7 of NI 52-107 to file financial statements prepared in accordance with U.S. GAAP.
8. By an order cited as *Nova Gas Transmission Ltd., Re*, 2014 ABASC 62, the Filer was granted relief substantially similar to the Exemption Sought by the Decision Maker on February 19, 2014 (the **Existing Relief**).
9. The Existing Relief will expire not later than January 1, 2019.
10. The International Accounting Standards Board (**IASB**) continues to work on a project focusing on accounting specific to activities subject to rate regulation. It is not yet known when this project will be completed or whether IFRS will include a specific standard that is mandatory for entities with activities subject to rate regulation.

### Decision

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

The decision of the Decision Makers under the Legislation is that:

- (a) the Existing Relief is revoked;
- (b) the Exemption Sought is granted to the Filer in respect of the Filer's financial statements required to be filed on or after the date of this order, provided that the Filer prepares those financial statements in accordance with U.S. GAAP; and
- (c) the Exemption Sought will terminate on the earliest of the following:
  - (i) January 1, 2024;
  - (ii) if the Filer ceases to have activities subject to rate regulation, the first day of the Filer's financial year that commences after the Filer ceases to have activities subject to rate regulation; and

- (iii) the effective date prescribed by the IASB for the mandatory application of a standard within IFRS specific to entities with activities subject to rate regulation.

**For the Commission:**

“Tom Cotter”  
Vice-Chair

”Kari Horn”  
Vice-Chair

## 2.2 Orders

### 2.2.1 Northern Empire Resources Corp.

#### Headnote

National Policy 11-206 Process for Cease to be a Reporting Issuer Applications – The issuer ceases to be a reporting issuer under securities legislation.

#### Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., s. 1(10)(a)(ii).

October 22, 2018

**IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
BRITISH COLUMBIA AND ONTARIO  
(the Jurisdictions)**

**AND**

**IN THE MATTER OF  
THE PROCESS FOR CEASE TO BE A  
REPORTING ISSUER APPLICATIONS**

**AND**

**IN THE MATTER OF  
NORTHERN EMPIRE RESOURCES CORP.  
(the Filer)**

**ORDER**

#### Background

1 The securities regulatory authority or regulator in each of the Jurisdictions (Decision Maker) has received an application from the Filer for an order under the securities legislation of the Jurisdictions (the Legislation) that the Filer has ceased to be a reporting issuer in all jurisdictions of Canada in which it is a reporting issuer (the Order Sought).

Under the Process for Cease to be a Reporting Issuer Applications (for a dual application):

- (a) British Columbia is the principal regulator for this application,
- (b) the Filer has provided notice that subsection 4C.5(1) of Multilateral Instrument 11-102 *Passport System* (MI 11-102) is intended to be relied upon in Alberta, Saskatchewan, Manitoba, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, Northwest Territories, Nunavut and Yukon, and
- (c) this order is the order of the principal regulator and evidences the decision of the securities regulatory authority or regulator in Ontario.

#### Interpretation

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

#### Representations

## Decisions, Orders and Rulings

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- 3 This order is based on the following facts represented by the Filer:
1. the Filer is not an OTC reporting issuer under Multilateral Instrument 51-105 *Issuers Quoted in the U.S. Over-the-Counter Markets*;
  2. the outstanding securities of the Filer, including debt securities, are beneficially owned, directly or indirectly, by fewer than 15 securityholders in each of the jurisdictions of Canada and fewer than 51 securityholders in total worldwide;
  3. no securities of the Filer, including debt securities, are traded in Canada or another country on a marketplace as defined in National Instrument 21-101 *Marketplace Operation* or any other facility for bringing together buyers and sellers of securities where trading data is publicly reported;
  4. the Filer is applying for an order that the Filer has ceased to be a reporting issuer in all of the jurisdictions of Canada in which it is a reporting issuer; and
  5. the Filer is not in default of securities legislation in any jurisdiction.

### Order

- 4 Each of the Decision Makers is satisfied that the order meets the test set out in the Legislation for the Decision Maker to make the order.

The decision of the Decision Makers under the Legislation is that the Order Sought is granted.

“John Hinze”  
Director, Corporate Finance  
British Columbia Securities Commission

2.2.2 Donald Mason – s. 8

FILE NO.: 2018-1

**IN THE MATTER OF  
DONALD MASON**

Mark J. Sandler, Commissioner and Chair of the Panel

October 31, 2018

**ORDER**  
Section 8 of the  
*Securities Act*, RSO 1990, c S.5

WHEREAS on October 30, 2018, the Ontario Securities Commission received a Notice of Withdrawal filed by Donald Mason (**Mason**) in relation to an application Mason filed on December 29, 2017 to review a decision of a Director of the Commission dated November 30, 2017;

ON READING the Notice of Withdrawal;

IT IS ORDERED THAT the hearing scheduled for November 23, 2018 is vacated.

“Mark J. Sandler”

2.2.3 Tangelo Games Corp.

**Headnote**

National Policy 11-206 Process for Cease to be a Reporting Issuer Applications – The issuer ceases to be a reporting issuer under securities legislation.

**Applicable Legislative Provisions**

Securities Act, R.S.O. 1990, c. S.5, as am., s. 1(10)(a)(ii).

October 31, 2018

**IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
ONTARIO  
(the Jurisdiction)**

AND

**IN THE MATTER OF  
THE PROCESS FOR CEASE TO BE  
A REPORTING ISSUER APPLICATIONS**

AND

**IN THE MATTER OF  
TANGELO GAMES CORP.  
(the Filer)**

**ORDER**

**Background**

The principal regulator in the Jurisdiction has received an application from the Filer for an order under the securities legislation of the Jurisdiction of the principal regulator (the **Legislation**) that the Filer has ceased to be a reporting issuer in all jurisdictions in Canada in which it is a reporting issuer (the **Order Sought**).

Under the Process for Cease to be a Reporting Issuer Applications (for a passport application):

- (a) the Ontario Securities Commission is the principal regulator for this application, and
- (b) the Filer has provided notice that subsection 4C.5(1) of Multilateral Instrument 11-102 *Passport System* (**MI 11-102**) is intended to be relied upon in British Columbia, Alberta, Saskatchewan, Manitoba and New Brunswick.

**Interpretation**

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

## Representations

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

1. the Filer is not an OTC reporting issuer under Multilateral Instrument 51-105 *Issuers Quoted in the U.S. Over-the-Counter Markets*;
2. the outstanding securities of the Filer, including debt securities, are beneficially owned, directly or indirectly, by fewer than 15 securityholders in each of the jurisdictions of Canada and fewer than 51 securityholders in total worldwide;
3. no securities of the Filer, including debt securities, are traded in Canada or another country on a marketplace as defined in National Instrument 21-101 Marketplace Operation or any other facility for bringing together buyers and sellers of securities where trading data is publicly reported;
4. the Filer is applying for an order that the Filer has ceased to be a reporting issuer in all of the jurisdictions of Canada in which it is a reporting issuer; and
5. the Filer is not in default of securities legislation in any jurisdiction.

## Order

The principal regulator is satisfied that the order meets the test set out in the Legislation for the principal regulator to make the order.

The decision of the principal regulator under the Legislation is that the Order Sought is granted.

“Michael Balter”  
Manager, Corporate Finance  
Ontario Securities Commission

## 2.2.4 Caspian Energy Inc.

### Headnote

National Policy 11-206 Process for Cease to be a Reporting Issuer Applications – The issuer ceased to be a reporting issuer under securities legislation.

### Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., s. 1(10)(a)(ii).

**Citation:** *Re Caspian Energy Inc.*, 2018 ABASC 171

**October 31, 2018**

**IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
ALBERTA AND ONTARIO  
(the Jurisdictions)**

**AND**

**IN THE MATTER OF  
THE PROCESS FOR CEASE TO BE A  
REPORTING ISSUER APPLICATIONS**

**AND**

**IN THE MATTER OF  
CASPIAN ENERGY INC.  
(the Filer)**

**ORDER**

### Background

The securities regulatory authority or regulator in each of the Jurisdictions (the **Decision Maker**) has received an application from the Filer for an order under the securities legislation of the Jurisdictions (the **Legislation**) that the Filer has ceased to be a reporting issuer in all jurisdictions of Canada in which it is a reporting issuer (the **Order Sought**).

Under the Process for Cease to be a Reporting Issuer Applications (for a dual application):

- (a) the Alberta Securities Commission is the principal regulator for this application;
- (b) the Filer has provided notice that subsection 4C.5(1) of Multilateral Instrument 11-102 *Passport System (MI 11-102)* is intended to be relied upon in British Columbia; and
- (c) this order is the order 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* or MI 11-102 have the same meaning if used in this order, unless otherwise defined herein.

### Representations

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

1. the Filer is not an OTC reporting issuer under Multilateral Instrument 51-105 *Issuers Quoted in the U.S. Over-the-Counter Markets*;
2. the outstanding securities of the Filer, including debt securities, are beneficially owned, directly or indirectly, by fewer than 15 securityholders in each of the jurisdictions of Canada and fewer than 51 securityholders in total worldwide;
3. no securities of the Filer, including debt securities, are traded in Canada or another country on a marketplace as defined in National Instrument 21-101 *Marketplace Operation* or any other facility for bringing together buyers and sellers of securities where trading data is publicly reported;
4. the Filer is applying for an order that the Filer has ceased to be a reporting issuer in all of the jurisdictions of Canada in which it is a reporting issuer; and
5. the Filer is not in default of securities legislation in any jurisdiction.

### Order

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

The decision of the Decision Makers under the Legislation is that the Order Sought is granted.

“Timothy Robson”  
Manager, Legal  
Corporate Finance  
Alberta Securities Commission

### 2.2.5 Beaufield Resources Inc.

#### Headnote

National Policy 11-206 Process for Cease to be a Reporting Issuer Applications – The issuer ceases to be a reporting issuer under securities legislation.

#### Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., s. 1(10)(a)(ii).

November 1, 2018

**IN THE MATTER OF  
THE SECURITIES LEGISLATION OF  
ONTARIO  
(the Jurisdiction)**

**AND**

**IN THE MATTER OF T  
HE PROCESS FOR CEASE TO BE A  
REPORTING ISSUER APPLICATIONS**

**AND**

**IN THE MATTER OF  
BEAUFIELD RESOURCES INC.  
(the Filer)**

**ORDER**

#### Background

The principal regulator in the Jurisdiction (**Decision Maker**) has received an application from the Filer for an order under the securities legislation of the Jurisdiction of the principal regulator (the **Legislation**) that the Filer has ceased to be a reporting issuer in all jurisdictions of Canada in which it is a reporting issuer (the **Order Sought**).

Under the Process for Cease to be a Reporting Issuer Applications (for a passport application):

- a) the Ontario Securities Commission is the principal regulator for this application, and
- b) the Filer has provided notice that subsection 4C.5(1) of Multilateral Instrument 11-102 *Passport System (MI 11-102)* is intended to be relied upon in British Columbia, Alberta and Québec.

#### Interpretation

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

## Representations

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

1. The Filer is not an OTC reporting issuer under Multilateral Instrument 51-105 *Issuers Quoted in the U.S. Over-the-Counter Markets*.
2. The outstanding securities of the Filer, including debt securities, are beneficially owned, directly or indirectly, by fewer than 15 securityholders in each of the jurisdictions of Canada and fewer than 51 securityholders in total worldwide.
3. No securities of the Filer, including debt securities, are traded in Canada or another country on a marketplace as defined in National Instrument 21-101 *Marketplace Operation* or any other facility for bringing together buyers and sellers of securities where trading data is publicly reported.
4. The Filer is applying for an order that the Filer has ceased to be a reporting issuer in all of the jurisdictions of Canada in which it is a reporting issuer.
5. The Filer is not in default of securities legislation in any jurisdiction.

## Order

The principal regulator is satisfied that the order meets the test set out in the Legislation for the principal regulator Decision Maker to make the order.

The decision of the principal regulator under the Legislation is that the Order Sought is granted.

“Winnie Sanjoto”  
Manager, Corporate Finance  
Ontario Securities Commission

## 2.2.6 Enercare Inc.

### Headnote

National Policy 11-206 Process for Cease to be a Reporting Issuer Applications – The issuer ceased to be a reporting issuer under securities legislation.

### Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., s. 1(10)(a)(ii).

November 5, 2018

**IN THE MATTER OF  
THE SECURITIES LEGISLATION OF THE  
ONTARIO SECURITIES COMMISSION  
(the Jurisdiction)**

**AND**

**IN THE MATTER OF  
THE PROCESS FOR CEASE TO BE A  
REPORTING ISSUER APPLICATIONS**

**AND**

**IN THE MATTER OF  
ENERCARE INC.  
(the Filer)**

**ORDER**

### Background

The principal regulator in the Jurisdiction has received an application from the Filer for an order under the securities legislation of the Jurisdiction of the principal regulator (the Legislation) that the Filer has ceased to be a reporting issuer in all jurisdictions of Canada in which it is a reporting issuer (the Order Sought).

Under the Process for Cease to be a Reporting Issuer Applications (for a passport application):

- (a) the Ontario Securities Commission is the principal regulator for this application, and
- (b) the Filer has provided notice that subsection 4C.5(1) of Multilateral Instrument 11-102 *Passport System* (MI 11-102) is intended to be relied upon in British Columbia, Alberta, Saskatchewan, Manitoba, Quebec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland & Labrador, Northwest Territories, Yukon and Nunavut.

**Interpretation**

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

**Representations**

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

1. the Filer is not an OTC reporting issuer under Multilateral Instrument 51-105 *Issuers Quoted in the U.S. Over-the-Counter Markets*;
2. the outstanding securities of the Filer, including debt securities, are beneficially owned, directly or indirectly, by fewer than 15 securityholders in each of the jurisdictions of Canada and fewer than 51 securityholders in total worldwide;
3. no securities of the Filer, including debt securities, are traded in Canada or another country on a marketplace as defined in National Instrument 21-101 *Marketplace Operation* or any other facility for bringing together buyers and sellers of securities where trading data is publicly reported;
4. the Filer is applying for an order that the Filer has ceased to be a reporting issuer in all of the jurisdictions of Canada in which it is a reporting issuer; and
5. the Filer is not in default of securities legislation in any jurisdiction.

**Order**

The principal regulator is satisfied that the order meets the test set out in the Legislation for the principal regulator to make the order.

The decision of the principal regulator under the Legislation is that the Order Sought is granted.

“Winnie Sanjoto”  
Manager, Corporate Finance  
Ontario Securities Commission

2.2.7 Money Gate Mortgage Investment Corporation et al.

File No.: 2017-79

**IN THE MATTER OF  
MONEY GATE MORTGAGE INVESTMENT CORPORATION,  
MONEY GATE CORP.,  
MORTEZA KATEBIAN and  
PAYAM KATEBIAN**

Timothy Moseley, Vice-Chair and Chair of the Panel  
Frances Kordyback, Commissioner  
Lawrence P. Haber, Commissioner

November 6, 2018

**ORDER**

WHEREAS the Ontario Securities Commission (the **Commission**) held a hearing to consider a request by Staff of the Commission (**Staff**) to amend the Statement of Allegations dated December 19, 2017, pertaining to Money Gate Mortgage Investment Corporation, Money Gate Corp., Morteza Katebian and Payam Katebian (the **Respondents**), and a request by the Respondents to adjourn the hearing on the merits in this matter;

ON READING the motion record filed by Staff and on hearing submissions from the parties, and on being advised that the Respondents do not oppose Staff's request to amend the Statement of Allegations and that Staff does not oppose the Respondents' adjournment request;

IT IS ORDERED THAT:

1. the Statement of Allegations is to be amended, as attached at Appendix "A";
2. an interlocutory attendance for this matter shall be held on December 3, 2018, commencing at 10:00 a.m.;
3. the hearing dates previously scheduled for December 4, 5, 6, 10, 12, 13, 14, 17, 18, 19 and 20, 2018, are hereby vacated; and
4. the hearing on the merits shall be held on January 7, 9, 10, 11, 14, 15, 16, 18, 28, 29 and 30, February 21, 22, 25 and 27, March 4, 6, 7 and 8 and May 1, 2, 3, 6, 8 and 10, 2019, commencing at 10:00 a.m. on each scheduled day, or such other dates and times as provided by the Office of the Secretary and agreed to by the parties.

"Timothy Moseley"

"Frances Kordyback"

"Lawrence P. Haber"

Appendix A

IN THE MATTER OF  
MONEY GATE MORTGAGE INVESTMENT CORPORATION,  
MONEY GATE CORP.,  
MORTEZA KATEBIAN, and  
PAYAM KATEBIAN

AMENDED STATEMENT OF ALLEGATIONS  
(Subsection 127(1) and Section 127.1 of the  
*Securities Act*, R.S.O. 1990, c. S.5)

**A. ORDER SOUGHT**

1. Staff of the Enforcement Branch of the Ontario Securities Commission (**Enforcement Staff**) requests that the Commission make the following orders against Morteza (Ben) Katebian (**Ben**), Payam Katebian (**Payam**) (together, the **Principals**), Money Gate Mortgage Investment Corporation (**MGMIC**), and Money Gate Corp. (**MGC**), (together with the Principals, the **Respondents**):
  - (a) pursuant to paragraph 2 of subsection 127(1) of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the **Act**), that trading in any securities or derivatives by the Respondents cease permanently or for such period as is specified by the Commission;
  - (b) pursuant to paragraph 2.1 of subsection 127(1) of the Act, that the acquisition of any securities by the Respondents is prohibited permanently or for such period as is specified by the Commission;
  - (c) pursuant to paragraph 3 of subsection 127(1) of the Act, that any exemptions contained in Ontario securities law do not apply to the Respondents permanently or for such period as is specified by the Commission;
  - (d) pursuant to paragraph 6 of subsection 127(1) of the Act, that the Principals be reprimanded;
  - (e) pursuant to paragraphs 7, 8.1 and 8.3 of subsection 127(1) of the Act that the Principals resign one or more positions that they hold as a director or officer of any issuer, registrant, or investment fund manager;
  - (f) pursuant to paragraphs 8, 8.2 and 8.4 of subsection 127(1) of the Act, that the Principals be prohibited from becoming or acting as directors or officers of any issuer, registrant, or investment fund manager, permanently or for such period as is specified by the Commission;
  - (g) pursuant to paragraph 8.5 of subsection 127(1) of the Act that the Respondents be prohibited from becoming or acting as registrants, investment fund managers, or as promoters, permanently or for such period as is specified by the Commission;
  - (h) pursuant to paragraph 9 of subsection 127(1) of the Act, that each Respondent pay an administrative penalty of not more than \$1 million for each failure by the respective Respondent to comply with Ontario securities law;
  - (i) pursuant to paragraph 10 of subsection 127(1) of the Act, that each Respondent disgorge to the Commission any amounts obtained as a result of non-compliance with Ontario securities law;
  - (j) that the Respondents be ordered to pay the costs of the Commission investigation and the hearing, pursuant to section 127.1 of the Act; and
  - (k) such other order as the Commission considers appropriate in the public interest.

**B. FACTS**

2. Enforcement Staff make the following allegations of fact:
  - (a) **Overview**
3. This proceeding involves fraud, misleading and untrue statements in disclosure documents, unregistered trading, and the illegal distribution of securities.

4. Between August 2014 and April ~~2017 (the Material Time)~~, 2017, the, the Respondents raised approximately \$11 million from approximately 155 investors through the sale of preferred shares of MGMIC.
5. The Respondents solicited investors in Ontario to purchase securities of MGMIC, which invested in pools of residential and commercial mortgages. Disclosure provided to investors and other relevant documents outlined various business practices and lending policies, which provided safeguards to reduce risks for investors. MGMIC was supposed to abide by these practices and policies in its operation as a mortgage investment entity.
6. In fact, between August 2014 and December 2017 (the Material Time), MGMIC was not following these practices and policies and MGMIC was operating a far riskier mortgage investment business than the one represented to investors. Instances where MGMIC failed to comply with stated business practices and lending policies, resulting in increased risk to investors, include the following:
  - (a) The Respondents represented that MGMIC's Investment Committee would review transactions involving potential conflicts of interest, when in fact no review was conducted in accordance with the stated practice. As a result, MGMIC made several investments in mortgages on properties with potential conflicts of interest directly or indirectly owned by the Principals and related parties;
  - (b) The Respondents represented that MGMIC would limit its exposure to any one asset class by limiting investment in commercial and industrial properties, when in fact MGMIC made significant investments in mortgages on two (2) industrial properties owned indirectly by related parties accounting for over 60% of MGMIC's total mortgage portfolio, well in excess of its stated limitations; and
  - (c) The Respondents represented that MGMIC would limit the loan-to-value (LTV) ratio on mortgages it invested in, when in fact MGMIC made significant investments in mortgages on several properties owned directly or indirectly by related parties with LTV ratios well in excess of the stated limits.

7. In addition, unbeknownst to MGMIC investors, some funds purportedly advanced on loans to third party borrowers ultimately flowed to the benefit of Ben, his family members and/or companies controlled by them.

8. As of August 2018, MGMIC had seven mortgages outstanding. Six of those mortgages, were in default and over \$9 million in principal was owed on those mortgages.

9. 7- Information that is publicly disclosed by an issuer must be accurate and not misleading or untrue in order to accomplish the goals of Ontario securities law to protect investors from unfair or improper practices and to foster fair and efficient capital markets and confidence in those markets. Disclosure that intentionally deceives investors about the true nature of a company's operations and use of investors' funds, that prevents investors from making informed investment decisions, and that misrepresents to investors the risk actually posed to their investment thwarts these important objectives.

10. 8- In the course of their conduct, the Respondents failed to comply with the registration and prospectus requirements of Ontario securities law and, in doing so, breached important investor protection provisions. The registration requirements ensure that properly qualified and suitable individuals are permitted to engage in the business of trading in securities, ensuring honest and responsible conduct. Further, the prospectus requirements and available exemptions ensure that investors have appropriate information to enable them to properly assess risks and make fully informed investment decisions.

11. 9- By disseminating documents to investors that contained information that was misleading or untrue and which impermissibly failed to disclose the material risks that the actual operations, practices and policies of MGMIC posed to investors' capital, the Respondents engaged in improper disclosure practices and fraudulent conduct that breached Ontario securities laws and undermined the integrity of Ontario's capital markets.

**(b) The Respondents**

12. 40- MGMIC was incorporated in the province of Ontario in May 2014. It has a registered address located in Thornhill, Ontario. It is a mortgage investment entity, as such term is defined in CSA Staff Notice 31-323 *Guidance Relating to the Registration Obligations of Mortgage Investment Entities*, and lends capital for pooled residential and commercial mortgages. All of these mortgages are on underlying properties in Ontario.

13. 44- Further, MGMIC represented to investors that it would conduct its affairs to qualify at all times as a mortgage investment corporation (MIC), as such term is defined in the *Income Tax Act*, R.S.C., 1985, c. 1, as amended (the ITA).

- ~~14. 42.~~ MGC was incorporated federally under the laws of Canada and registered extra-provincially in the province of Ontario in August 2007. It has a registered address located in Toronto, Ontario. MGC is licensed by the Financial Services Commission of Ontario (**FSCO**) as a mortgage brokerage and mortgage administrator. It operates as a mortgage administrator for MGMIC, finding and servicing the mortgages MGMIC lends on. It receives a fee from MGMIC for performing these services.
- ~~15. 43.~~ Ben is a director, officer and directing mind of MGMIC. He is the sole director of MGC and he is licensed by FSCO as the principal broker of MGC. He is a resident of Ontario.
- ~~16. 44.~~ Payam is a director, officer and a directing mind of MGMIC. He is licensed by FSCO as an agent with MGC. Payam is Ben's son. He is a resident of Ontario.
- ~~17. 45.~~ Neither MGMIC nor MGC is a reporting issuer in Ontario and neither has ever filed a preliminary prospectus and prospectus in Ontario. None of the Respondents has ever been registered with the Commission in any capacity.

(c) **Conduct at Issue**

(i) ***Unregistered Trading and Illegal Distribution***

- ~~18. 46.-~~ In 2014, the Principals began offering preferred shares in MGMIC to prospective investors. They offered the shares at a price of \$1 per share and represented that investors would receive an annualized return of approximately 9% to 10% on their investment. Investors were told that dividends would be paid monthly to each shareholder or could be reinvested in a dividend reinvestment and share purchase program (**DRIP**). The preferred shares of MGMIC are "securities", as defined in subsection 1(1) of the Act.
- ~~19. 47.~~ MGMIC prepared five (5) offering memorandums (the **OMs**) in connection with the sale and distribution of its preferred shares to investors. The date of the initial OM is August 1, 2014 and four (4) revised versions followed on May 5, 2015, May 13 and May 30, 2016, and January 31, 2017. These OMs were provided to prospective investors and contained disclosure about the terms of the investment and the business practices and activities of MGMIC, including MGMIC's investment policies, which set out the terms and conditions under which MGMIC made investments.
- ~~20. 48.~~ The Principals actively solicited investors, discussing the investment opportunity in MGMIC during meetings with prospective investors, and answering questions that investors had about the opportunity. The Principals also prepared and provided marketing materials to prospective investors, which set out MGMIC's proposed investment activities and the terms of the investment. Solicitations to investors involved advertising via live presentations, websites, social media postings, and print materials. The Respondents executed formal subscription agreements with investors who purchased shares in MGMIC.
- ~~21. 49.-~~ By engaging in this conduct, the Respondents traded and engaged in, or held themselves out as engaging in, the business of trading in MGMIC securities, in circumstances where there were no exemptions available under the Act, contrary to section 25 of the Act.
- ~~22. 20.-~~ None of the Respondents has ever filed a preliminary prospectus and prospectus with the Commission or obtained a receipt to qualify the sale of MGMIC securities, contrary to section 53 of the Act. In distributing MGMIC securities, the Respondents did not properly rely on available exemptions to the prospectus requirements, as set out in National Instrument 45-106 *Prospectus Exemptions*.

(ii) ***Misleading Statements and Fraudulent Conduct***

- ~~23. 24.~~ The OMs and marketing materials provided to investors, as well as other relevant documents, contained numerous misleading or untrue statements about (1) the controls and processes governing the business operations of MGMIC, including the process by which it made investment decisions, and (2) the lending parameters, practices and restrictions in place with respect to the investments in MGMIC's mortgage portfolio.
- ~~24. 22.-~~ Failure by the Respondents to adhere to stated business practices and lending policies, which provided safeguards for investors, placed investors' capital at increased risk.
- ~~25. 23.-~~ By engaging in the conduct described below, the Respondents perpetrated a fraud on investors by exposing investors' capital to higher risks than those disclosed. In addition, the Respondents made statements to investors in an offering document that were misleading or untrue in a material respect in the circumstances they were made, as follows:

**1. Failure to Disclose the True Nature of MGMIC's Operations, Controls and Processes**

*Failure to Fulfill the Mandate of the MGMIC Credit Committee*

~~26-24-~~ The Respondents represented to investors that MGMIC only makes investment decisions, which include decisions relating to loans, borrowings, acquisitions and/or dispositions by MGMIC, if recommended by MGC and approved by the Credit Committee.

~~27-25-~~ The mandate of the Credit Committee is to review all proposals and to approve or reject such proposals. According to the OMs, the Credit Committee was supposed to meet as required and no less than on a quarterly basis, to provide strategic guidance and direction.

~~28-26-~~ However, the Credit Committee did not meet as required and did not review and approve many of the investments made by MGMIC, contrary to the disclosure provided to investors. The function of the Credit Committee was to provide oversight and supervision over MGMIC's investment decisions, when in reality this safeguard was absent.

*Failure to Fulfill the Mandate of the MGMIC Investment Committee*

~~29-27-~~ The Respondents represented to investors that MGMIC established an Investment Committee to, among other things, (1) adjudicate and advise on transactions involving potential conflicts of interest and (2) approve or reject investments in mortgages which may adversely affect MGMIC's status as a MIC.

~~30-28-~~ However, contrary to the disclosure provided to investors, the members of the Investment Committee did not appropriately review such transactions. The function of the Investment Committee was to provide oversight and supervision over MGMIC's lending practices, when in reality this safeguard was absent. [The Principals also approved loans that involved conflicts of interest, despite the fact that they themselves were in a conflict of interest in relation to those transactions.](#)

~~31-29-~~ As a result, MGMIC invested in a number of mortgages involving potential conflicts of interest on properties [controlled and/or owned, directly or indirectly, by the Principals and ~~related parties~~/or the undisclosed principals referred to in paragraph 37 below.](#)

*MGMIC Did Not Qualify as a Mortgage Investment Corporation (MIC)*

~~32-30-~~ Throughout the Material Time, the Respondents represented to investors that MGMIC conducted its affairs to qualify at all times as a MIC, as defined in the ITA.

~~33-31-~~ As a MIC, MGMIC would be subject to "special rules" under the ITA that would permit MGMIC to be operated, in effect, as a tax-free "flow through" conduit of its profit to shareholders. This meant that MGMIC would pay out substantially all of its net income and realized gains and would not be liable to pay income tax in any year. Further, as long as MGMIC qualified as a MIC, shares of MGMIC would be qualified investments for the purpose of registered retirement savings plans, deferred profit sharing plans, registered retirement income funds and registered education savings plans.

~~34-32-~~ However, MGMIC did not qualify as a MIC from its inception until approximately mid-2016. In particular, notes to the fiscal 2015 and 2016 audited financial statements state that MGMIC did not meet the criteria to qualify as a MIC. Further, the 2016 audited financial statements state that MGMIC was in a taxable position for the relevant year.

~~35-33-~~ No revisions to the OMs were made to reflect the fact that MGMIC did not qualify as a MIC and investors were never otherwise adequately informed. MGMIC's inability to maintain its tax status as a MIC jeopardized its ability to pay returns to shareholders and potentially meant adverse tax consequences for investors.

*Undisclosed Control of MGMIC*

~~36-34-~~ Until May 30, 2016, the Respondents represented to investors that the Principals, along with one other individual, BG, were the directors and senior officers of MGMIC. Beginning May 30, 2016, the revised OMs disclose that the Principals were the sole directors and senior officers of MGMIC after BG left the company in April 2016.

~~37-35-~~ However, in March 2016 Ben sent an email to BG stating that control of MGMIC rested with himself and two other individuals. The control and direction of MGMIC by these two individuals was not disclosed to investors in the previous or subsequent revised OMs. Further, MGMIC invested in mortgages on properties with potential conflicts of interest owned, directly or indirectly, by these two individuals, in contravention of its investment policies.

~~38. 36.~~ No revision to the OMs was made to reflect this undisclosed control over MGMIC and investors were never otherwise informed. No information was provided to investors about the management experience or qualifications of the other two individuals with whom actual control and direction over MGMIC rested, which restricted investors' ability to make a fully informed decision about the potential risks of investing in MGMIC.

## 2. **Failure to Abide by MGMIC's Lending Parameters, Policies and Restrictions**

### *Undisclosed Investment in Third Mortgages*

~~39. 37.~~ Until January 2017, the Respondents represented to investors that MGMIC would invest in only certain types of mortgages, including builders' mortgages, first and second mortgages, development and construction mortgages, and term financing mortgages on income producing properties. The OMs stated that approximately 85% of its investments would be secured by second mortgages with the balance secured by first mortgages.

~~40. 38.~~ However, in April 2015 MGMIC made an investment in a third mortgage in the amount of \$500,000 with respect to a property owned by one of the Principals located in Richmond Hill, Ontario (the **Richmond Hill Property**). The Respondents applied investors' funds in a manner wholly inconsistent with the disclosure provided in the OMs by investing in a higher-risk third mortgage on a property owned by a related party.

### *Investment in Mortgages in Excess of Stated Size and Concentration*

~~41. 39.~~ Until January 2017, the Respondents represented to investors that a "typical loan size" would range from \$20,000 to \$2 million with respect to the mortgages in MGMIC's portfolio. Similarly, marketing materials distributed by MGMIC stated that the mortgages provided by MGMIC would range from \$20,000 to \$1 million in value.

~~42. 40.~~ Further, the Respondents represented to investors that MGMIC established a policy that limited its credit exposure to any one borrowing group. To achieve this, the OMs provide that a maximum of 35% of MGMIC's assets may consist of mortgages on commercial and industrial properties and that a minimum of 50% of MGMIC's assets will consist of mortgages on residential properties.

~~43. 41.~~ However, contrary to the representations made to investors:

- In or around February 2016, MGMIC lent a total of approximately \$2.4 million on an industrial property owned indirectly by a related party located in Timmins, Ontario (the **Timmins Property**).
- In June and July 2016, MGMIC lent a total of approximately \$4 million on an industrial property owned indirectly by a related party located in Temiskaming Shores, Ontario (the **Temiskaming Property**).

~~44. 42.~~ These investments were in excess of the typical loan ranges disclosed to investors. Further, these investments accounted for 62% of MGMIC's total mortgage portfolio<sup>1</sup> and were significantly in excess of the stated maximum of 35% of MGMIC's assets that may consist of industrial or commercial properties. The Respondents applied investors' funds in a manner wholly inconsistent with the disclosure provided in the OMs by failing to limit its credit exposure and overexposing investors' funds to certain asset classes.

### *Lending Contrary to Terms of Commitment*

~~45. 43.~~ In August 2015, MGMIC lent on a mortgage to a related party contrary to the terms of its own mortgage commitment on a condominium unit located in Toronto, Ontario (the **Lakeshore Property**). The commitment letter for this property required an appraisal of reflecting a minimum value of \$1.65 million. The appraisal attributed a value of only \$1.55 million. Regardless, MGMIC lent the full amount of the mortgage commitment.

~~46. 44.~~ In 2016, the terms of the mortgage commitment letters for the Temiskaming and Timmins Properties required marketability timelines of 60 to 90 days. The appraisals for these properties gave marketability timelines of 5 years, which reflected decreased marketability and therefore decreased liquidity for the properties. Regardless, MGMIC granted the mortgages on both properties.

~~47. 45.~~ MGMIC failed to follow its own internal lending parameters by not complying with the terms of its mortgage commitment documents. As a result, MGMIC created higher-risk lending circumstances in which there was insufficient value in the Lakeshore Property and decreased marketability and liquidity in the Temiskaming and Timmins Properties.

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<sup>1</sup> As at March 2017

*Investment in Mortgages in Excess of Appraised Values*

48. 46- The Respondents represented to investors that MGMIC attempted to minimize risk by being prudent in both its credit decisions and in assessing the value of the underlying real property offered as security. Further, the Respondents stated that MGMIC restricted its lending to mortgages where the maximum loan-to-value (LTV) ratio was 85% on second mortgages and 90% on bundled first and second mortgages.

49. 47- However, the Respondents applied investors' funds in a manner wholly inconsistent with the disclosure provided in the OMs by investing in high-risk assets where the LTV ratio exceeded the stated maximums in the following instances:

- In April 2015, a third mortgage in the amount of \$500,000 granted by MGMIC on the Richmond Hill Property caused the LTV ratio to exceed 100%. The appraisal on the Richmond Hill Property attributed a value of \$2,150,000 while the addition of the \$500,000 mortgage brought the total of the mortgages on the property to \$2,284,566.
- As additional collateral for its mortgage on the Richmond Hill Property, MGMIC took security on a property owned by Ben located in Vaughan, Ontario (the **Vaughan Property**). However, the Vaughan Property provided no additional collateral since the property was funded by mortgages totalling \$1,750,729, which exceeded its appraised value.

50. 48- Further, the mortgages on the Temiskaming and Timmins Properties also had LTV ratios in excess of the stated maximum. Although the Respondents caused appraisals to be done on the properties prior to granting the mortgages, the appraisals significantly overvalued both the Temiskaming and the Timmins Properties.

51. 49- With respect to monitoring LTV ratios, the Respondents represented to investors that MGC would establish a database of comparative properties with similar characteristics to assess the LTV ratio of the portfolio as part of its ongoing risk management practices. Contrary to the disclosure provided to investors, this database was never established.

3. *Conduct related to a property on Birchmount Road*

52. On November 6, 2017, after the Respondents advised Staff of their desire to wind-up MGMIC, the Respondents caused MGMIC to enter into a mortgage assignment agreement (Assignment Agreement) with World Finance Corporation (WFC), a company under the control of one of the undisclosed principals. Under the terms of the Assignment Agreement, MGMIC agreed to loan \$1,850,000 to WFC, which amount was to be secured by an assignment of a portion of WFC's interest in a third mortgage on a property located at 4 Birchmount Road, Toronto (the Birchmount Property).

53. Unbeknownst to investors, approximately \$1.1 million in advances made under the Assignment Agreement ultimately benefitted Ben, his family members, or companies under their control.

54. In addition, contrary to representations made to investors regarding MGMIC's prudent approach to credit decisions and the sufficiency of security, the underlying security for the Assignment Agreement was a third mortgage that had been in default for 9 years, granted by an owner who was bankrupt. The Respondents performed inadequate due diligence with respect to WFC and did not require any personal guarantees in respect of the loan. Finally, the Respondents relied on an appraisal valuing the property at \$9,250,000 that was based on the hypothetical condition that the property could be developed with a senior citizens apartment development, although that use was not permitted by zoning.

55. The value of the Birchmount Property was far less than the amount indicated in the appraisal. In April 2018, a receiver was appointed for the Birchmount Property. In June 2018, a sale of the Birchmount Property for \$3,450,000 was approved. MGMIC has not received any amounts from the distribution of these proceeds and has not otherwise recovered any amounts owing under the Assignment Agreement.

4. *Diversion of Loan Advances on the Temiskaming Property*

56. In January 2017, the Respondents caused MGMIC to make a final advance of \$445,000 on the mortgage on the Temiskaming Property. The Respondents arranged for certain funds from the advance to be diverted to the benefit of Ben, his family members, and/or companies under their control.

5. *Conclusion*

57. The conduct of the Respondents described above gave rise to an increased risk of economic loss to investors in MGMIC. In addition, the significant losses and costs arising from the mortgages in default have and will continue to cause actual losses to MGMIC's investors.

~~58-50-~~ By engaging in the conduct described above, individually and collectively, each of the Respondents breached subsection 126.1(1)(b) of the Act by directly or indirectly engaging in or participating in an act, practice or course of conduct relating to securities which they each knew, or reasonably ought to have known, would perpetrate a fraud on investors.

~~59-54-~~ Further, each of the Respondents breached subsection 122(1)(b) of the Act by making statements in an offering document that, in a material respect and in the circumstances they were made, were misleading or untrue.

C. BREACHES OF ONTARIO SECURITIES LAW AND CONDUCT CONTRARY TO THE PUBLIC INTEREST

~~60-52-~~ Enforcement Staff alleges the following breaches of Ontario securities law and/or conduct contrary to the public interest:

- (a) The Respondents traded and engaged in, or held themselves out as engaging in, the business of trading in securities without being registered to do so, and where no exemption to the registration requirements of Ontario securities law was available, contrary to subsection 25(1) of the Act;
- (b) The Respondents distributed securities where no preliminary prospectus and prospectus was issued or receipted under the Act, and where exemptions to the prospectus requirements of Ontario securities law were improperly relied upon, contrary to subsection 53(1) of the Act;
- (c) The Respondents made statements in a document required to be furnished or filed under Ontario securities law that, in a material respect at the time and in light of the circumstances under which it is made, are misleading or untrue or do not state a fact that is required to be stated or that is necessary to make the statements not misleading, contrary to subsection 122(1)(b) of the Act;
- (d) The Respondents engaged in or participated in acts, practices, or courses of conduct relating to securities that they knew or reasonably ought to have known perpetrated a fraud on persons or companies, contrary to subsection 126.1(1)(b) of the Act; ~~and~~
- (e) The Principals, as directors and officers of the corporate Respondents, authorized, permitted or acquiesced in the breaches by the corporate Respondents set out above, and, in doing so, are deemed to have not complied with Ontario securities law, pursuant to section 129.2 of the Act; ~~and~~

~~(f) The Respondents acted contrary to the public interest by carrying out the conduct identified above.~~

~~61-53-~~ Enforcement Staff reserve the right to make such other allegations as Enforcement Staff may advise and the Commission may permit.

**DATED** at Toronto, ~~December 19, 2017~~ October 31, 2018.

~~Christie Johnson~~  
~~Litigation Counsel~~  
~~Enforcement Branch~~  
Jamie Gibson  
Litigation Counsel

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~~Lawyer~~ Lawyers for Staff of the Ontario Securities Commission

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## Chapter 3

# Reasons: Decisions, Orders and Rulings

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### 3.1 OSC Decisions

#### 3.1.1 Michael Pearson and LeadFX Inc. – s. 127

IN THE MATTER OF  
MICHAEL PEARSON

AND

IN THE MATTER OF  
LEADFX INC.

REASONS FOR DECISION  
(Section 127 of the  
*Securities Act, RSO 1990, c S.5*)

**Citation:** *Pearson (Re)*, 2018 ONSEC 53

**Date:** 2018-10-31

**File No.:** 2018-53

**Hearing:** September 28, 2018

**Decision:** October 31, 2018

**Panel:** D. Grant Vingoe Vice-Chair and Chair of the Panel  
Frances Kordyback Commissioner  
Lawrence P. Haber Commissioner

**Appearances:** Cynthia Spry For Michael Pearson  
Brendan Monahan  
  
Alexander D. Rose For LeadFX Inc.  
Patrick Corney  
Matt Hunt  
  
Robert Staley For Sentient Executive GP III, Limited and Sentient Executive GP IV,  
Jeff Kerbel Limited  
Sander Grieve  
Jonathan Bell  
Andrew Disipio  
William A. Bortolin  
  
Robert Brush For InCoR Energy Materials Limited  
Clarke Tedesco  
Mitchell Fournie  
  
Robert Gain For Staff of the Commission  
Naizam Kanji  
Jason Koskela  
David Mendicino  
Jordan Lavi  
David Steinhauer

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## REASONS FOR DECISION

### I. BACKGROUND

#### A. The Application

- [1] On September 28, 2018, a hearing was held before the Ontario Securities Commission (the **Commission**) with respect to preliminary motions in relation to an application brought under s. 127 of the *Securities Act*<sup>1</sup> (the **Act**) by Michael Pearson (**Pearson** or the **Applicant**), a minority shareholder of LeadFX Inc. (**LeadFX** or the **Respondent**), dated September 18, 2018 (the **Application**).
- [2] The Application related to a special meeting of shareholders of LeadFX, scheduled for October 3, 2018, called to consider and approve LeadFX's going-private transaction, to be completed by means of a statutory plan of arrangement (the **Plan of Arrangement**) under s. 192 of the *Canada Business Corporations Act* (**CBCA**).<sup>2</sup> On August 10, 2018, LeadFX received an Interim Order from the Ontario Superior Court of Justice in relation to the Plan of Arrangement, which scheduled the consideration of the final approval of the Plan of Arrangement for October 5, 2018. The Applicant takes issue with the Plan of Arrangement being able to proceed without it having to be approved by a majority of the minority vote.
- [3] The Plan of Arrangement permits InCoR Energy Materials Limited (**InCoR**) and Sentient Executive GP III, Limited, and Sentient Executive GP IV, Limited (collectively, **Sentient**) (together with InCoR, the **Controlling Shareholders**) to indirectly acquire all of the issued and outstanding common shares of LeadFX, cashing out all the remaining shareholders.
- [4] The Applicant also takes issue with the **InCoR Transaction** (described below) which preceded the Plan of Arrangement in 2017. The Applicant alleges that the InCoR Transaction and Plan of Arrangement are linked. Pearson alleged that he was adversely affected by the InCoR Transaction because it resulted in a change in the equity ownership of the company, making it possible for LeadFX to rely on the exemption from the minority approval requirement in s. 4.6(1)(a) of MI 61-101 (**90 Percent Exemption**) for the later approval of the Plan of Arrangement.
- [5] Pearson alleged that LeadFX structured its going-private transaction to circumvent the requirement to obtain majority of the minority shareholder approval under Multilateral Instrument 61-101 (**MI 61-101**). He requested that the Commission

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<sup>1</sup> RSO 1990, c S.5

<sup>2</sup> RSC 1985, c C-44

intervene and require that LeadFX minority shareholder approval be obtained. Specifically, Pearson sought the following relief from the Commission:

- a. an order permitting this application to be heard;
- b. an order that LeadFX has not complied with MI 61-101 – with respect to the Plan of Arrangement;
- c. an order pursuant to section 127(1)3 of the Act that the 90 Percent Exemption is not available to LeadFX with respect to the Plan of Arrangement;
- d. an order restraining LeadFX and its affiliates from completing the transaction (whether through a plan of arrangement or otherwise) without complying with MI 61-101, including, without limitation, the requirement of obtaining the approval of a majority of the minority shareholders in accordance with Part 8 of MI 61-101;
- e. an order pursuant to section 127(1)5 of the Act requiring LeadFX to:
  - i. immediately disseminate to the public a news release advising that, as a result of the Commission's orders, LeadFX must obtain minority approval as a condition for approval of the Plan of Arrangement resolution;
  - ii. immediately amend or supplement its management information circular dated August 10, 2018 (the **Circular**) to reflect that minority approval is required as a condition for approval of the Plan of Arrangement resolution; and
  - iii. send such amended or supplemented Circular to shareholders of LeadFX as of the Record Date for the meeting not less than 10 days prior to the meeting, as adjourned or postponed;
- f. an order pursuant to section 127(1)2 of the Act that trading cease in respect of any shares of LeadFX issued, or to be issued, under or in connection with the Plan of Arrangement, unless and until LeadFX satisfies the Commission that the provisions of paragraph "e." above have been complied with;
- g. an order pursuant to section 127(1)2.1 of the Act that the acquisition of any shares of LeadFX by the Controlling Shareholders (as defined below) or their affiliates is prohibited unless and until LeadFX satisfies the Commission that the provisions of paragraph "e." above have been complied with; and
- h. such alternative or further and other relief as counsel for the Applicant may request and the Commission may order.

[6] On September 24, 2018, Pearson made a request for disclosure to LeadFX and the Controlling Shareholders in connection with the Application consisting of:

- a. All documents relating to the Umbrella Agreement (as described below) (for example, communications involving LeadFX, Sentient or InCoR regarding the potential participation by InCoR in LeadFX (whether by debt or equity), the licensing or transfer of lead technology by InCoR to LeadFX, the financing of the Definitive Feasibility Study, etc.);
- b. The business case presented by Lincoln Greenidge to the Board of Directors of LeadFX opposing the InCoR transaction that ultimately became the Umbrella Agreement;
- c. All documents relating to the termination of the employment of Lincoln Greenidge, the former Chief Financial Officer of LeadFX;
- d. Any shareholders' agreement entered into between Sentient or InCoR in respect of LeadFX;
- e. All records relating to efforts by LeadFX to source financing for the restart of the Mine (defined below) or the construction of the Hydrometallurgical Facility from third parties from April 26, 2016 to present;
- f. All resolutions and/or minutes of meetings of the Board of Directors relating to the Umbrella Agreement or the Plan of Arrangement;
- g. All documents relating to the resignation of any directors from the LeadFX Board from April 26, 2016 to present; and
- h. All communications with INFOR Financial Inc., regarding its valuation and fairness opinion.

**B. Preliminary Motions**

- [7] Before the merits of the Application could be heard, there were two preliminary matters to be addressed:
- (1) Does the Applicant, a private party, have standing to bring the application? and
  - (2) If it is determined that the Application should be heard by the Commission, should the Applicant's request for further disclosure from LeadFX and the Controlling Shareholders be granted?
- [8] At a first attendance held on September 24, 2018, the Commission decided to bifurcate the preliminary issues from a potential consideration of the merits of the Application and address these preliminary issues at a hearing on September 28, 2018. If Pearson was granted standing to advance his Application under section 127, a hearing could be scheduled to address the merits of the Application the following week.
- [9] On September 28, 2018, after hearing the preliminary motions, the Commission dismissed the Applicant's motion for standing with reasons to follow. Consideration of Pearson's motion for disclosure thereby became unnecessary.
- [10] These are our reasons on the preliminary motions.

**C. The Parties**

- [11] Pearson resides in Toronto and is currently LeadFX's largest minority shareholder. Over the years, Pearson purchased over CAD \$6 million of LeadFX shares and as of September 25, 2018, Pearson is the beneficial owner of 2,363,715 common shares of LeadFX, representing approximately 3.4% of the common shares issued and outstanding on a non-diluted basis. If the Plan of Arrangement is approved, Pearson will be paid CAD \$2,363,715 for his investment and would no longer be a shareholder of LeadFX.
- [12] LeadFX is a Canadian-based mining company focused on the operation and development of lead mines. Its principal asset and sole material mineral project is a 100% equity interest in Rosslyn Hill Mining Pty Ltd, an Australian-incorporated entity that owns a 100% interest in the currently non-producing Paroo Station Lead Mine in Western Australia (the **Mine**).
- [13] InCoR and Sentient, the Controlling Shareholders, collectively own approximately 91.8% of the issued and outstanding shares of LeadFX.
- [14] As set out in the Circular, as of August 10, 2018:
- a. InCoR holds 27,306,475 common shares of LeadFX constituting 39.2% of the common shares outstanding, and
  - b. Sentient and its affiliates hold 36,609,182 common shares representing 52.6% of the common shares outstanding.
- [15] InCoR describes itself as a privately held venture capital and technology company based in London, England. InCoR became a shareholder of LeadFX in May 2017 through participating in the InCoR Transaction (described below).
- [16] Sentient Equity Partners SPC (**SEP**) describes itself as a segregated portfolio company incorporated under the laws of the Cayman Islands. SEP is described as an adviser to investment funds, which, through its affiliates, manages over US \$2.7 billion involved in the development of metal, mineral and energy assets. Sentient Executive GP I, Limited & Sentient (Aust.) Pty Ltd, Sentient Executive GP II, Limited & Sentient Trustees PTC Limited, Sentient Executive GP III, Limited and Sentient Executive GP IV, Limited are described as either the general partner of the relevant investment fund that are limited partnerships or the trustee of the relevant investment fund that are unit trusts, which receive investment advice from SEP.
- [17] Sentient regards LeadFX as one of its portfolio companies, in which Sentient holds a significant equity stake. Until March 2016, Sentient's common shares were held indirectly, through Enirgi Group Corporation (**Enirgi**), a wholly-owned subsidiary of Sentient. In March 2016, Enirgi's common shares of LeadFX were redistributed among Sentient I, II, III and IV. Sentient is also LeadFX's primary lender.
- [18] While the Application did not specifically name the Controlling Shareholders as parties, they are identified in the Application. Specifically, the Applicant's requested order, if granted, would apply to them, and the Application scrutinizes the conduct of the Controlling Shareholders, specifically the events surrounding the InCoR Transaction that

resulted in the Controlling Shareholders holding 91.8% of the company. In essence, the Controlling Shareholders are *de facto* respondents to the Application.

- [19] At the outset of the hearing on September 28, 2018, the status and participation of the Controlling Shareholders was addressed. We found that the Controlling Shareholders should be granted full intervenor status and have the ability to provide evidence and make submissions and have full participatory rights as parties. We indicated, however, that as a matter of scheduling, approximately half of the day would be reserved for submissions on behalf of Pearson and half of the day would be reserved for the Respondent and Controlling Shareholders, and we urged that duplication of submissions be avoided.
- [20] Staff of the Commission (**Staff**) participated in the hearing by providing written and oral submissions.
- [21] None of the parties objected to granting the Controlling Shareholders full party status or to the scheduling direction.
- [22] The Panel was also advised by the parties that no additional evidence would be offered during this phase of the Hearing and that the parties would limit themselves to materials filed, without any cross-examination and to the submissions made by their respective counsel.

#### D. Transactional History

- [23] On December 6, 2016, Sentient and InCoR entered into a confidentiality agreement relating to a potential transaction. A preliminary term sheet was provided on December 14, 2016. The term sheet would form the basis for the Umbrella Agreement that would reflect the elements of the InCoR Transaction (described below).
- [24] On January 17, 2017, the first draft of the Umbrella Agreement was circulated. A special committee of independent directors of LeadFX was appointed to review the transaction (**Umbrella Agreement Special Committee**) on April 14, 2017. The Umbrella Agreement Special Committee retained independent counsel to represent it. By May 4, 2017, the Umbrella Agreement Special Committee had determined that the Umbrella Agreement and the proposed transaction were in the best interests of LeadFX.
- [25] On May 12, 2017, LeadFX issued a news release announcing that the board of directors of LeadFX approved entering into an arm's length transaction with InCoR related to the transfer of lead refining technologies to LeadFX for the initial development of a lead refinery at the Mine, as reflected in the Umbrella Agreement (the **InCoR Transaction**). As set out in the May 12, 2017 news release, the rationale for the InCoR Transaction is to benefit all LeadFX shareholders by providing an opportunity to increase: (1) the Mine's life of mine and economics (2) the likelihood of a successful and profitable restart of the Mine, and (3) financing options for the Mine.
- [26] As part of the overall InCoR Transaction, the Umbrella Agreement would be entered into by LeadFX and InCoR. The key components of the InCoR Transaction are described in paragraphs 27 to 30.
- [27] The Umbrella Agreement provides that InCoR will undertake and pay for a DFS for the development of a lead refinery at the Mine. SNC-Lavalin will be contracted by InCoR to conduct the Definitive Feasibility Study (the DFS). The estimated cost of the DFS and associated works is US\$5 million to be funded solely by InCoR.
- [28] The Umbrella Agreement also provides that LeadFX will issue two separate common share purchase warrants to InCoR (the **Warrants**) that would allow InCoR to acquire up to 28,750,000 common shares, representing approximately 42.9% of the outstanding common shares on a non-diluted basis. The Warrants would be exercisable, for no additional consideration, subject to the occurrence of the following triggering events:
- a. 80% of the Warrants are to be exercised only on completion of the DFS (if it meets strict criteria and delivers a superior economic outcome for LeadFX) and fully funded by InCoR; and
  - b. the remaining 20% of the Warrants are to be exercisable only upon the receipt of definitive environmental approvals by LeadFX to construct a lead refinery at the Mine.
- [29] InCoR will transfer its proprietary hydrometallurgical technology for recovering lead from mixed oxide material to unlock previously unrealizable value at the Mine upon the successful completion of the DFS and exercise of 80% of the Warrants. LeadFX would then have the exclusive rights to use and sub-license InCoR's lead refining technologies worldwide.
- [30] LeadFX will also nominate an InCoR representative to its board and following the delivery of a successful DFS, LeadFX will nominate a second InCoR representative to its board.

- [31] Between May 12, 2017 and June 19, 2017, the Umbrella Agreement and warrant certificates were finalized and approved by the Toronto Stock Exchange. On June 20, 2017, the parties executed the Umbrella Agreement.
- [32] On August 15, 2017, LeadFX issued the Warrants to InCoR to acquire up to 28,750,000 common shares in the capital of LeadFX.
- [33] On August 23, 2017, the Umbrella Agreement was posted on SEDAR as a schedule to the applicable warrant certificate.
- [34] Subsequent to the InCoR Transaction, a number of private placements occurred. On August 29, 2017, LeadFX announced the first private placement with Sentient and InCoR for the issue of up to 3,125,000 common shares for gross proceeds of \$2.5 million to close in two separate tranches. The closing of the first and second tranches occurred on August 31, 2017 and October 27, 2017, respectively.
- [35] With the completion of the private placement on October 27, 2017, Sentient held approximately 82.3% of the issued and outstanding common shares and InCoR held approximately 3.9% of the issued and outstanding common shares.
- [36] On December 14, 2017, LeadFX announced a second private placement with Sentient and InCoR for the issue of up to 2,374,301 units for gross proceeds of \$1,163,407 to close in two separate tranches. The closing of the first and second tranches occurred on December 19, 2017 and January 12, 2018, respectively.
- [37] With the completion of the private placement on January 12, 2018, Sentient held approximately 80.5% of the issued and outstanding common shares and InCoR held approximately 6.5% of the issued and outstanding common shares.
- [38] On February 28, 2018, InCoR exercised 80% of the Warrants from the InCoR Transaction after the completion of the DFS, which met the success criteria outlined in the Umbrella Agreement. At the same time, InCoR signed the Technology Transfer Agreement under which InCoR will exclusively license its lead refining technology rights to LeadFX. After the exercise of Warrants, Sentient held a 52.8% interest in the common shares and InCoR held a 38.7% interest in the common shares, for a total of 91.8%.
- [39] On March 1, 2018, LeadFX announced that they had issued an Early Warning Report, filed pursuant to National Instrument 62-103 *The Early Warning System and Related Take-Over Bid and Insider Reporting Issues* in connection with the acquisition of securities of LeadFX by InCoR.
- [40] On April 9, 2018, LeadFX announced a third private placement with Sentient and InCoR for the issue of up to 488,208 units for gross proceeds of \$683,491. The offering closed on May 17, 2018.
- [41] In April 2018, the Controlling Shareholders raised the idea of a going private transaction with LeadFX.<sup>3</sup> The idea of a going private transaction was only previously discussed internally at InCoR sometime in February 2017.<sup>4</sup>
- [42] On May 10, 2018, a special committee of independent directors was appointed by the board of directors of LeadFX to consider and evaluate a potential going private transaction (the **Going Private Special Committee**).
- [43] On June 4, 2018, Sentient exercised 1,153,554 warrants at \$0.61 for 1,153,554 common shares of LeadFX.
- [44] On July 18, 2018, InCoR exercised 1,220,747 warrants at \$0.61 for 1,220,747 new common shares in LeadFX. After the exercise of Warrants, Sentient held 52.6% interest in the common shares and InCoR held 39.2% interest in the common shares, for a total of 91.8%.
- [45] On July 23, 2018, LeadFX issued a news release announcing a proposed going private transaction to be completed by way of a statutory plan of arrangement pursuant to section 192 of the CBCA, following the recommendation of the Going Private Special Committee. Under the Plan of Arrangement, the common shares of LeadFX will be consolidated on the basis of five million pre-consolidation common shares to one post-consolidation common share (the **Consolidation**). In lieu of fractional common shares, shareholders other than the Controlling Shareholders, who would otherwise receive less than one whole post-Consolidation common share will be entitled to receive cash consideration of \$1.00 for each pre-Consolidation common share, thereby cashing out minority shareholders, including Pearson.
- [46] The July 23, 2018 news release also indicated that: (1) the Controlling Shareholders intended to rely on the exemption from the minority approval requirement pursuant to section 4.6(1)(a) of MI 61-101, (2) INFOR Financial Inc. provided LeadFX with a Valuation and Fairness Opinion for the going private transaction, (3) the Going Private Special

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<sup>3</sup> Exhibit 3, Affidavit of David Warner, sworn September 26, 2018 at paras 52-53.

<sup>4</sup> Exhibit 4, Affidavit of Jocelyn Bennett, sworn September 27, 2018 at para 53.

Committee unanimously recommended that the Board approve the Plan of Arrangement and that shareholders vote in favour of the Plan of Arrangement resolution, and (4) the special meeting of shareholders to approve the Plan of Arrangement was anticipated to be held on October 3, 2018 (the **Special Meeting**).

- [47] The result of the Special Meeting was a foregone conclusion by virtue of the holdings of the Controlling Shareholders if a majority of the minority vote was not required or other court or regulatory intervention did not occur.
- [48] The Circular confirmed October 3, 2018 as the date for the Special Meeting. In addition, it set out the steps taken by the Going Private Special Committee, specifically that on August 5, 2018 the Going Private Special Committee reaffirmed their July 23, 2018 recommendation and conclusion that the Plan of Arrangement is in the best interest of LeadFX and fair to LeadFX's shareholders.
- [49] On August 10, 2018, LeadFX received an Interim Order from the Ontario Superior Court of Justice in relation to the Plan of Arrangement.
- [50] The application for the final order approving the Plan of Arrangement was scheduled to be heard on October 5, 2018.

## II. THE ISSUES

- [51] The issues before us were as follows:
- a. Should the Commission hear the Application under s. 127 of the Act?
  - b. If the Commission permits the Application to proceed to a hearing on the merits, should the Commission order LeadFX and the Controlling Shareholders to produce some or all of the documents requested by the Applicant?

## III. POSITIONS OF THE PARTIES ON THE PRELIMINARY MOTIONS

### A. Pearson

- [52] Pearson submits that the Commission should exercise its discretion to hear this Application as the conduct of LeadFX and the Controlling Shareholders is abusive to minority shareholders and that a consideration of the factors set out in *MI Developments*<sup>5</sup> weighs in favor of considering the Application.
- [53] Pearson alleges that the Plan of Arrangement is part of a long-term deliberate strategy to take LeadFX private and force minority shareholders out at the lowest possible price. He submits that LeadFX deliberately structured its affairs to take advantage of the 90 Percent Exemption by issuing a substantial amount of equity to the Controlling Shareholders through the InCoR Transaction. This transaction ultimately led to the Controlling Shareholders reaching a total of 91.8% of the outstanding common shares, thus permitting the availability of the 90 Percent Exemption. Pearson alleges that this was an essential element of a long-term strategy to enable the Controlling Shareholders to take LeadFX private without a minority vote.
- [54] Pearson takes the position that he should not be denied the ability to participate in future appreciation of LeadFX without having a say through a majority of the minority vote.
- [55] Pearson submits that the Commission is best suited to determine the issues raised in his Application. It is his view that other avenues, including an oppression remedy, objecting to the application for the final order approving the Plan of Arrangement, exercising dissent rights and asking the Court to establish the fair value of his shares are not sufficient to protect Pearson from the unfair and improper practices of LeadFX and the Controlling Shareholders.
- [56] Pearson also submits that his Application was brought in a timely manner. He submits that the Application was brought on September 18, 2018, 14 days before the date of the Special Meeting and that this was not a case like *Catalyst*<sup>6</sup> where the application was brought only five days before the shareholder meeting. Further, Pearson submits that there is no prejudice to LeadFX or the Controlling Shareholders by virtue of his Application being commenced on September 18, 2018.
- [57] With respect to the disclosure motion, Pearson submits that his request for documents is not overbroad. All the categories of documents requested are relevant to the issues raised in his Application and he will be prejudiced if he is required to go to a hearing on the merits without the benefit of the documents.

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<sup>5</sup> *MI Developments (Re)*, 2009 ONSEC 47, (2009), 32 OSCB 126 (*MI Developments*).

<sup>6</sup> *Catalyst Capital Group Inc. (Re)*, 2016 ONSEC 14, (2016) 39 OSCB 4079 (*Catalyst*).

**B. LeadFX**

- [58] LeadFX submits that this is not an extraordinary circumstance where a private party should be granted standing to bring an application under s. 127 because: (1) Pearson waited too long to bring his Application; (2) the Application raises no novel or fundamental issues that need to be heard in the public interest; (3) Pearson's complaints regarding price, oppressive conduct and fairness of the transaction can be fully addressed through statutory dissent rights under the CBCA; and (4) there is no realistic chance of success on the Application as Pearson has failed to make out a *prima facie* case in support of his claim for an order under s. 127 of the Act.
- [59] LeadFX takes the position that they are properly relying upon the 90 Percent Exemption as the Controlling Shareholders hold 91.8%, LeadFX obtained an independent valuation and dissent rights are available to its minority shareholders.
- [60] Regarding the disclosure motion, LeadFX takes the position that except for the request for resolutions and minutes of the meetings of the Umbrella Agreement Special Committee and the Going Private Special Committee, which have already been provided to Pearson, the other documents requested are not relevant, necessary or within LeadFX's control. Further, Pearson's document request amounts to a 'fishing expedition' to obtain documents that are intended to be used both in the Commission proceeding and subsequent Court and dissent proceedings.

**C. The Controlling Shareholders**

- [61] The Controlling Shareholders take the position that the Commission should not exercise its discretion to hear the Application. In addition to the Application being brought in an untimely manner, the Applicant has not brought his grievances to the correct forum. Since the Applicant takes issue with the fairness and reasonableness of the consideration offered in the Plan of Arrangement, he has standing to appear before a judge and oppose its approval on that basis, or he can exercise his dissent and appraisal rights. Since he also claims the company has historically operated in a way that unfairly prejudiced minority shareholders, he can commence an oppression application. Further, the Controlling Shareholders submit that the Application should not be heard as the Applicant has not demonstrated a *prima facie* case and the Application is based on speculation and conjecture relating to the conduct of the Controlling Shareholders in conjunction with the InCoR Transaction and Plan of Arrangement.
- [62] With respect to the disclosure motion, the Controlling Shareholders supported the submissions made by LeadFX that disclosure should not be ordered and requested that if the Commission did order disclosure, then they would like to have the opportunity to make further submissions on the scope of such disclosure.

**D. Staff**

- [63] Staff's submissions addressed the law for granting standing to private parties under s. 127 of the Act. Staff's submissions emphasized that applications by private parties under s. 127 are an exception to the general rule that only Staff may commence such a proceeding. Staff agreed in their written submissions that the first five factors listed in MI Developments (described in paragraph 70 below) are satisfied, however Staff takes the position that the sixth public interest factor is not satisfied.
- [64] Having regard to the timeliness of the Application, the nature of the issues raised, and the standard that would be required to prohibit the Respondent from relying on the 90 Percent Exemption, Staff took the position that the Applicant has not presented sufficient *prima facie* evidence supporting its allegations that would warrant a hearing on the merits.
- [65] Staff also expressed concerns that granting standing in this case would encourage other parties to make similarly broad claims at a late stage in the future and without a sufficient evidentiary foundation.
- [66] With respect the disclosure motion, Staff did not take a position on which of the requested categories of documents, if any, should be ordered, as the outcome of the disclosure motion is dependent on the scope of the merits hearing, should the Applicant be granted standing.

**IV. THE LAW**

- [67] Section 127 of the Act grants the Commission jurisdiction to intervene in the capital markets and make certain orders when the Commission determines that it is in the public interest to do so.

- [68] The Supreme Court of Canada has observed that the Commission has broad discretion to intervene in Ontario capital markets if it is in the public interest.<sup>7</sup> Exercise of the public interest power does not require a breach of the Act, regulations or any policy statement.<sup>8</sup>
- [69] However, a private party cannot bring an application as a matter of right under section 127 of the Act. Rather, in the extraordinary circumstance in which a private party chooses to bring an application under section 127 of the Act, the Commission has discretion whether to permit it to do so.<sup>9</sup>
- [70] The Commission has considered the following factors from *MI Developments* when deciding whether to exercise its discretion in favour of permitting an application by a private party:
- a. the applications related to both past and future conduct regulated by Ontario securities law;
  - b. the applications were not, at their core, enforcement in nature;
  - c. the relief sought is future looking;
  - d. the Commission has the authority to grant an appropriate remedy; the applicants were directly affected by the conduct (past and future); and
  - e. the Commission concluded it was in the public interest to hear the applications.<sup>10</sup>
- [71] An applicant bears the onus of establishing that it is in the public interest to grant such an extraordinary remedy and must tender "sufficient *prima facie* evidence to satisfy that onus."<sup>11</sup>
- [72] With respect to the public interest factor, the Commission has considered the following non-exhaustive factors:
- a. whether the application raises a novel issue<sup>12</sup>;
  - b. whether the issues raised could have been addressed in previous applications<sup>13</sup>;
  - c. whether the application demonstrates that there is a *prima facie* case<sup>14</sup>; and
  - d. whether the timing of the application would interfere unduly with the justified expectations of market participants and affect fairness, efficiency and confidence in the capital markets<sup>15</sup>.

## V. ANALYSIS

### A. Standing: Application of the Law to the Facts

#### 1. *MI Developments* Factors

- [73] We agree with Pearson that all of the factors for the Commission exercising its jurisdiction set out in *MI Developments* are satisfied, other than, crucially, that it is in the public interest to exercise such jurisdiction on the facts of this case. LeadFX and the Controlling Shareholders only contested that the public interest standard was satisfied in this case.
- [74] The question of whether it is in the public interest to hear the Application is determinative in this case. In conducting our public interest analysis, we have considered: (i) the timing in bringing the Application, (ii) whether there is a *prima facie* case, and (iii) the proper forum for the Applicant's complaints.

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<sup>7</sup> *Committee for the Equal Treatment of Asbestos Minority Shareholders v Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 SCR 132 at para 45.

<sup>8</sup> *Patheon Inc. (Re)*, 2009 ONSEC 13, (2009), 32 OSCB 6445 at para 114; *Mithras (Re)* (1990), 13 OSCB 1600.

<sup>9</sup> *MI Developments* at paras 248, 108 and 127; *Catalyst* at para 25.

<sup>10</sup> *MI Developments*, at paras 109-110; *Central GoldTrust et al (Re)*, 2015 ONSEC 44, (2015), 38 OSCB 10768 at para 16 (**Central GoldTrust**); *Catalyst* at paras 26, 40-48.

<sup>11</sup> *Catalyst* at para 30.

<sup>12</sup> *Central GoldTrust* at para 18; *Catalyst* at para 49.

<sup>13</sup> *Central GoldTrust* at para 19.

<sup>14</sup> *Catalyst* at para 58.

<sup>15</sup> *Catalyst* at paras 60-61.

**2. Timing in Bringing the Application**

- [75] We agree with Staff's submissions that applications for relief under section 127 by private parties brought close in time to a definitive event such as a shareholder vote or Court approval should be closely scrutinized to determine whether there was a reasonable basis for the delay. This delay should then be weighed against the public interest issues at stake and whether an applicant has established a *prima facie* case to support its allegations. This scrutiny is necessary to protect reasonable expectations for certainty in corporate transactions that could be inappropriately frustrated through such delays. It is also necessary to avoid incentivizing tactical delays that would affect the ability of the Commission and other parties to adequately prepare during a compressed hearing schedule.
- [76] In this case, the Applicant could have commenced his application in a timelier manner following the July 23, 2018 press release announcing the going private transaction. This press release stated explicitly that the 90 Percent Exemption was being relied upon. Instead, the Applicant waited almost two months – to September 18th, to bring the Application, requiring a very compressed filing schedule in advance of a September 28th hearing date, and with a shareholders meeting scheduled to occur within three business days thereafter and Court approval within five business days.
- [77] Pearson denies that there was delay in bringing the Application. He argues, first, that the time period should be measured from the date that the Circular was issued – August 10, 2018, or even later, posted on SEDAR – August 16, 2018. We reject this view since the going private transaction and reliance on the 90 Percent Exemption were clearly announced on July 23, 2018 and Pearson had a strong incentive by virtue of being the largest minority shareholder to carefully follow events involving his investment. To use these later dates as a measure of timeliness would be unrealistic in these circumstances.
- [78] Second, Pearson argues that if the Application is regarded as late, there is no prejudice to the Respondent and the Controlling Shareholders since the Special Meeting could be adjourned or the vote proceed subject to the possibility of a second vote being required, and the hearing for the final approval of the Plan of Arrangement could be postponed. To the contrary, our concern that delay not unduly interfere with reasonable expectations in connection with corporate transactions are directly implicated by suggestions that a vote be postponed or proceed on a partial basis, or Court approval be postponed in the face of regulatory uncertainty resulting from a proceeding of this kind. Both the Special Meeting and the Court approval involve considerable planning and communications with shareholders and others, and changes in the timetable are not inconsequential. Any such changes can cause uncertainty for investors and other participants.
- [79] Third, Pearson argues that the decision to retain counsel to seek the remedies he is seeking was a major decision for him as an individual, and that it took time to retain counsel. We view Pearson as an experienced individual who can reasonably be expected to make such decisions in a timely manner. His process of retaining counsel does not afford a basis for us to disregard the delay in this case.

**3. Absence of a Prima facie Case**

[67] Pearson alleges that:

Since at least 2015, one of LeadFX's Controlling Shareholders, Sentient, has executed a long-term, deliberate strategy to take LeadFX private and force the minority shareholders out at the lowest possible price.<sup>16</sup>

Pearson alleges, and is supported in these allegations by his own affidavit and an affidavit of Wayne Richardson, a former Chief Executive Officer and director of LeadFX, that the elements of this strategy consist of the following:

- a. The use of a "death spiral" debt financing technique allowing Sentient to convert debt to equity and gain control of LeadFX, an approach for which Sentient is alleged to be well-known;
- b. False assurances to Pearson that he would be able to participate in the upside resulting from the re-opening of the Mine when market conditions improved;
- c. The Umbrella Agreement and resulting InCoR Transaction was the mechanism used to commence this squeeze-out strategy, and should be linked as part of a multi-step transaction with the Plan of Arrangement;
- d. If this was not the motivation, LeadFX would have instead moved to reopen the Mine without the need for the InCoR Transaction;

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<sup>16</sup> Memorandum of Fact and Law of Michael Pearson, dated September 25, 2018 at para 5.

- e. Sentient and InCoR must be joint actors since Sentient would not give up equity as it did to InCoR without a shareholders' agreement or understanding in place to protect its interests, which would mean that the Umbrella Agreement itself should have been subject to majority of minority approval and therefore everything that followed, including the share issuances to InCoR and the Plan of Arrangement, are tainted and legally impermissible; and
- f. The Special Committees conducted flawed processes and oversaw flawed valuations.

[80] We regarded the 'death spiral' language as no more than an emotionally-loaded label. There is no evidence that Sentient's behaviour as a shareholder and secured creditor, providing debt financing to keep LeadFX afloat after the collapse of lead prices, involved anything other than an effort to protect its investment.

[81] The Umbrella Agreement brought in a new refining technology that promised enhanced performance of the Mine through the placement of a new, extensive refinery immediately adjacent to the Mine, avoiding the need to transport the mined material to a distant refinery at greater cost and environmental risks. The technology license conferred on LeadFX the exclusive right to market this technology to others on a world-wide basis. In order to exercise the Warrants to acquire LeadFX stock included under the Umbrella Agreement, specific conditions had to be met by InCoR, including the successful completion of the DFS financed by InCoR and the receipt of environmental approvals. None of this appeared to us to be part of a long-term strategy to squeeze out Pearson. Our role is not to insert ourselves in the comparative business judgment regarding whether it was more advantageous to restart the Mine with or without this deal in place.

[82] On the assurances allegedly given to Pearson that he would be able to participate in the upside, these appeared to consist of general discussions. He could reasonably have sought formal legal assurances, including pre-emptive rights, but did not obtain these protections in connection with his investment.

[83] There was no evidence advanced by Pearson, only conclusory statements, that the Umbrella Agreement commenced a multi-stage scheme. If such a plan was being implemented it would have had to involve Sentient and InCoR, as well as the many professional advisors, including the lawyers and investment bankers, and boards of directors and executive officers of both entities, who would have had to be complicit in the false disclosures being made as a public company and substantial regulatory violations and other potential misconduct involved. This scenario involves very serious allegations, requiring some evidence to support moving to a hearing on the merits. Instead, the Applicant provided only speculation to support such bold inferences.

[84] It appeared to us that there were many more direct means by which Sentient could acquire the Mine using its power either as a controlling shareholder and first lien, secured creditor to achieve this objective rather than a circuitous route involving InCoR. Pearson has not shown a *prima facie* case that the 90 Percent Exemption should be unavailable. The inference that no multipart transaction or plan by joint actors is involved is at least as sustainable as the contrary theories advanced by Pearson.

[85] We have no basis to draw an inference that there was a long-term objective of squeezing out the minority arising from the entering into of the Umbrella Agreement rather than implementing other courses of action such as the restart of the Mine on a more expeditious basis.

[86] It appeared to us that the absence of an apparent shareholders agreement between Sentient and InCoR was evidence pointing away from either a multi-part transaction or joint actor status rather than the contrary. Sentient was certainly in a position as a secured creditor to exercise its rights in a manner making it highly questionable whether Sentient also required some type of voting agreement to be in place. It could be just as readily inferred that InCoR needed protection against Sentient exercising its rights as a creditor, but could not secure such an agreement, than Sentient needed an agreement with InCoR when it was diluting its control position. Counsel for Sentient and InCoR, after making inquiries of their clients, each represented on behalf of their respective clients, that there was no voting agreement or understanding in place. Given the evidence before us, we did not see a need to have this reflected in affidavits to be delivered to us for the purposes of this decision.

[87] The flaws that Pearson outlines in the processes leading to the Umbrella Agreement and the Plan of Arrangement are disagreements with regard to business strategy and the outcome of the valuation process. There is no evidence that these processes were flawed so as to require regulatory intervention or were part of a long-term scheme to squeeze-out the minority shareholders, including Pearson.

[88] On the basis of the foregoing, we do not find that Pearson has made out a *prima facie* case supporting moving to a merits hearing. Given our determination that there was no *prima facie* case, there was no need to decide whether the issues raised by the Applicant were novel.

**4. Proper Forum for the Applicant's Complaints**

[89] Pearson's primary complaint is about the price fixed in the Plan of Arrangement. At various times Pearson was completely transparent about his focus on recouping at least his original investment in his exchanges with representatives of LeadFX.<sup>17</sup> The primary purpose of the 90 Percent Exemption is to prevent a minority shareholder with a relatively small percentage interest from holding up a transaction sought by the majority – to prevent that holder to block a transaction unless that shareholder's price is met. If there was substantial evidence that a scheme had been employed to attain 90% without proper disclosure or as a result of non bona-fide multipart transactions as an end-run around a requirement of minority shareholder approval, we would have good reason to exercise our jurisdiction both to protect investors and the integrity of capital markets. However, here the evidence of such misconduct is lacking, and the policy preventing a shareholder from exercising a blocking power in a transaction once 90% is attained governs in this case. Pearson has other remedies, if appropriate, to his complaints about price either through the fairness hearing conducted by the Court set to approve the Plan of Arrangement, in an oppression action or pursuant to an appraisal remedy, in each case under the CBCA.

**B. Disclosure**

[90] As we did not grant standing, it was unnecessary to further address the Applicant's disclosure motion.

**VI. CONCLUSION**

[91] Therefore, in the circumstances of this case, we decline to grant standing to the Applicant, a private party, to bring a section 127 application.

Dated at Toronto this 31st day of October, 2018.

"D. Grant Vingo"

"Frances Kordyback"

"Lawrence P. Haber"

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<sup>17</sup> Exhibit 3, Affidavit of David Warner, sworn September 26, 2018 at paras 68-75.

### 3.2 Director's Decisions

#### 3.2.1 Donald Mason

*[Editor's Note: This is an addendum to the Director's Decision, dated November 30, 2017 and published on December 7, 2017 at (2017), 40 OSCB 9697.]*

#### ADDENDUM – JOINT RECOMMENDATION BY STAFF AND DONALD MASON TO DEBRA FOUBERT IN HER CAPACITY AS DIRECTOR

Staff (**Staff**) of the Ontario Securities Commission and Donald Mason jointly recommend that in light of your decision in the capacity of Director dated November 30, 2017 (the **Director's Decision**), and in light of subsequent clarifications of Mr. Mason's activities on behalf of the Apostolic Pentecostal Church of Pickering (the **Church**) as outlined herein, the terms and conditions imposed on Mr. Mason in the Director's Decision should be modified as follows:

- (i) Mr. Mason will file a Current Employment Disclosure Change to expand on his submission in Item 10 to Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals* to clarify that Mr. Mason is neither a Pastor, a Lay Pastor nor a Ministry Leader; that in his capacity as a Lay Minister, Mr. Mason will deliver infrequent messages to the Church as requested by, and under the direction of, the Pastor of the Church; that Mr. Mason will deliver a limited number of messages each year; and that no messages will relate to financial matters.
- (ii) Mr. Mason acknowledges that he is in a position of potential influence over those he visits in hospitals, jails or prisons subject to a Christian Worker's licence, and that the terms and conditions appropriately apply to this narrower set of restricted clients.
- (iii) Accordingly, the Director's Decision should be modified to replace the imposed terms and conditions with the following:

*The Registrant may not act as a dealing representative in respect of any person, who is not already his client, who the Registrant visits pursuant to his Christian Worker's licence (**Restricted Clients**), or of a spouse, parent, brother, sister, grandparent or child of Restricted Clients, who is not already a client of the Registrant.*
- (iv) If the Director accepts this joint recommendation, Mr. Mason will immediately withdraw his application dated December 29, 2017 for a hearing and review of the Director's Decision.
- (v) If the Director accepts this joint recommendation, Mr. Mason agrees to waive all rights to a review of this matter.
- (vi) If the Director accepts this joint recommendation, none of the parties will make any public statement that is inconsistent with this joint recommendation.
- (vii) If the Director does not accept this joint recommendation, all discussions and negotiations between Staff and Mr. Mason in relation to this matter, and the joint recommendation itself, shall be without prejudice to the parties.

Respectfully jointly submitted by,

"Michael Denyszyn"  
Manager, Registrant Conduct  
Compliance and Registrant Regulation  
On behalf of Staff of the Ontario Securities Commission

October 29, 2018

"Chris Somerville"  
Affleck Greene McMurtry LLP  
On behalf of Donald Mason

October 29, 2018

In my capacity as Director, I hereby accept the joint recommendation.

Debra Foubert  
Director, Compliance and Registrant Regulation

October 29, 2018

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## Chapter 4

# Cease Trading Orders

### 4.1.1 Temporary, Permanent & Rescinding Issuer Cease Trading Orders

Company Name	Date of Temporary Order	Date of Hearing	Date of Permanent Order	Date of Lapse/Revoke
THERE IS NOTHING TO REPORT THIS WEEK.				

### Failure to File Cease Trade Orders

Company Name	Date of Order	Date of Revocation
CellCube Energy Storage Systems Inc.	02 November 2018	
KuuHubb Inc.	02 November 2018	
Martina Minerals Corp.	02 November 2018	

### 4.2.1 Temporary, Permanent & Rescinding Management Cease Trading Orders

Company Name	Date of Order	Date of Lapse
THERE IS NOTHING TO REPORT THIS WEEK.		

### 4.2.2 Outstanding Management & Insider Cease Trading Orders

Company Name	Date of Order or Temporary Order	Date of Hearing	Date of Permanent Order	Date of Lapse/Expire	Date of Issuer Temporary Order
Performance Sports Group Ltd.	19 October 2016	31 October 2016	31 October 2016		

Company Name	Date of Order	Date of Lapse
Katanga Mining Limited	15 August 2017	

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## Chapter 7

# Insider Reporting

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This chapter is available in the print version of the OSC Bulletin, as well as as in Carswell's internet service SecuritiesSource (see [www.carswell.com](http://www.carswell.com)).

This chapter contains a weekly summary of insider transactions of Ontario reporting issuers in the System for Electronic Disclosure by Insiders (SEDI). The weekly summary contains insider transactions reported during the seven days ending Sunday at 11:59 pm.

To obtain Insider Reporting information, please visit the SEDI website ([www.sedi.ca](http://www.sedi.ca)).



## Chapter 11

# IPOs, New Issues and Secondary Financings

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### INVESTMENT FUNDS

**Issuer Name:**

Cambridge American Equity Fund  
Cambridge American Equity Corporate Class  
CI Pacific Fund  
CI Pacific Corporate Class  
Signature Tactical Bond Pool  
Principal Regulator – Ontario

**Type and Date:**

Amendment #2 to Final Simplified Prospectus dated  
November 1, 2018  
Received on November 2, 2018

**Offering Price and Description:**

–

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

CI Investments Inc.  
Project #2777804

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**Issuer Name:**

Canoe Bond Advantage Fund  
Canoe Canadian Corporate Bond Fund  
Canoe Floating Rate Income Fund  
Canoe Strategic High Yield Fund  
Canoe Canadian Monthly Income Portfolio Class  
Canoe North American Monthly Income Portfolio Class  
Canoe Asset Allocation Portfolio Clas (formerly Canoe  
Canadian Asset Allocation Class)  
Canoe Equity Income Portfolio Class  
Canoe Premium Income Fund  
Canoe U.S. Equity Income Portfolio Class  
Canoe Equity Portfolio Class  
Principal Regulator – Alberta (ASC)

**Type and Date:**

Amendment #1 to Final Simplified Prospectus dated  
November 2, 2018  
Received on November 5, 2018

**Offering Price and Description:**

–

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

Canoe Financial Corp.  
Canoe Financial LP  
Project #2797142

**Issuer Name:**

Evolve Active US Core Equity ETF  
Principal Regulator – Ontario

**Type and Date:**

Amendment #1 to Final Long Form Prospectus dated  
November 2, 2018  
Received on November 2, 2018

**Offering Price and Description:**

–

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

Evolve Funds Group Inc.  
Project #2794934

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**Issuer Name:**

Fiera Capital Diversified Bond Fund  
Fiera Capital Income and Growth Fund  
Fiera Capital High Income Fund  
Fiera Capital Core Canadian Equity Fund  
Fiera Capital Equity Growth Fund  
Fiera Capital U.S. Equity Fund  
Fiera Capital International Equity Fund  
Fiera Capital Global Equity Fund  
Fiera Capital Defensive Global Equity Fund  
Principal Regulator – Quebec

**Type and Date:**

Amendment #1 to Final Simplified Prospectus dated  
November 2, 2018  
Received on November 2, 2018

**Offering Price and Description:**

–

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

Fiera Capital Corporation  
Project #2799529

**Issuer Name:**

NEI Jantzi Social Index® Fund (formerly Meritas Jantzi Social Index® Fund)  
NEI U.S. Equity Fund (formerly OceanRock U.S. Equity Fund)  
NEI International Equity Fund (formerly Meritas International Equity Fund)  
NEI Select Income Portfolio (formerly OceanRock Income Portfolio)  
NEI Select Growth & Income RS Portfolio (formerly Meritas Growth & Income Portfolio)  
NEI Select Growth & Income Portfolio (formerly OceanRock Growth & Income Portfolio)  
NEI Select Maximum Growth RS Portfolio (formerly Meritas Maximum Growth Portfolio)  
Principal Regulator – British Columbia

**Type and Date:**

Amended and Restated to Final Simplified Prospectus dated October 29, 2018  
Received on November 5, 2018

**Offering Price and Description:**

–

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

OceanRock Investments Inc.

Project #2740993

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**Issuer Name:**

Russell Investments Canadian Equity Fund  
Russell Investments US Equity Fund  
Russell Investments Global Equity Fund  
Principal Regulator – Ontario

**Type and Date:**

Amendment #1 to Final Simplified Prospectus dated October 29, 2018  
Received on October 30, 2018

**Offering Price and Description:**

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**Underwriter(s) or Distributor(s):**

Russell Investments Corporate Class Inc.  
Russell Investments Canada Limited

**Promoter(s):**

Russell Investments Corporate Class Inc.

Project #2776467

**Issuer Name:**

NBI Active Canadian Preferred Shares ETF  
NBI Canadian Family ETF  
NBI Global Real Assets Income ETF  
Principal Regulator – Quebec

**Type and Date:**

Preliminary Long Form Prospectus dated November 1, 2018

NP 11-202 Preliminary Receipt dated November 2, 2018

**Offering Price and Description:**

Units

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

N/A

Project #2837321

---

**Issuer Name:**

NBI Liquid Alternatives ETF  
Principal Regulator – Quebec

**Type and Date:**

Preliminary Long Form Prospectus dated November 1, 2018

NP 11-202 Preliminary Receipt dated November 2, 2018

**Offering Price and Description:**

Units

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

N/A

Project #2837326

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**Issuer Name:**

The Bitcoin Fund

**Type and Date:**

Preliminary Long Form Prospectus dated October 30, 2018  
(Preliminary) Receipted on October 31, 2018

**Offering Price and Description:**

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**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

3iQ Corp.

Project #2835709

**Issuer Name:**

Vanguard Global Liquidity Factor ETF  
Vanguard Global Minimum Volatility ETF  
Vanguard Global Momentum Factor ETF  
Vanguard Global Value Factor ETF  
Vanguard Conservative ETF Portfolio  
Vanguard Balanced ETF Portfolio  
Vanguard Growth ETF Portfolio  
Principal Regulator – Ontario

**Type and Date:**

Amendment #1 to Final Long Form Prospectus dated  
November 1, 2018  
Received on November 1, 2018

**Offering Price and Description:**

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**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

Vanguard Investments Canada Inc.

Project #2692070

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**Issuer Name:**

Vanguard FTSE Canada Index ETF  
Vanguard FTSE Canada All Cap Index ETF  
Vanguard FTSE Canadian High Dividend Yield Index ETF  
Vanguard FTSE Canadian Capped REIT Index ETF  
Vanguard Canadian Aggregate Bond Index ETF  
Vanguard Canadian Government Bond Index ETF  
Vanguard Canadian Corporate Bond Index ETF  
Vanguard Canadian Short-Term Bond Index ETF  
Vanguard Canadian Short-Term Government Bond Index  
ETF  
Vanguard Canadian Short-Term Corporate Bond Index  
ETF  
Vanguard Canadian Long-Term Bond Index ETF  
Vanguard S&P 500 Index ETF  
Vanguard S&P 500 Index ETF (CAD-hedged)  
Vanguard U.S. Total Market Index ETF  
Vanguard U.S. Total Market Index ETF (CAD-hedged)  
Vanguard U.S. Dividend Appreciation Index ETF  
Vanguard U.S. Dividend Appreciation Index ETF (CAD-  
hedged)  
Vanguard FTSE Global All Cap ex Canada Index ETF  
Vanguard FTSE Developed All Cap ex U.S. Index ETF  
Vanguard FTSE Developed All Cap ex U.S. Index ETF  
(CAD-hedged)  
Vanguard FTSE Developed All Cap ex North America  
Index ETF  
Vanguard FTSE Developed All Cap ex North America  
Index ETF (CAD-hedged)  
Vanguard FTSE Developed ex North America High  
Dividend Yield Index ETF  
Vanguard FTSE Developed Europe All Cap Index ETF  
Vanguard FTSE Developed Europe All Cap Index ETF  
(CAD-hedged)  
Vanguard FTSE Developed Asia Pacific All Cap Index ETF  
Vanguard FTSE Developed Asia Pacific All Cap Index ETF  
(CAD-hedged)  
Vanguard FTSE Emerging Markets All Cap Index ETF  
Vanguard U.S. Aggregate Bond Index ETF (CAD-hedged)  
Vanguard Global ex-U.S. Aggregate Bond Index ETF  
(CAD-hedged)  
Principal Regulator – Ontario

**Type and Date:**

Amendment #1 to Final Long Form Prospectus dated  
November 1, 2018  
Received on November 1, 2018

**Offering Price and Description:**

–

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

Vanguard Investments Canada Inc.

Project #2778608

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**Issuer Name:**

Vanguard Global Balanced Fund  
Vanguard Global Dividend Fund  
Vanguard International Growth Fund  
Vanguard Windsor U.S. Value Fund  
Principal Regulator – Ontario

**Type and Date:**

Amendment #1 to Annual Information Form dated  
November 1, 2018

Received on November 1, 2018

**Offering Price and Description:**

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**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

Vanguard Investments Canada Inc.

Project #2731117

---

**Issuer Name:**

US Equity Alpha Corporate Class  
Principal Regulator – Ontario

**Type and Date:**

Amendment #1 to Final Simplified Prospectus dated  
October 25, 2018

NP 11-202 Receipt dated November 2, 2018

**Offering Price and Description:**

–

**Underwriter(s) or Distributor(s):**

Assante Capital Management Ltd.

**Promoter(s):**

N/A

Project #2777764

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**Issuer Name:**

Canadian Equity Alpha Pool  
International Equity Value Currency Hedged Pool  
US Equity Value Currency Hedged Pool  
Principal Regulator – Ontario

**Type and Date:**

Final Simplified Prospectus dated October 30, 2018

NP 11-202 Receipt dated October 31, 2018

**Offering Price and Description:**

Class A, E, E3, E4, E5, F, F3, F4, F5, I, OF and W units

**Underwriter(s) or Distributor(s):**

Assante Capital Management Ltd.

**Promoter(s):**

CI Investments Inc.

Project #2823165

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**Issuer Name:**

Counsel All Equity Portfolio  
Counsel Balanced Growth Portfolio  
Counsel Balanced Portfolio  
Counsel Canadian Dividend  
Counsel Canadian Growth  
Counsel Canadian Value  
Counsel Conservative Portfolio  
Counsel Fixed Income  
Counsel Global Dividend  
Counsel Global Real Estate  
Counsel Global Small Cap  
Counsel Global Trend Strategy  
Counsel Growth Portfolio  
Counsel High Income Portfolio  
Counsel High Yield Fixed Income  
Counsel Income Portfolio  
Counsel International Growth  
Counsel International Value  
Counsel Money Market  
Counsel Monthly Income Portfolio  
Counsel Retirement Accumulation Portfolio  
Counsel Retirement Foundation Portfolio  
Counsel Retirement Income Portfolio  
Counsel Retirement Preservation Portfolio  
Counsel Short Term Bond  
Counsel U.S. Growth  
Counsel U.S. Value  
Principal Regulator – Ontario

**Type and Date:**

Final Simplified Prospectus dated October 29, 2018

NP 11-202 Receipt dated October 31, 2018

**Offering Price and Description:**

Series A, F, I, C, B, FT, IB, IT, Private Wealth I and T  
securities @ net asset value

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

N/A

Project #2818942

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**Issuer Name:**

Evolve Active Global Fixed Income ETF  
Principal Regulator – Ontario

**Type and Date:**

Final Long Form Prospectus dated October 30, 2018

NP 11-202 Receipt dated November 1, 2018

**Offering Price and Description:**

Units

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

Evolve Funds Group Inc.

Project #2830246

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**Issuer Name:**

Fidelity American Balanced Currency Neutral Fund	Fidelity Founders Investment Trust
Fidelity American Balanced Fund	Fidelity Frontier Emerging Markets Fund (formerly Fidelity Latin America Fund)
Fidelity American Disciplined Equity Currency Neutral Fund	Fidelity Global Asset Allocation Currency Neutral Private Pool
Fidelity American Disciplined Equity Fund	Fidelity Global Asset Allocation Fund
Fidelity American Equity Fund	Fidelity Global Asset Allocation Private Pool
Fidelity American High Yield Currency Neutral Fund	Fidelity Global Balanced Portfolio
Fidelity American High Yield Fund	Fidelity Global Bond Currency Neutral Fund
Fidelity AsiaStar Fund	Fidelity Global Bond Currency Neutral Investment Trust
Fidelity Balanced Managed Risk Portfolio	Fidelity Global Bond Fund
Fidelity Balanced Portfolio	Fidelity Global Bond Investment Trust
Fidelity Canadian Asset Allocation Fund	Fidelity Global Concentrated Equity Currency Neutral Fund
Fidelity Canadian Balanced Fund	Fidelity Global Concentrated Equity Fund (formerly Fidelity Global Opportunities Fund)
Fidelity Canadian Bond Fund	Fidelity Global Consumer Industries Fund
Fidelity Canadian Disciplined Equity Fund	Fidelity Global Credit Ex-U.S. Investment Trust
Fidelity Canadian Equity Investment Trust	Fidelity Global Disciplined Equity Currency Neutral Fund
Fidelity Canadian Focused Equity Investment Trust	Fidelity Global Disciplined Equity Fund
Fidelity Canadian Growth Company Fund	Fidelity Global Dividend Fund
Fidelity Canadian Large Cap Fund	Fidelity Global Dividend Investment Trust
Fidelity Canadian Money Market Fund	Fidelity Global Equity Investment Trust
Fidelity Canadian Money Market Investment Trust	Fidelity Global Financial Services Fund
Fidelity Canadian Opportunities Fund	Fidelity Global Fund
Fidelity Canadian Real Return Bond Index Investment Trust	Fidelity Global Growth and Value Investment Trust (formerly, Fidelity Core Global Equity Investment Trust)
Fidelity Canadian Short Term Bond Fund	Fidelity Global Growth Portfolio
Fidelity Canadian Short Term Fixed Income Investment Trust	Fidelity Global Health Care Fund
Fidelity China Fund	Fidelity Global High Yield Investment Trust
Fidelity ClearPath 2005 Portfolio	Fidelity Global Income Portfolio
Fidelity ClearPath 2010 Portfolio	Fidelity Global Innovators Investment Trust
Fidelity ClearPath 2015 Portfolio	Fidelity Global Intrinsic Value Investment Trust
Fidelity ClearPath 2020 Portfolio	Fidelity Global Large Cap Fund
Fidelity ClearPath 2025 Portfolio	Fidelity Global Monthly Income Currency Neutral Fund
Fidelity ClearPath 2030 Portfolio	Fidelity Global Monthly Income Fund
Fidelity ClearPath 2035 Portfolio	Fidelity Global Natural Resources Fund
Fidelity ClearPath 2040 Portfolio	Fidelity Global Real Estate Fund
Fidelity ClearPath 2045 Portfolio	Fidelity Global Real Estate Investment Trust
Fidelity ClearPath 2050 Portfolio	Fidelity Global Small Cap Fund
Fidelity ClearPath 2055 Portfolio	Fidelity Global Telecommunications Fund
Fidelity ClearPath Income Portfolio	Fidelity Greater Canada Fund
Fidelity ClearPath® 2060 Portfolio	Fidelity Growth Portfolio
Fidelity Concentrated Canadian Equity Investment Trust	Fidelity High Income Commercial Real Estate Investment Trust
Fidelity Concentrated Value Investment Trust	Fidelity Income Allocation Fund
Fidelity Conservative Income Fund	Fidelity Income Portfolio
Fidelity Conservative Income Private Pool	Fidelity Insights Investment Trust
Fidelity Conservative Managed Risk Portfolio	Fidelity International Concentrated Equity Currency Neutral Fund
Fidelity Convertible Securities Investment Trust	Fidelity International Concentrated Equity Fund (formerly Fidelity International Value Fund)
Fidelity Corporate Bond Fund	Fidelity International Disciplined Equity Currency Neutral Fund
Fidelity Dividend Fund	Fidelity International Disciplined Equity Fund
Fidelity Dividend Investment Trust	Fidelity International Equity Investment Trust
Fidelity Dividend Plus Fund (formerly Fidelity Income Trust Fund)	Fidelity International Growth Fund (formerly Fidelity Overseas Fund)
Fidelity Emerging Markets Debt Investment Trust	Fidelity International Growth Investment Trust
Fidelity Emerging Markets Equity Investment Trust	Fidelity Investment Grade Total Bond Currency Neutral Fund
Fidelity Emerging Markets Fund	Fidelity Investment Grade Total Bond Fund
Fidelity Emerging Markets Local Currency Debt Investment Trust	Fidelity Japan Fund
Fidelity Europe Fund	Fidelity Monthly Income Fund
Fidelity Event Driven Opportunities Fund	
Fidelity Far East Fund	
Fidelity Floating Rate High Income Currency Neutral Fund	
Fidelity Floating Rate High Income Fund	
Fidelity Floating Rate High Income Investment Trust	

Fidelity Multi-Sector Bond Currency Neutral Fund  
Fidelity Multi-Sector Bond Fund  
Fidelity North American Equity Investment Trust  
Fidelity NorthStar Balanced Currency Neutral Fund  
Fidelity NorthStar Balanced Fund  
Fidelity NorthStar Currency Neutral Fund  
Fidelity NorthStar Fund  
Fidelity Premium Fixed Income Private Pool  
Fidelity Premium Money Market Private Pool  
Fidelity Premium Tactical Fixed Income Private Pool  
Fidelity Small Cap America Fund  
Fidelity Special Situations Fund  
Fidelity Strategic Income Currency Neutral Fund  
Fidelity Strategic Income Fund  
Fidelity Tactical Fixed Income Fund  
Fidelity Tactical High Income Currency Neutral Fund  
Fidelity Tactical High Income Fund  
Fidelity Tactical Strategies Fund  
Fidelity Technology Innovators Fund (formerly, Fidelity Global Technology Fund)  
Fidelity True North Fund  
Fidelity U.S. All Cap Fund  
Fidelity U.S. Bond Investment Trust  
Fidelity U.S. Dividend Currency Neutral Fund  
Fidelity U.S. Dividend Fund  
Fidelity U.S. Dividend Investment Trust  
Fidelity U.S. Dividend Private Pool  
Fidelity U.S. Dividend Registered Fund  
Fidelity U.S. Equity Investment Trust  
Fidelity U.S. Focused Stock Fund (formerly Fidelity Growth America Fund)  
Fidelity U.S. Growth and Income Private Pool  
Fidelity U.S. Money Market Fund  
Fidelity U.S. Money Market Investment Trust  
Fidelity U.S. Monthly Income Currency Neutral Fund  
Fidelity U.S. Monthly Income Fund  
Fidelity U.S. Multi-Cap Investment Trust  
Fidelity U.S. Small/Mid Cap Equity Investment Trust  
Principal Regulator – Ontario  
**Type and Date:**  
Final Simplified Prospectus dated November 1, 2018  
NP 11-202 Receipt dated November 5, 2018  
**Offering Price and Description:**  
–  
**Underwriter(s) or Distributor(s):**  
Fidelity Investments Canada ULC  
Fidelity Investments Canada Limited  
**Promoter(s):**  
N/A  
**Project #2822465**

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**Issuer Name:**  
Genus Dividend Equity Fund  
Genus Fossil Free CanGlobe Equity Fund  
Genus Fossil Free Corporate Bond Fund  
Genus Fossil Free Dividend Equity Fund  
Genus Fossil Free High Impact Equity Fund  
Genus Government Bond Fund  
Genus Short-Term Bond Fund  
Principal Regulator – British Columbia  
**Type and Date:**  
Final Simplified Prospectus dated October 30, 2018  
NP 11-202 Receipt dated October 31, 2018  
**Offering Price and Description:**  
Series F Units  
**Underwriter(s) or Distributor(s):**  
Genus Capital Management Inc.  
**Promoter(s):**  
Genus Capital Management Inc.  
**Project #2820513**

---

**Issuer Name:**  
US Equity Alpha Pool  
Principal Regulator – Ontario  
**Type and Date:**  
Amendment #1 to Final Simplified Prospectus dated October 25, 2018  
NP 11-202 Receipt dated November 2, 2018  
**Offering Price and Description:**  
Class A, E, E3, E4, E5, F, F3, F4, F5, I, OF and W units  
**Underwriter(s) or Distributor(s):**  
Assante Capital Management Ltd.  
**Promoter(s):**  
CI Investments Inc.  
**Project #2787126**

---

**Issuer Name:**  
iShares Canadian Financial Monthly Income ETF  
iShares Equal Weight Banc & Lifeco ETF  
iShares Premium Money Market ETF  
iShares Short Duration High Income ETF (CAD-Hedged)  
Principal Regulator – Ontario  
**Type and Date:**  
Final Long Form Prospectus dated October 30, 2018  
NP 11-202 Receipt dated October 31, 2018  
**Offering Price and Description:**  
Common Units  
**Underwriter(s) or Distributor(s):**  
N/A  
**Promoter(s):**  
N/A  
**Project #2826259**

---

**Issuer Name:**

iShares Gold Bullion ETF  
iShares Silver Bullion ETF  
Principal Regulator – Ontario

**Type and Date:**

Final Long Form Prospectus dated October 30, 2018  
NP 11-202 Receipt dated October 31, 2018

**Offering Price and Description:**

Hedged and non-hedged units @ net asset value

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

N/A

**Project #2825805**

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**Issuer Name:**

Lawrence Park Alternative Investment Grade Credit Fund  
Marret Alternative Absolute Return Bond Fund  
Munro Alternative Global Growth Fund  
Principal Regulator – Ontario

**Type and Date:**

Final Simplified Prospectus dated October 30, 2018  
NP 11-202 Receipt dated October 31, 2018

**Offering Price and Description:**

Class A, F and I units

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

CI Investments Inc.

**Project #2824182**

---

**Issuer Name:**

Next Edge AHL Fund  
Principal Regulator – Ontario

**Type and Date:**

Final Long Form Prospectus dated November 2, 2018  
NP 11-202 Receipt dated November 5, 2018

**Offering Price and Description:**

Class A Units, Class F Units, Class H Units, Class J Units,  
Class K Units, Class L Units and Class M Units

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

N/A

**Project #2828219**

**Issuer Name:**

Partners Value Split Corp.  
Principal Regulator – Ontario

**Type and Date:**

Final Shelf Prospectus (NI 44-102) dated October 29, 2018  
NP 11-202 Receipt dated October 30, 2018

**Offering Price and Description:**

\$750,000,000 – Class AA Preferred Shares

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

N/A

**Project #2821250**

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**Issuer Name:**

Tangerine Balanced Growth Portfolio  
Tangerine Balanced Income Portfolio  
Tangerine Balanced Portfolio  
Tangerine Dividend Portfolio  
Tangerine Equity Growth Portfolio  
Principal Regulator – Ontario

**Type and Date:**

Final Simplified Prospectus dated October 30, 2018  
NP 11-202 Receipt dated October 31, 2018

**Offering Price and Description:**

units @ net asset value

**Underwriter(s) or Distributor(s):**

Tangerine Investment Funds Limited

**Promoter(s):**

N/A

**Project #2827469**

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**Issuer Name:**

TD Active Preferred Share ETF  
TD Select Short Term Corporate Bond Ladder ETF  
TD Select U.S. Short Term Corporate Bond Ladder ETF  
Principal Regulator – Ontario

**Type and Date:**

Final Long Form Prospectus dated October 31, 2018  
NP 11-202 Receipt dated November 1, 2018

**Offering Price and Description:**

CAD and USD units @ net asset value

**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

TD Asset Management Inc.

**Project #2823716**

**Issuer Name:**

Vanguard Global Liquidity Factor ETF  
Vanguard Global Minimum Volatility ETF  
Vanguard Global Momentum Factor ETF  
Vanguard Global Value Factor ETF  
Vanguard Conservative ETF Portfolio  
Vanguard Balanced ETF Portfolio  
Vanguard Growth ETF Portfolio  
Principal Regulator – Ontario

**Type and Date:**

Amendment #1 to Final Long Form Prospectus dated  
November 1, 2018  
NP 11-202 Receipt dated November 5, 2018

**Offering Price and Description:**

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**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

Vanguard Investments Canada Inc.

**Project #2692070**

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**Issuer Name:**

Vanguard Global Balanced Fund  
Vanguard Global Dividend Fund  
Vanguard International Growth Fund  
Vanguard Windsor U.S. Value Fund  
Principal Regulator – Ontario

**Type and Date:**

Amendment #1 to Annual Information Form dated  
November 1, 2018  
NP 11-202 Receipt dated November 5, 2018

**Offering Price and Description:**

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**Underwriter(s) or Distributor(s):**

N/A

**Promoter(s):**

Vanguard Investments Canada Inc.

**Project #2731117**

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NON-INVESTMENT FUNDS

**Issuer Name:**

BIP Investment Corporation  
Principal Regulator – Ontario

**Type and Date:**

Preliminary Shelf Prospectus dated November 1, 2018  
NP 11-202 Preliminary Receipt dated November 1, 2018

**Offering Price and Description:**

Senior Preferred Shares  
C\$3,000,000,000.00

**Underwriter(s) or Distributor(s):**

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**Promoter(s):**

–

**Project #2836768**

**Issuer Name:**

Brookfield Infrastructure Finance Pty Ltd  
Principal Regulator – Ontario

**Type and Date:**

Preliminary Shelf Prospectus dated November 1, 2018  
NP 11-202 Preliminary Receipt dated November 1, 2018

**Offering Price and Description:**

Senior Preferred Shares  
C\$3,000,000,000.00

**Underwriter(s) or Distributor(s):**

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**Promoter(s):**

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**Project #2836763**

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**Issuer Name:**

Brookfield Infrastructure Finance Limited  
Principal Regulator – Ontario

**Type and Date:**

Preliminary Shelf Prospectus dated November 1, 2018  
NP 11-202 Preliminary Receipt dated November 1, 2018

**Offering Price and Description:**

Senior Preferred Shares  
C\$3,000,000,000.00

**Underwriter(s) or Distributor(s):**

–

**Promoter(s):**

–

**Project #2836758**

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**Issuer Name:**

Brookfield Infrastructure Finance ULC  
Principal Regulator – Ontario

**Type and Date:**

Preliminary Shelf Prospectus dated November 1, 2018  
NP 11-202 Preliminary Receipt dated November 1, 2018

**Offering Price and Description:**

Senior Preferred Shares  
C\$3,000,000,000.00

**Underwriter(s) or Distributor(s):**

–

**Promoter(s):**

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**Project #2836750**

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**Issuer Name:**

Brookfield Infrastructure Finance LLC  
Principal Regulator – Ontario

**Type and Date:**

Preliminary Shelf Prospectus dated November 1, 2018  
NP 11-202 Preliminary Receipt dated November 1, 2018

**Offering Price and Description:**

Senior Preferred Shares  
C\$3,000,000,000.00

**Underwriter(s) or Distributor(s):**

–

**Promoter(s):**

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**Project #2836754**

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**Issuer Name:**

CANSORTIUM INC.  
Principal Regulator – Ontario

**Type and Date:**

Preliminary Long Form Prospectus dated October 30, 2018  
NP 11-202 Preliminary Receipt dated November 2, 2018

**Offering Price and Description:**

\* Common Shares and \* Common Share Purchase  
Warrants Issuable  
on Exercise Of \* Outstanding Subscription Receipts  
Price Per Subscription Receipt: \$3.50

**Underwriter(s) or Distributor(s):**

Paradigm Capital Inc.  
Eight Capital  
Echelon Wealth Partners Inc.  
GMP Securities L.P.

**Promoter(s):**

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**Project #2836559**

**Issuer Name:**

Green Panda Capital Corp.  
Principal Regulator – Ontario

**Type and Date:**

Preliminary CPC Prospectus (TSX-V) dated October 30, 2018

NP 11-202 Preliminary Receipt dated October 30, 2018

**Offering Price and Description:**

Minimum Offering: \$200,000.00 (2,000,000 Common Shares)

Maximum Offering: \$600,000.00 (6,000,000 Common Shares)

Price: \$0.10 per Common Share

**Underwriter(s) or Distributor(s):**

Hampton Securities Limited

**Promoter(s):**

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**Project #2835576**

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**Issuer Name:**

Lumina Gold Corp.  
Principal Regulator – British Columbia

**Type and Date:**

Preliminary Short Form Prospectus dated November 5, 2018

NP 11-202 Preliminary Receipt dated November 5, 2018

**Offering Price and Description:**

Maximum Offering: \$9,520,000.00 or 17,000,000 Common Shares

Price: \$0.56 per Common Share

**Underwriter(s) or Distributor(s):**

HAYWOOD SECURITIES INC.

**Promoter(s):**

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**Project #2837828**

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**Issuer Name:**

Patriot One Technologies Inc.  
Principal Regulator – British Columbia

**Type and Date:**

Preliminary Short Form Prospectus dated November 2, 2018

NP 11-202 Preliminary Receipt dated November 2, 2018

**Offering Price and Description:**

\$40,000,000.00 – 16,000,000 Units  
Consisting of 16,000,000 Common Shares and 16,000,000 Warrants

Price: \$2.50 per Unit

1,120,000 Underwriter Warrants

**Underwriter(s) or Distributor(s):**

CANACCORD GENUITY CORP.

GMP SECURITIES L.P.

**Promoter(s):**

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**Project #2837441**

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**Issuer Name:**

Perihelion Capital Ltd.  
Principal Regulator – British Columbia

**Type and Date:**

Amendment dated October 31, 2018 to Preliminary CPC Prospectus (TSX-V) dated October 31, 2018

NP 11-202 Preliminary Receipt dated October 31, 2018

**Offering Price and Description:**

\$600,000.00

6,000,000 Common Shares

Price: \$0.10 per Common Share

**Underwriter(s) or Distributor(s):**

Mackie Research Capital Corporation

**Promoter(s):**

Alexandros Tziliios

**Project #2802323**

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**Issuer Name:**

Skarb Exploration Corp.  
Principal Regulator – Ontario

**Type and Date:**

Amendment #1 dated October 30, 2018 to Preliminary Long Form Prospectus dated August 1, 2018

NP 11-202 Preliminary Receipt dated October 31, 2018

**Offering Price and Description:**

1,401,500 Common Shares on Exercise of 1,401,500

Outstanding Special Warrants

**Underwriter(s) or Distributor(s):**

–

**Promoter(s):**

Craig Parry

**Project #2801515**

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**Issuer Name:**

Tempus Capital Inc.  
Principal Regulator – Ontario

**Type and Date:**

Amendment dated October 29, 2018 to Preliminary Long Form Prospectus dated August 1, 2018

NP 11-202 Preliminary Receipt dated October 31, 2018

**Offering Price and Description:**

No securities are being offered pursuant to this Prospectus

**Underwriter(s) or Distributor(s):**

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**Promoter(s):**

Russell Tanz

**Project #2801631**

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**Issuer Name:**

Cargojet Inc.  
Principal Regulator – Ontario

**Type and Date:**

Final Short Form Prospectus dated October 30, 2018  
NP 11-202 Receipt dated October 30, 2018

**Offering Price and Description:**

\$75,000,000.00 – 5.75% Listed Senior Unsecured Hybrid  
Debentures

Price: \$1,000.00 per Debenture

**Underwriter(s) or Distributor(s):**

RBC Dominion Securities Inc.  
CIBC World Markets Inc.  
National Bank Financial Inc.  
Scotia Capital Inc.  
Canaccord Genuity Corp.  
Laurentian Bank Securities Inc.  
Raymond James Ltd.  
Acumen Capital Finance Partners Limited  
Beacon Securities Limited  
Echelon Wealth Partners Inc.

**Promoter(s):**

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**Project #2831498**

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## Chapter 12

# Registrations

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### 12.1.1 Registrants

Type	Company	Category of Registration	Effective Date
New Registration	Visavis Investment Counsel Inc.	Portfolio Manager	October 30, 2018
Change in Registration Category	Vancity Investment Management Limited	From: Portfolio Manager To: Portfolio Manager, Investment Fund Manager & Exempt Market Dealer	November 5, 2018

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## Chapter 13

# SROs, Marketplaces, Clearing Agencies and Trade Repositories

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### 13.2 Marketplaces

#### 13.2.1 Canadian Securities Exchange – Proposed Fee Change – Monthly Tier Credits – Top of Book – Notice and Request for Comments

##### CANADIAN SECURITIES EXCHANGE

##### PROPOSED FEE CHANGE

##### MONTHLY TIER CREDITS – TOP OF BOOK

##### NOTICE AND REQUEST FOR COMMENTS

CNSX Markets Inc. (“CSE”) is publishing proposed fee changes regarding monthly fee credits – top of book (“Fee Change”) in accordance with s. 6(a) of Appendix C (“Process for the Review and Approval of Rules and Information Contained in Form 21-101F1 and the Exhibits Thereto”) of the CSE Recognition Order, as amended and s. 3.2(2) of National Instrument 21-101 *Marketplace Operation*.

The Fee Change will provide monthly tier credits to traders that have placed orders reaching a stated target percentage of time at the NBBO on a per symbol basis. The monthly tier credits are calculated on all of the trader’s eligible passive trades for that symbol for the month.

A copy of the [CSE Notice](#) is published on our website at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

#### Description of the Changes

The CSE proposes the following fee change:

#### Monthly Tier Credits – Top of Book (TOB)

Tier credits will be provided for TSX-listed securities trading equal to or greater than \$1.00. A Trader ID or a Trader ID Group with orders that reach the stated target percentage of time at the NBBO on a per symbol basis will be awarded fee credits based on all of their eligible passive trades on that symbol for the month. Eligible passive trades means passives trades excluding intentional crosses, registered unintentional crosses, odd-lot trades, flat fee trades and dark trading volumes.

#### Non Market Makers

		Passive Fee
Current: No Change	Equal to or greater than \$1.00	\$0.0018
Proposed: Tier 1	Equal to or greater than \$1.00 >=15% TOB (NBB or NBO) on either side – average for the month	\$0.0017
Proposed: Tier 2	Equal to or greater than \$1.00 >=15% TOB (NBB or NBO) on each side or >=30% in total for both sides combined – average for the month	\$0.0016

**Market Makers**

		Passive Fee
Current: No Change	Equal to or greater than \$1.00	\$0.0016
Proposed: Tier 1	Equal to or greater than \$1.00 >=15% TOB (NBB or NBO) on either side – average for the month	\$0.0015
Proposed: Tier 2	Equal to or greater than \$1.00 >=15% TOB (NBB or NBO) on each side or >=30% in total for both sides combined – average for the month	\$0.0014

Percentage time at the NBB/NBO = (total amount of time at the NBB/NBO) divided by (the total amount of trading time for the month). Trading time is measured from 9:30 am EST to 4:00 pm EST (6.5 hours).

Marketplace participants booking one boardlot (either the bid or the offer) on the CSE for a given symbol, that is equal to the NBB or NBO for a minimum of 15% of the time<sup>1</sup>, qualify for the Monthly Tier Credits. The calculation is based at time at the top of book, not on trading volumes. For example, if a Trader ID or a Trader ID Group had orders reaching the stated target percentage of time at the NBBO for a symbol but such orders did not trade because all contra orders went to another marketplace, were filled in the dark, or were filled by other booked orders ahead in priority, the Trader ID or a Trader ID Group would still receive the credit on all eligible passive trades on that symbol for that month – this would include credits on orders booked outside the NBBO that eventually traded.

**Expected Implementation Date:**

The proposed fee changes are expected to be implemented upon the receipt of regulatory approval.

**Rationale and relevant supporting analysis**

The monthly credits are intended to reduce the overall dealer cost of trading, with incentives targeted at increasing liquidity as well as rewarding dealers already providing liquidity. The approach responds to competitive factors and dealer consultation. The proposed Monthly Tier Credits will be available to all marketplace participants.

**Expected Impact of the Proposed Fee Change on the Market Structure, Members and, if applicable, on Investors, Issuers and the Capital Markets**

The proposed trading fees will benefit the industry through expected enhanced liquidity. Additionally, qualifying CSE Dealers would see savings on monthly trading fees.

**Discussion of the expected impact of the proposed Fee Change on the Exchange's compliance with Ontario securities law and in particular on requirements for fair access and maintenance of fair and orderly markets**

There will be no impact on the CSE's compliance with Ontario securities law. The changes do not alter any of the requirements for fair access or the maintenance of fair and orderly markets.

The proposed Monthly Tier Credits will be available to all marketplace participants. The calculation is performed on a Trader ID or a Trader ID Group basis as instructed by a marketplace participant. As there is no volume-based incentive, there is no volume-based advantage in grouping Trader IDs. There is no discrimination associated with such grouping in calculating the monthly fee credits.

**Will the Fee Change (as a Significant Change) require members and service vendors to modify their own systems after implementation of the Fee Change, and, if applicable, a reasonable estimate of the amount of time needed to perform the necessary work, or an explanation as to why a reasonable estimate was not provided**

The Fee Change would not require members and service vendors to modify their own systems.

**Other Markets or Jurisdictions**

While the proposed Fee Change would be new in terms of the specific qualification criteria for reduced fees in the Canadian markets, it does follow in the footsteps of fee models employed by other Canadian marketplaces that provide incentive programs. For example, (1) TSX Alpha Liquidity Provision Program (passive liquidity providers meeting volume thresholds),<sup>2</sup>

<sup>1</sup> For a month with 23 trading days, 15% of the time would be 58.5 minutes per day.

<sup>2</sup> <https://www.tsx.com/resource/en/1850>.

(2) NASDAQ CXC Trading Incentive Program (total volume of a Trader ID Group's NBBO Settling Trades meeting a volume threshold),<sup>3</sup> and Omega ATS Breakpoint Pricing (discounted liquidity providing rate based on volume thresholds).<sup>4</sup>

**Comments**

Comments on the proposed amendments should be in writing and submitted no later than December 3, 2018 to:

Mark Faulkner  
Vice President, Listings and Regulation  
CNSX Markets Inc.  
220 Bay Street, 9th Floor  
Toronto, ON, M5J 2W4  
Fax: 416.572.4160  
Email: [Mark.Faulkner@thecse.com](mailto:Mark.Faulkner@thecse.com)

A copy of the comments should be provided to:

Market Regulation Branch  
Ontario Securities Commission  
20 Queen Street West, 22nd Floor  
Toronto, ON, M5H 3S8  
Fax: 416.595.8940  
Email: [marketregulation@osc.gov.on.ca](mailto:marketregulation@osc.gov.on.ca)

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<sup>3</sup> See Nasdaq Canada Notice 2018-1029-02 issued October 29, 2018.

<sup>4</sup> <http://omegaats.com/fees/>.

### 13.3 Clearing Agencies

#### 13.3.1 Notice and Request for Comment – Application by LME Clear Limited for Exemption from Recognition as a Clearing Agency

##### NOTICE AND REQUEST FOR COMMENT

##### APPLICATION BY LME CLEAR LIMITED FOR EXEMPTION FROM RECOGNITION AS A CLEARING AGENCY

November 8, 2018

#### A. Background

LME Clear Limited (**LMEC**) has applied (the **Application**) to the Commission for an order pursuant to section 147 of the *Securities Act* (Ontario) (**OSA**) to exempt it from the requirement to be recognized as a clearing agency in subsection 21.2(0.1) of the OSA.

LMEC is an approved central counterparty (**CCP**) under Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (**EMIR**) and is also subject to the *Financial Services and Markets Act 2000* (**FSMA**). LMEC obtained its authorization on September 3, 2014. LMEC is also authorized to provide Automated Trading Services in Hong Kong and is the clearing organization for the LME under its Foreign Board of Trade License in the US.

LMEC proposes to offer direct access to its clearing and settlement facilities to prospective participants in Ontario.

As LMEC will be carrying on business in Ontario, it is required to be recognized as a clearing agency under the OSA or apply for an exemption from the recognition requirement. Among other factors set out in the Application, LMEC is seeking an exemption from the recognition requirement on the basis that it is subject to an appropriate regulatory and oversight regime in its home jurisdiction of the United Kingdom (**UK**) by the Bank of England (**Bank**).

The Application accompanies the related application made by the London Metal Exchange (**LME**) to exempt it from the requirement to be recognized as an exchange in subsection 21(1) of the OSA.

#### B. Application and Draft Exemption Order

In the Application, LMEC describes its requirements under EMIR and the FSMA that are generally comparable or that achieve similar outcomes to the requirements of National Instrument 24-102 *Clearing Agency Requirements* (**NI 24-102**). Subject to comments received, staff propose to recommend to the Commission that it grant LMEC an exemption order in the form of the proposed draft order attached at Appendix A (**Draft Order**). We are prepared to recommend to the Commission that it exempt LMEC because it does not currently pose significant risk to Ontario's capital markets and is subject to an appropriate regulatory and oversight regime in another jurisdiction by its home regulator.

In determining whether a clearing agency poses significant risk to Ontario, we consider the level of activity of the clearing agency in Ontario (using indicators such as notional value and volume of transactions cleared for Ontario-based market participants) and other qualitative and quantitative factors, such as interconnectedness, size of obligations and the role and central importance of a clearing agency to a particular market.

The Draft Order requires LMEC to comply with various terms and conditions set forth in Schedule "A" to the Draft Order, including relating to:

1. Regulation of LMEC
2. Governance
3. Permitted scope of clearing activities in Ontario
4. Filing requirements
5. Information sharing

The Draft Order also acknowledges that the scope of the terms and conditions imposed by the Commission, or the determination as to whether it is appropriate that LMEC continue to be exempted from the requirement to be recognized as a clearing agency, may change as a result of the Commission's monitoring of developments in international and domestic capital markets, LMEC's activities or regulatory status, or as a result of any changes to the laws in the UK or Ontario affecting trading in or clearing and settlement of derivatives or securities.

**C. Comment Process**

The Commission is publishing for public comment LMEC's Application and Draft Order. We are seeking comment on all aspects of the Application and Draft Order.

Please provide your comments in writing, via e-mail, on or before December 7, to the attention of:

Ontario Securities Commission  
20 Queen Street West  
22nd Floor  
Toronto, Ontario M5H 3S8  
Fax: 416-593-2318  
Email: [comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)

The confidentiality of submissions cannot be maintained as the comment letters and a summary of written comments received during the comment period will be published.

Questions may be referred to:

Oren Winer  
Legal Counsel, Market Regulation  
Tel: 416-593-8250  
Email: [owiner@osc.gov.on.ca](mailto:owiner@osc.gov.on.ca)

Colm Dowds  
Legal Counsel, Market Regulation  
Tel: 416-263-7659  
Email: [cdowds@osc.gov.on.ca](mailto:cdowds@osc.gov.on.ca)

Youssef Sekal  
Risk Specialist, Market Regulation  
Tel: 416-597-7815  
Email: [ysekal@osc.gov.on.ca](mailto:ysekal@osc.gov.on.ca)



29 May 2018

Ontario Securities Commission  
20 Queen Street West  
22nd Floor  
Toronto, ON M5H 3S8

Attention: Secretary to the Commission

Dear Sirs/Mesdames:

**RE: LMEC Limited – Application for an Exemption from Recognition as a Clearing Agency**

LME Clear Limited (**LMEC**) is applying, pursuant to section 147 of the *Securities Act* (Ontario) (the **Act**) and National Instrument 24-102 *Clearing Agency Requirements (NI 24-102)*, for an order exempting it from recognition as a clearing agency under section 21.2 of the Act, in order to provide its central counterparty (**CCP**) service to Ontario market participants (**Exemption Order**). The London Metal Exchange is concurrently filing an application for exemption from the requirements to be recognised as an exchange.

Capitalized terms that appear in this application but are not defined in the body of this application have the meanings ascribed thereto in the LMEC Rules which can be found at <https://www.lme.com/LME-Clear/Rules-and-regulations>.

**1. Background**

**Location**

- 1.1 LMEC is a private company incorporated in England and Wales on 21 April 2011, under registered number 07611628. LMEC's registered office and head office is at 10 Finsbury Square, London EC2A 1AJ. All corporate documentation relating to LMEC is filed with Companies House in the United Kingdom (**UK**).
- 1.2 LMEC is based in London and carries on all of its activities in London. Its Membership base comprises the members of the London Metal Exchange (**LME**) that are categorised as clearing members of LME. Any prospective Members will have to apply to, and satisfy the Membership Criteria of, LMEC.

**History and Strategy**

- 1.3 LMEC was established to act as the CCP in relation to all classes of contracts that are traded on the LME as part of LME's global strategy which included expanding its activities to clearing. LME business was previously cleared by LCH Limited (formerly LCH.Clearnet Ltd).
- 1.4 LMEC also provides transaction and position reporting services for those Members electing for this service for on-exchange and over-the-counter (**OTC**) transactions. This service started in February 2014 and is called LMEwire. This reporting service is a separate service from the clearing services to facilitate financial counterparties' compliance with their reporting obligations under Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (**EMIR**). In effect, LMEC acts as the reporting agent on behalf of the users of the reporting service to report the transaction data to the appointed transaction repository (**DTCC**).
- 1.5 LMEC is regulated in the UK as an approved CCP under EMIR and is subject to the *Financial Services and Markets Act 2000 (FSMA)*. LMEC is supervised by the Bank of England (the **Bank**). Its authorisation was obtained on 3 September 2014. LMEC is also authorised to provide Automated Trading Services in Hong Kong and is the clearing organisation for the LME under its Foreign Board of Trade Licence in the US.

**Size**

- 1.6 LMEC started clearing LME Contracts on 22 September 2014. It currently employs approximately 48 employees and those functions not directly resourced by LMEC staff are provided on an outsourced basis (such as finance, human resources, company secretariat, marketing etc.) from its sister company, the LME.
- 1.7 Its revenues are generated from the clearing of LME trades (including profits generated from investing collateral balances) and its transaction reporting service. LME is a highly liquid market and in 2017 achieved traded volumes of approximately 157.4 million lots, equivalent in value to approximately US\$12.7 trillion annually and 3.5 billion tonnes of material. LME is a global market with an international membership. More than 450 brands of metal from over 60 countries are approved as “good delivery” against LME Contracts. There are over 550 LME approved warehouses in approximately 14 countries and 34 locations globally.
- 1.8 LMEC’s revenues for the 2016 and 2017 fiscal years, respectively, were USD\$92.992mn and USD\$ 91.788mn.

**Eligible Products**

- 1.9 LMEC seeks an exemption from the clearing agency recognition requirement in relation to all products eligible to be cleared on LMEC (as set out in paragraph 1.11(a) to (f) below). The contracts that are cleared at the time of this submission are those contracts traded on LME that are eligible to be cleared via the Clearing System (**Eligible Products**). The product specifications for the Eligible Products are set out in Annex 1 of the LMEC Rules and have been categorized as follows: .
- (a) **LME Exchange-Traded Forwards**, which are referred to on the **LME Execution Venues** (being the Ring, LMEselect and the Inter-office Market) as “Metal Futures”, are physically or cash settled futures contracts in thirteen metals. LME Metal Futures contracts provide for the delivery of a prescribed quantity of metal on a specified date (the **Prompt Date**). They are settled by offset or delivery on their Prompt Dates.
  - (b) LME Exchange-Traded futures (Minis, LMEX and ferrous futures). These cover:
    - (i) **Index Futures**, which are referred to on the LME Execution Venues as “LMEX” (**LMEX Contracts**). These are index contracts based on the weighted values of six LME metals and are available for futures. LMEX Contracts are presently available for trade but have never been traded. LMEX Contracts are cash-settled only; and
    - (ii) small lot size contracts, which are referred to as “LMEminis” on LME Execution Venues, are traded in five-ton lots of copper, aluminum and zinc as opposed to larger lots for **LME Exchange Traded Futures**. These LMEminis are settled in cash only.
  - (c) LME exchange-traded American Options. The contracts are traded options contracts (referred to as **LME Traded American Options** on the LME Execution Venues) that give the right to buy or sell the underlying LME Metal Futures for all LME metals. LME Traded American Options are American options that can be purchased against a long or short futures contract. These are settled by offset or delivery on their Prompt Dates.
  - (d) LME exchange-traded average price options (**TAPOs**). TAPOs give the right to buy or sell any of the LME metals at the average of the LME official prices for a given month. TAPOs are Asian options. TAPOs are intended to be physically settled.
  - (e) LME exchange-trade average price futures, which are referred to as “LMEswaps” on the LME Execution Venues, are average monthly price futures contracts. LMEswaps are cash-settled against the average of the daily cash settlement price of the relevant LME metal during the relevant month.
  - (f) Exchange traded gold and silver futures called LMEprecious futures.
- 1.10 The Eligible Products are split into two main Services: LME Base Metal Products and LMEprecious Products. Members may subscribe to either Service or to both (see below).
- 1.11 LMEC therefore seeks an exemption from the clearing agency recognition requirement in relation to:
- (a) Exchange Traded Forwards relating to metals;

- (b) Exchange Traded Futures relating to metals;
- (c) Exchange Traded Futures relating to metal indices (Index Futures);
- (d) Exchange Traded American Options relating to metals;
- (e) Exchange Traded Average Price Options (TAPOs) relating to metals;
- (f) Exchange Traded Monthly Average Futures relating to metals.

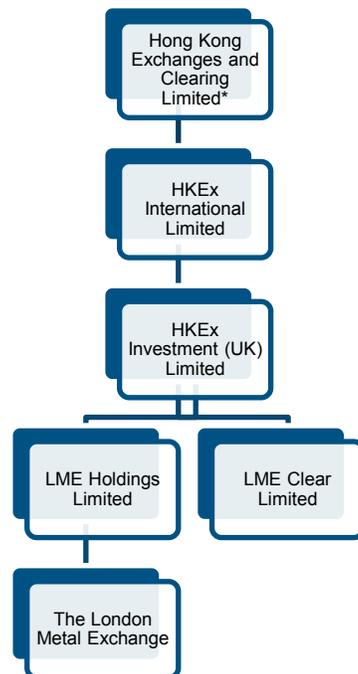
**LMEC's Rules and Procedures**

1.12 The LMEC's Rules and Procedures (**LMEC Rules**) act as the master agreement between LMEC and Members in respect of all transactions cleared by LMEC. A copy of the current LMEC Rules can be found at:

<https://www.lme.com/en-GB/LME-Clear/Rules-and-regulations#tabIndex=2>

**2. Ownership, Corporate Structure and Governance Structure**

- 2.1 LMEC is 100% owned by HKEX Investment UK Limited (**HKEX UK**), a holding company which also owns 100% of the shares in LME, through LME Holdings Limited. LMEC has no subsidiaries.
- 2.2 HKEX UK's ultimate parent company is Hong Kong Exchanges and Clearing Limited (**HKEX**). The HKEX Group consists of HKEX and 25 directly or indirectly owned subsidiaries. Except for three wholly owned subsidiaries which are incorporated in the People's Republic of China (**China**) and operate their business in China and the four wholly owned UK-based subsidiaries that make up the LME Group, all other HKEX Group companies are incorporated in Hong Kong and operate their businesses in Hong Kong. HKEX also maintains a representative office in Beijing, with representatives located in Shanghai and Guangzhou.
- 2.3 The following is a diagram of the chain of ownership above LMEC and LME:



\*a widely held listed company in Hong Kong

2.4 HKEX is incorporated in Hong Kong with company number 681388 with its registered office at 12/F, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong. HKEX is listed in Hong Kong on the Main Board of the Stock Exchange of Hong Kong Limited. Under the SFO, no person shall be entitled to exercise or control the exercise of 5% or more of the voting power in a general meeting of shareholders of

- HKEX except with the Securities and Futures Commission's (**SFC**) approval, after consultation with the Financial Secretary of Hong Kong (such approved person being referred to as Minority Controller).
- 2.5 The Board of LMEC (the **Board**) retains overall responsibility for the management of LMEC. It has delegated the day-to-day management to the Executive Committee of LMEC (**ExCom**), which is supported by an extended management team representing the key functional areas of the organisation (Operations and Technology; Risk; Business Development; Legal and Compliance).
- 2.6 The Board is solely responsible for setting the strategy of LMEC. In setting the strategy, the Board considers the views of all stakeholders including the HKEX Group, the Relevant Regulations and seeks to achieve an appropriate balance between commercial and risk mandates in determining what is appropriate for LMEC.
- 2.7 LMEC, as required under the Relevant Regulations, remains responsible and accountable for the good management and performance of LMEC and ensures that it has a competent management team to which the Board has properly and effectively delegated the day-to-day management of LMEC.
- 2.8 The Board has delegated some of its responsibilities to Board committees. The responsibilities of each committee are defined by terms of reference approved by the Board. The Board retains overall control of any matter delegated to a committee and retains responsibility for approving any decisions that could have a significant impact on the risk profile of LMEC.
- 2.9 The Board is comprised of:
- (a) four Executive Directors; and
  - (b) five Non-Executive Directors,
- (together the **Directors**).
- Non-Executive Directors comprise a majority of the Board. Some of the Executive Directors and Non-Executive Directors are also directors elsewhere in the HKEX Group.
- Non-Executive Directors are Directors who do not hold an executive office across the LME Group. Currently all non-Executive Directors are also independent directors (as defined in EMIR). There may in the future be circumstances in which a Non-Executive Director is not considered independent in accordance with that definition, but LMEC will ensure that it continues to meet all relevant regulatory requirements relating to independence. Further, LMEC looks to observe best practice guidance when considering its board composition where relevant, such as the UK Corporate Governance Code (which requires at least half of the Board to be independent).
- 2.10 At the time of this submission, the following individuals are serving on the Board as Executive Directors:
- (a) Adrian Farnham (CEO of LMEC);
  - (b) Romnesh Lamba (Co-Head of Market Development of HKEX);
  - (c) Matthew Chamberlain (CEO of LME); and
  - (d) Roland Chai (HKEX Group Risk Officer).
- 2.11 The following individuals are serving on the Board as Non-Executive Directors:
- (a) Richard Thornhill (Chairman);
  - (b) Marye Humphery;
  - (c) Marco Strimmer (also chairman of the Board Risk Committee);
  - (d) Anthony Stuart; and
  - (e) Stephen Yiu.

- 2.12 The Non-Executive Directors have been selected on the basis that they are of sufficiently good repute and have adequate expertise in financial services, risk management and clearing services. They have been selected based on the balance of skills they bring to the Board as a group.
- 2.13 LMEC's main strategy is to focus on clearing contracts traded on the LME. Accordingly there is some cross-membership of Directors to allow for greater collaboration. In addition Messrs Romnesh Lamba and Roland Chai are representatives of the HKEX Group and are permitted to have further directorships across the HKEX Group<sup>1</sup>.
- 2.14 The following individuals serve as members of the Board, or on a Committee of the Board, of LMEC as well as on the board of directors of LME or a committee of such board: Matthew Chamberlain, Romnesh Lamba, Anthony Stuart and Stephen Yiu.
- (a) Mr Chamberlain is also a Director of the LME.
  - (b) Mr Lamba is a director of both the LME and LMEC. He is also a member of LMEC's Audit and Nomination Committees and a member of the LME's Audit and Risk Committee.
  - (c) Mr Stuart is a member of LMEC's Audit and Board Risk Committees. In addition Mr Stuart is a Director of the LME and a member of the LME's Audit and Risk and Nomination Committees.
  - (d) Mr Yiu – the Chairman of LMEC's Audit Committee – is the Chairman of the LME's Audit and Risk Committee. Mr Yiu is also a member of LMEC's Remuneration and Nomination Committees and is a member of further committees across the HKEX Group, including at the ultimate parent company level.
- 2.15 Each entity within the LME Group is operated as a separate legal entity and therefore each member of the board, including those with cross-memberships, are required to act in the best interests of the company of the board on which they serve. No one board has a veto over another.
- 2.16 The Articles of Association of LMEC also contain provisions dealing with potential conflicts of interest at Board level and complies with the relevant provisions of the UK Companies Act 2006. Where a Conflict of Interest is identified between a Board Committee Member and any other person, such conflict shall be dealt with in accordance with the terms of the relevant Committee Terms of Reference. For the avoidance of doubt, where a Board Committee Member is also an Employee, the Employee shall also be subject to the terms of the LME Group Conflicts of Interest Policy.

### **Policy Summary**

- 2.17 The following standards are applied in the Group Conflicts of Interest Policy:
- (a) Avoiding Conflicts of Interest – involves identifying the different areas of risk of conflicts of interest and establish
  - (b) Reporting Conflicts of Interest – includes establishing a process for identification of a conflict of interest and a reporting structure for all employees.
  - (c) Declaration – all employees are obliged to declare any conflicts of interest.
  - (d) Record Keeping – maintain a register of all reported conflicts of interest in line with legal and regulatory requirements.
  - (e) Managing and Mitigating Conflicts of Interest – on identification and reporting of a conflict of interest the authorised person must agree a means of mitigation.
  - (f) Disclosure – in the event that the authorised person determines any mitigation is not sufficient a disclosure of the conflict may be made.
  - (g) Awareness and Training – provide all employees with appropriate training in relation to conflicts of interest.

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<sup>1</sup> At the present time, Mr Lamba holds other directorships within the HKEX Group, including being a member of the LME board. Mr Chai does not hold any other HKEX directorships at present.

- (h) Management Information – ensure senior management are actively engaged in the Companies' approach
- 2.18 The Conflicts of Interest Policy also makes explicit reference to the management of conflicts of interest within ExCom, particularly when executive and employees sit on more than one committee.
- 2.19 Under section 175 of the UK *Companies Act 2006*, a director has a statutory duty to avoid any situations in which he has, or could have, a direct or indirect interest that conflicts, or could conflict, with the interests of the company. Section 175 (2) emphasises the applicability of the duty to the exploitation of any property, information or opportunity, and confirms that it is irrelevant whether the company itself could have taken advantage of that property, information and opportunity.
- 2.20 EMIR and Commission Delegated Regulation (EU) No. 153/2013 of 19 December 2012 supplementing EMIR with regard to regulatory technical standards on requirements for central counterparties (**EMIR RTS 153/2013**) include the following provisions pertaining to CCP independence:
  - (a) Preamble, paragraph 61 of EMIR provides, "A CCP should have robust governance arrangements, senior management of good repute and independent members of its board, irrespective of its ownership structure. At least one-third, and no less than two, members of its board should be independent. However, different governance arrangements and ownership structures may influence a CCP's willingness or ability to clear certain products. It is thus appropriate that the independent members of the board and the risk committee to be established by the CCP address any potential conflict of interests within a CCP. Clearing members and clients need to be adequately represented as decisions taken by the CCP may have an impact on them."
  - (b) Article 3(4) of Reg. 153/2013 provides, "A CCP that is part of a group shall take into account any implications of the group for its own governance arrangements including whether it has the necessary level of independence to meet its regulatory obligations as a distinct legal person and whether its independence could be compromised by the group structure or by any board member also being a member of the board of other entities of the same group. In particular, such a CCP shall consider specific procedures for preventing and managing conflicts of interest including with respect to outsourcing arrangements."

#### **Committee Structure**

- 2.21 The governance structure of LMEC provides for a number of committees which report to the Board. The following Committees have been appointed by the Board to deal with specific aspects of LMEC's affairs.

##### **a. Executive Committee**

- 2.22 The ExCom is composed of the following individuals:
  - (a) Chief Executive Officer of LMEC, Adrian Farnham;
  - (b) Chief Executive Officer of LME, Matthew Chamberlain;
  - (c) Chief Risk Officer, Chris Jones;
  - (d) Chief Operating Officer, James Cressy;
  - (e) Head of Market Development, Robin Martin;
  - (f) General Counsel, Tom Hine;
  - (g) Chief Compliance Officer (CCO), Gavin Hill;
  - (h) Chief Finance Officer, Catherine Lester
  - (i) LMEC Chief Technology Officer, Neil Duggan; and
  - (j) Head of HR, Sarah Burdett.

- 2.23 The ExCom is a committee of the Board to which the Board has delegated the overall day-to-day management of LMEC. The ExCom has specific responsibility for matters including:
- (a) implementation of Board approved strategies and policies;
  - (b) approval of all changes to the LMEC Rules at the recommendation of the Rulebook Committee (save for those reserved to the Board and the Board Risk Committee);
  - (c) proposing the annual budget and making proposals on fees;
  - (d) approval of expenditures within budget;
  - (e) designing and establishing compliance and internal controls and procedures that promote LMEC's objectives and subjecting such procedures to regular review and testing;
  - (f) ensuring that sufficient resources are devoted to risk management and compliance;
  - (g) active involvement in the risk control process;
  - (h) financial performance of investment activities;
  - (i) receiving and considering reports and recommendation from the Executive Risk Committee and ensuring implementation of relevant recommendations;
  - (a) ensuring that risks posed to LMEC are duly addressed and that all decisions are taken in line with the Risk Appetite Statement;
  - (j) receiving and considering reports and recommendations from the Board Risk Committee and ensuring implementation of recommendations made by the Board Risk Committee (subject to approval of the Board); and
  - (k) ensuring and overseeing the compliance with all statutory duties imposed on it under all Applicable Laws and regulatory requirements.

**b. Board Risk Committee**

- 2.24 The Board Risk Committee will at all times be composed of 9 individuals. At least two and a maximum of three members will be selected from the Non-Executive Directors; at least two and a maximum of three shall be selected from Clients of Members; and at least two and a maximum of four will be selected from Members. The Committee is composed to ensure that no one set of membership group shall have a majority of votes. The Member and Client representatives are selected by the Nominations Committee in accordance with criteria set out in the terms of reference of the Board Risk Committee.
- 2.25 The role of this committee is to be an advisory committee to the Board (as required under EMIR).
- 2.26 The responsibilities and governance arrangements include:
- (a) advising the Board on any arrangements that may impact the risk management of LMEC, including a significant change in its risk model, the default procedures, the criteria for accepting Members, the clearing of new classes of instruments and the outsourcing of functions;
  - (b) advising the Board in relation to developments impacting the risk management of LMEC in emergency situations;
  - (c) monitor and assess the adequacy and effectiveness of LMEC's risk management policies, procedures, and risk management systems and methodology;
  - (d) discussing and advising the Board on the initial versions of, and any changes to, the LMEC Rules which impact the risk management of LMEC;
  - (e) reviewing and making recommendations to the Board in relation to key risk policies such as the Margin Policy, Collateral Policy, Liquidity Policy and funding plans, Credit Policy, Default Fund Policy and the Default Management Policy;

- (f) reviewing and making recommendations to the Board in relation to Membership Criteria; and
  - (g) reviewing and making recommendations to the Board in relation to the risks that any of LMEC's outsourcing arrangements may create for LMEC.
- 2.27 Any recommendation of the Board Risk Committee which is not followed by the Board shall be reported to the Bank. The Board Risk Committee meets four times a year or more frequently as required.

**c. Risk Committees**

2.28 In addition to the Board Risk Committee, LMEC has also set up two risk-focussed committees: the Clearing Risk Committee and the Executive Risk Committee which both report directly to the ExCom. The Clearing Risk Committee is composed of the following individuals:

- (a) Chief Executive Officer;
  - (b) Chief Risk Officer;
  - (c) Chief Operating Officer;
  - (d) Chief Compliance Officer;
  - (e) Head of Market Development;
  - (f) Head of Risk;
  - (g) Head of Credit Risk;
  - (h) Head of Liquidity and Collateral Risk;
  - (i) Head of Market Risk;
  - (j) Head of Quantitative Risk;
  - (k) Head of Clearing Operations;
  - (l) Head of LMEC Legal; and
  - (m) Deputy Group Risk Officer.
- 2.29 This committee is responsible, under delegated powers from the ExCom, for overseeing certain matters relating to the day-to-day risk management of LMEC and any LME risks which fall under the headings within its Terms of Reference. In addition, the Committee will oversee the implementation of the relevant parts of the Risk Appetite Statement. The Executive Risk Committee also facilitates the work of the Board Risk Committee by assisting the chief risk officer in producing and providing all relevant information to the Board Risk Committee.

2.30 The Executive Risk Committee is composed of the following individuals:

- (a) Chief Executive Officer, LMEC;
- (b) Chief Executive Officer, LME;
- (c) Chief Risk Officer;
- (d) Chief Operating Officer;
- (e) Head of Regulation and Compliance;
- (f) Chief Financial Officer;
- (g) General Counsel;

- (h) Head of Market Development;
- (i) Chief Technology Officer, LMEC;
- (j) Chief Technology Officer, LME;
- (k) Head of Risk;
- (l) Chief Compliance Officer, LMEC;
- (m) Head of ERM and Operational Risk;
- (n) Group Head of ERM; and
- (o) Group Risk Officer.

2.31 The Committee is responsible for overseeing the day-to-day risk management of LME and LMEC, the implementation of the relevant parts of the Risk Appetite Statement and to ensure the active management of financial and non-financial risks.

**d. Nomination Committee**

2.32 The Nomination Committee is composed of a maximum of five individuals with a majority of Non-Executive Directors. The roles and responsibilities of the Nomination Committee include:

- (a) regular reviews of the structure, size and composition (including but not limited to the skills, knowledge and experience) of the Board and recommendations to the Board with regard to any changes;
- (b) giving full consideration to succession planning for Non-Executive Directors nominated and appointed by the Board;
- (c) responsible for identifying and recommending, for approval by the Board, candidates to fill vacancies for the position of Non-Executive Directors;
- (d) responsible for selecting the representatives of Members and Clients to sit on the Board Risk Committee and attend Board meetings for matters relevant to Article 38 and 39 of EMIR; and
- (e) performance evaluation on Directors' time to fulfil their duties.

**e. Audit Committee**

2.33 The Audit Committee is composed of at least four individuals with at least three Non-Executive Directors and one individual with relevant and recent financial experience. The Audit Committee plays a key role in the oversight of the compliance function at LMEC. It is responsible for the approval of the key compliance policies. It also plays an important role in the monitoring of the effectiveness of the internal controls and the risk management framework of LMEC. The Audit Committee's responsibilities include, amongst other things:

- (a) Financial Reporting – monitoring of the integrity of the financial statements of LMEC, including its annual and interim reports and any other formal announcement relating to its financial performance;
- (b) Internal Controls – monitoring and keeping under review the effectiveness of the Company's internal controls as well as the adequacy of LMEC's policies and procedures relating to financial, operational, IT, information security, outsourcing, legal and compliance risks;
- (c) Risk Management – monitoring the risk management system and monitoring and reviewing of the key risks faced by, or relating to, LMEC (enterprise risk);
- (d) Business Continuity – reviewing the adequacy of the business continuity and disaster recovery plan and monitor its effectiveness;
- (e) Bribery and Fraud Prevention – reviewing and approve LMEC's assessment of the corruption risks to which it is subject and the framework of controls put in place to mitigate those risks;

- (f) Whistleblowing – reviewing the company’s arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters;
  - (g) Internal Audit – monitoring and reviewing the effectiveness of LMEC’s internal audit function as well as reviewing and approving the annual internal audit plan and any internal audit findings; and
  - (h) External Audit – overseeing the appointment of LMEC’s external auditors as well as overseeing the relationship, independence and objectivity of such auditors, approving the annual external audit plan and reviewing the findings of the external audit with the external auditors.
- f. Remuneration Committee
- 2.34 The Remuneration Committee is composed of four Non-Executive Directors. In carrying out its functions, the Remuneration Committee liaises with the remuneration committee of HKEX. The Remuneration Committee’s role is mainly to:
- (a) design and develop the Remuneration Policy for LMEC (including determining targets for any performance-related pay schemes operated by LMEC), oversee the implementation of that policy by the management and review its operation on a continuous basis. The Remuneration Committee shall ensure that the Remuneration Policy complies with the requirements of Article 8 of the EMIR RTS153/2013;
  - (b) review the Remuneration Policy on at least an annual basis;
  - (c) ensure that the Remuneration Policy is subject to independent audit on an annual basis and review the policy in line with any recommendations made following the audit;
  - (d) ensure that contractual terms on termination, and any payments made, are fair to the individual and LMEC, that failure is not rewarded and that the duty to mitigate loss is fully recognised;
  - (e) within the terms of the agreed policy, determine the remuneration package of the chief executive officer, the chairman of the Board, the members of the Board, the members of any committee of the Board and such other members of management as it is designated by the Board to consider, having specific regard to the requirements of Article 8 of the EMIR RTS 153/2013; and
  - (f) review and note annually the remuneration trends at LMEC.

**Conflict of Interest**

- 2.35 The terms of reference of the Board Risk Committee contain a provision dealing with potential conflicts. Committee members must disclose to the chairman any situation which may amount to a conflict and the chairman will assess whether such situation constitute a conflict or not. If it amounts to a conflict, the committee member may be excluded from discussions or not permitted to vote.
- 2.36 LMEC has adopted a Conflicts of Interest Policy which sets out the arrangements to identify and manage conflicts of interest between (a) itself (including LMEC’s managers, employees and persons with indirect control or close links) and its Members or Members’ Clients (where known to LMEC); and (b) itself and other members of the HKEX Group; and (c) Members and Clients as members of the Board Risk Committee.
- 2.37 The policy first defines the concept of conflicts of interest, identifies potential conflicts of interest situations and sets out the procedures to be put into place to manage such conflicts, including the internal organisation of LMEC and the use of information barriers.
- 2.38 In the event that a conflict relates to a Member, the Conflicts of Interest Policy specifies that disclosure of a conflict should be made to the Member (and where the conflict concerns a Client who is known to LMEC, the Client) in circumstances where arrangements to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the Member or the Client will be prevented.
- 2.39 The Conflicts of Interest Policy also sets out how information must be treated in order to ensure that it is not misused or used for business purposes other than those for which the information was intended.
- 2.40 All employees are required to complete a conflicts of interest declaration form at the start of their employment and to update it on an annual basis.

### 3. Regulatory Status and Regulatory Framework

- 3.1 LMEC is an Authorised CCP under Article 17 of the EMIR; a Recognised Central Counterparty in accordance with section 288 of the *Financial Services and Markets Act 2000 (FSMA)* in the UK; and a designated system under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (**Settlement Finality Regulations**). LMEC is authorized and primarily supervised by the Bank in the UK.
- 3.2 The Bank is the responsible body for authorizing and supervising CCPs in the UK. Under the EMIR regime, a College of European regulators (the **College**) is also formed to authorize and supervise the CCPs. The day to day supervision role is therefore delegated to the national regulator (being in the UK, the Bank) but the authorization as well as the extension of the authorization to include additional services or activities not covered by the initial authorization must involve the College.
- 3.3 The Bank exercises its supervision of CCPs within the framework of the UK legal regime. Part 18 of FSMA is the main UK legislation relating to the regulation of CCPs. The standards that UK CCPs must meet to be recognized are set out in the *Financial Services and Markets Act 2000* (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations. CCPs must continue to meet these standards to maintain their recognized status. The Bank oversees CCPs' continuing compliance with the recognition requirements. The UK legal regime sits within the applicable European Union regulations being specifically EMIR together with the related technical standards adopted by the European Securities and Markets Authority.
- 3.4 The Principles for Financial Market Infrastructures (**PFMIs**), published by the Committee on Payment and Market Infrastructure (**CPMI**) and the International Organisation of Securities Commissions (**IOSCO**), form the keystone for the Bank's supervisory approach. The UK regulatory framework is therefore consistent with the minimum standards set out in the PFMIs.
- 3.5 CCPs have primary responsibility for meeting the minimum standards of the PFMIs. Consistent with that, the Bank expects CCPs to complete their own self-assessment against the Principles and to provide these to the Bank. CCPs are also expected to review their self-assessment at least annually. LMEC's latest CPMI-IOSCO disclosure statement can be found at:

<https://www.lme.com/en-GB/LME-Clear/Rules-and-regulations/Disclosure-and-transparency>.

- 3.6 According to the Bank's statement on FMI Supervision, the self-assessment does not replace the Bank's own judgement but is used as one input to its supervision. The Bank seeks to reach forward-looking judgements on whether a CCP's governance, operational design, policies or actions pose unacceptable risks to financial stability. Where the Bank judges such risks to be unacceptably high, it expects the CCP to take action to reduce them.
- 3.7 The Bank is also a party to the memorandum of understanding with the Ontario Securities Commission, Alberta Securities Commission and British Columbia Securities Commission concerning consultation, cooperation and the exchange of information related to the supervision of cross-border regulated entities, which is available at:

[http://www.osc.gov.on.ca/en/About\\_mou\\_20130711\\_nmou-osc-asc-bcsc-bank-england.htm](http://www.osc.gov.on.ca/en/About_mou_20130711_nmou-osc-asc-bcsc-bank-england.htm)

- 3.8 The regulatory regime for all financial market infrastructures (**FMI**s) is framed by the CPMI-IOSCO Principles. This demonstrates the co-operation between the regulators and is consistent with CPMI-IOSCO Principle 5. The Bank is committed to the CPMI-IOSCO Principles and accepts particular responsibility for ensuring effective co-operative oversight between regulators.

- 3.9 The Bank's system for the supervision of CCPs and FMIs more generally is outlined in the most recent annual report of the Bank, which is available at:

<https://www.bankofengland.co.uk/-/media/boe/files/annual-report/2017/supervision-of-financial-market-infrastructures-annual-report-2017.pdf?la=en&hash=E116F8DAA8F255D3AE9B777E52F11B86CEB621BB>

The above annual report states that the Bank adopts a risk based approach, reaching forward-looking judgements on whether a CCP's governance, operation design, policies or actions pose unacceptable risks to financial stability and will expect a CCP to reduce them if the risks become too high. The Bank's key supervisory pillars are focusing on these specific areas:

- (a) Governance: the centrality of systemic risk management to culture and decision-making;
- (b) Promotion and maintenance of standards: FMI's own role in promoting risk management in the markets they serve; and
- (c) Financial risk mitigates: loss absorbency.

The Bank will seek evidence that CCPs, including LMEC, are reaching adequate standards in such areas.

- 3.10 In line with the CPMI-IOSCO principles, the Bank considers that co-operation with other authorities is an essential part of the Bank's supervision of FMIs and works closely with other international authorities in respect of the UK FMIs it supervises.
- 3.11 LMEC's status as an authorized CCP under EMIR is evidenced by its inclusion in the European Securities and Markets Authority's List of Central Counterparties authorized to offer services and activities in the Union (available at: [https://www.esma.europa.eu/system/files/force/library/ccps\\_authorized\\_under\\_emir.pdf](https://www.esma.europa.eu/system/files/force/library/ccps_authorized_under_emir.pdf)).
- 3.12 LMEC's status as a Recognised Central Counterparty in accordance with FSMA and a designated system under the Settlement Finality Regulations is evidenced by its inclusion in the Bank's list of Recognised CCPs (available at: <https://www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision>).
- 3.13 The UK has voted to leave the European Union in March 2019. However, the UK government has stated that it intends to copy all EU legislation into UK law, so that the laws and regulations that will apply on the UK's departure from the EU will be identical to those which applied beforehand. The UK government is currently laying before Parliament the necessary statutory instruments needed to transpose EU law onto the UK statute books and as such it is clear that the legal and regulatory framework that LMEC will be subject to post-Brexit will, from a UK perspective, be the same as it is today. It is possible that over time the applicable UK regulatory regime may diverge from the European requirements in some respects. However, representatives of the UK government and the UK financial services regulators have clearly indicated that they do not wish to enter into a "regulatory race to the bottom".
- 3.14 From an EU perspective, EMIR provides that a CCP established outside the EU may only provide clearing services to members or trading venues established within the EU where that CCP first obtains recognition from the European Securities and Markets Authority (**ESMA**). The LMEC intends to obtain third country recognition from ESMA as soon as possible. Obtaining recognition as a third country CCP is, however, subject to a determination by the European Commission that the UK meets its "equivalence" conditions. It is unclear at this time how quickly such a determination would be made.
- 3.15 The UK and the EU have, in principle, agreed to a transitional period (from 29 March until the end of December 2020) during which the UK would continue to be treated as though it were still a member of the EU. However, this forms part of the overall withdrawal agreement which is still being negotiated, and there remains a risk that the UK will leave the EU without such an agreement in place. If the transitional period does apply, then we would expect that LMEC could continue to service its EU members for the duration of that period, even before it is able to obtain recognition as a third country CCP. At the end of the transitional period (or from the date of Brexit if no transitional period applies), and in the absence of any specific agreement to the contrary between the EU and UK, LMEC will no longer be permitted to have or to continue to directly service EU members until such time as it has become a recognised third country CCP. It is difficult to speculate upon what form of agreement might be reached between the EU and the UK at this point, but LMEC has made contingency plans that will be applied in the event that the UK leaves the EU without any form of agreement in place.
- 3.16 The LME and LMEC have published a 'Brexit Factsheet' for Members, which can be found on the LME website: <https://www.lme.com/en-GB/About/Regulation/Brexit>.

#### 4. LMEC Clearing Participants: Individual Clearing Members and General Clearing Members

- 4.1 There are two categories of LMEC Membership:
  - (a) "Individual Clearing Members" (**ICMs**) are permitted to clear transactions on their own behalf only;
  - (b) "General Clearing Members" (**GCMs**) may clear transactions on their own behalf and also in respect of transactions effected (i) by the GCM with its Clients or (ii) by its Clients with other non-Members.

There are no other participant types.

- 4.2 Only Members, in their capacity as ICMs or GCMs, can set up Accounts with LMEC and access the system for clearing services. All Members are subject to the same Membership Criteria applicable to their membership category. The criteria on Membership are described under LMEC Rule 3. Once admitted as Members, all Members have access to the same range of Accounts and services as described in the LMEC Rules. There are no clearing privileges available to some Members only.
- 4.3 As a GCM or ICM, a Member has the ability to access the following services:
- (a) EMIR compliant accounts structure, as further described below;
  - (b) automated real time feed from LME of matched transactions in eligible Products to be cleared and settled in real time by LMEC;
  - (c) manual input or cancellation of transactions;
  - (d) cash and Collateral management in real time;
  - (e) real time assessment of risk exposure;
  - (f) data validation and Position risk checked against collateral/limits;
  - (g) management of contract expiry and option exercise;
  - (h) settlement and delivery management; and
  - (i) monitoring of trades and Positions by either subscribing to reports in the Reporting section of the LMEC clearing system or by querying the screens directly.
- 4.4 Reports available include:
- (a) Position Reports;
  - (b) Trade Reports;
  - (c) Exercise Reports; and
  - (d) Collateral Reports.
- 4.5 LMEC allows Members to set up a client account structure which allows Members to record Positions or Collateral arising as a result of transactions effected or cleared by the Member on behalf of a Client or an Indirect Client on a segregated basis. In relation to such Positions or Collateral, LMEC's contractual relationship remains with the Member. LMEC does not have any contractual relationship with either a Client or an Indirect Client. However, a Client has the right to request to port the Positions and Collateral in a Client Account in certain circumstances. Accounts of an Indirect Client can also be ported at the request of a Member.
- 4.6 Members can subscribe to either or both of the services provided by LMEC – the LME Base Service, LMEprecious Service or both. A Member will continue to be categorised as either a GCM or an ICM. An ICM may not act as a GCM in relation to any service but a GCM may choose to only undertake house business in respect of one of the services (and therefore, in practice, act as an ICM in respect of that service).

## 5. Clearing Services

- 5.1 LMEC offers Members the ability to operate the following types of Accounts (see LMEC Rule 4.2):
- (a) House Account: in which Members can only record Positions and Collateral attributable to their proprietary trading activities.
  - (b) Omnibus Segregated Client Accounts (Omnibus Accounts): in which Members record Positions and Collateral attributable to trading activities conducted with or for Clients, where the Client has chosen

not to be segregated by reference to individual Clients. Each Omnibus Account would therefore cover multiple Clients.

- (c) Individual Segregated Client Accounts (ISA): in which Members can record Positions and Collateral attributable to trading activities conducted with or for specific Clients. Only one Client may be allocated to any specific ISA.

- 5.2 The LMEC Rules confirm that it is the responsibility of the Member and not LMEC to ensure that the Member has established an account structure within LMEC that is appropriate to enable the Member to satisfy its obligations under any Applicable Law (see LMEC Rule 4.5).

**Account Structures: Rule Requirements**

- 5.3 Each Member must establish at least one House Account. House Accounts may only be used to record Positions and Collateral arising as a result of transactions effected by the Member on its own behalf (see LMEC Rule 4.2.1).
- 5.4 A GCM may elect, depending on the requests of its Clients, to establish one or more of the following types of Client Accounts:
  - (a) an Omnibus Account; and/or
  - (b) an ISA (LMEC Rule 4.2.2), which can be of the following type:
    - (i) Direct ISA;
    - (ii) Indirect ISA; or
    - (iii) Indirect Omnibus Account.
- 5.5 An Omnibus Account is used to record Positions and Collateral arising as a result of transactions effected or cleared by a GCM on behalf of one or more Clients (LMEC Rule 4.2.3).
- 5.6 A Direct ISA may only be used to record Positions and Collateral arising as a result of transactions effected or cleared by a GCM on behalf of a single Client (LMEC Rule 4.2.4).
- 5.7 An Indirect ISA may only be used to record Positions and Collateral arising as a result of transactions effected or cleared by a GCM on behalf of a single Clearing Client which relate to a single Indirect Client (LMEC Rule 4.2.5).
- 5.8 An Indirect Omnibus Account may only be used to record Positions and Collateral arising as a result of transactions effected or cleared by a GCM on behalf of a single Clearing Client which relate to one or more Indirect Clients (LMEC Rule 4.2.6).
- 5.9 An ICM will have only a House Account, as it will not be clearing transactions entered into with or by Clients.

**Segregation**

- 5.10 LMEC segregates each Account from each other Account in the books and records of LMEC and treats each Account maintained for a Member separately from other Accounts maintained for that Member, for the purposes of:
  - (a) recording the Positions and Collateral referable to each Account;
  - (b) recording and accounting for any excess collateral referable to that Account;
  - (c) where applicable, the netting of Positions referable to that Account;
  - (d) the exercise of any right by LMEC under the LMEC Rules to combine or consolidate balances on Accounts or any set-off rights;
  - (e) the allocation or discharge of losses; and

- (f) the exercise of porting rights (being the rights of a client of a defaulting clearing member to request, if some specific conditions are met, the transfer of Positions and Collateral relating to such client to a non-defaulting clearing member).

## 6. Overview on Default Management, the Default Fund and At-Risk Capital

### Default Management

- 6.1 LMEC default management procedures govern the processes that apply to Members in the case of a clearing Member default; clearing Members remain responsible for the credit risk of their Clients. These procedures facilitate transparent and practical market action in stress situations.
- 6.2 In broad terms LMEC will look to neutralise risk by hedging the overall house Position of a defaulting Member against the most liquid market dates and roll forward any prompt physical delivery Positions to manage its risk. LMEC will then seek to auction the defaulting Member's remaining house portfolio to other participants as its preferred method of disposal; however it will also be able to execute the close out of all remaining open house Positions if required.
- 6.3 A Member must successfully complete simulated default tests to demonstrate they have the appropriate expertise and operational processes in place prior to beginning clearing operations. Once live, all Members are required to participate in fire drills regularly to confirm their operational readiness to manage a Member default.

### Margin

- 6.4 Each Member provides LMEC with, and maintains on a daily basis for so long as it is a Member, Eligible Collateral with a Collateral Value sufficient to satisfy its Margin Requirement, which comprises of:
  - (a) the End of Day Margin Requirement;
  - (b) the Intra-Day Margin Requirement(s); and
  - (c) any other margin requirements (which excludes a Default Fund Contribution) required at any time by LMEC pursuant to the Rules and the Procedures,as security, cover and/or credit support for the performance by that Member of all of its present and future obligations to LMEC pursuant to the Rules or the operation of the Clearing System.
- 6.5 The Margin Requirement for each Member will be the amount which LMEC may determine and notify the Member from time to time. A Member's Margin Requirement will be calculated, maintained and applied for each of the following Accounts on a net basis. Such net calculations are applied separately in respect of:
  - (a) the House Account of the Member;
  - (b) each Direct NOSA of the Member;
  - (c) each Indirect NOSA of the Member;
  - (d) each Direct ISA of the Member; and
  - (e) each Indirect ISA of the Member,such that any Collateral provided by the Member in respect of the Client or Clients allocated to the Account shall be in respect of a net Margin Requirement calculation.
- 6.6 A Member's Margin Requirement will be calculated, maintained and applied for each of the following Accounts on a gross basis. Such gross calculations are applied separately in respect of:
  - (a) each Direct Gross Omnibus Segregated Client Account of the Member; and
  - (b) each Indirect Gross Omnibus Segregated Client Account of the Member,

such that any Collateral provided by the Member in respect of the Client or Clients allocated to the Account are in respect of a gross Margin Requirement calculation.

### **Additional Margin**

- 6.7 LMEC has a margin methodology that includes 4 types of additional margin which are concentration additional margin, default fund additional margin, credit additional margin and discretionary additional margin:
- (a) Concentration additional margin – will be used to cover the risk of large positions that in a default would potentially take longer to close out than the two day assumed liquidation period. It is automatically calculated by the clearing system. To determine the additional concentration margin for each clearing member LMEC calculates the average traded volume for each commodity. LMEC will utilise this, in conjunction with assumptions of the market depth it could trade, to calculate the tradable volume in the event of a default. This is then compared to the position that would be needed to liquidate in the event of the Member defaulting. If the position is determined to be larger than could be traded in a two day period, i.e. a concentrated position, then an additional charge is calculated.
  - (b) Default fund additional margin – If, at the end of each day, a Clearing Member has a total stress testing losses (TSTL) of greater than 40% of the total level of the Default Fund then LMEC will call for additional collateral to reduce the clearing Members TSTL to 40%. Total stress testing losses include loss of IM on the cleared product positions and loss over haircut for collateral. This is called default additional margin. This is an automatic calculation within the clearing system.
  - (c) Credit additional margin – Members will be required to provide collateral to cover some or all of their total stress testing losses, if their credit rating based on the LMEC internal credit risk assessment framework is below a minimum threshold. Once implemented this is also an automatic calculation within the clearing system.
- 6.8 As these additional margin calculations are automatically performed within the clearing system, this ensures the methodology is implemented as efficiently as possible. Automated reporting allows for transparency to clearing members.
- 6.9 Discretionary additional margin: LMEC has the ability to charge Members further additional margin that falls outside of the system calculated credit, concentration and default additional margin. For example this might be for exposures highlighted in the limitations of the SPAN algorithm for the LME products. This will be calculated outside of the system and manually input. Members impacted will be told in advance and the calculation fully explained.

### **Default Fund**

- 6.10 LMEC maintains a separate Default Fund for each Service and Members are only required to contribute to the Default Funds of the Services they participate in. Currently the Default Fund is sized according to EMIR requirements and is recalculated monthly based on the previous six months' data. Member contributions are based on relative initial margins subject to a minimum contribution. Members' Default Fund contributions are covered in cash and this is invested by LMEC in accordance with EMIR requirements.

### **LMEC's At-Risk Capital**

- 6.11 EMIR sets out the authorisation process that enables CCPs to provide central counterparty clearing services in the European Union. In order to be authorised under EMIR, a CCP must demonstrate, amongst other things, that it meets the requirements set out below.
- 6.12 A CCP is obliged to hold capital which is, at all times, sufficient to ensure an orderly wind-down or restructuring of the CCP's activities over an appropriate time span and adequately protects the CCP against credit, counterparty, market, operational, legal and business risks that are not already covered by specific financial resources (such as the Default Fund). This is subject to a minimum requirement that it has permanent and available initial capital of at least €7.5m. In addition, a CCP will be required to report, on an ongoing basis, to its competent authority should its capital fall below 110% of its capital requirement (meaning that, in practice, a CCP will aim to apply a 10% buffer at all times).
- 6.13 A CCP is required to maintain an additional amount of dedicated own resources which is equal to 25% of the amount of its capital requirement (not including the 10% buffer referred to above). Such amount is to be used

as part of its default waterfall as “skin in the game” in case of a Member’s default where the defaulting Member’s margins contributions and default fund contributions are not sufficient.

## 7. Participation in LMEC by Entities in Ontario

- 7.1 LMEC anticipates that at least two banks based in Ontario that are subject to the *Bank Act* (Canada) and are governed by the Office of the Superintendent of Financial Institutions (**Ontario Bank Participants**) may be interested in participating in LMEC. Potential Ontario Bank participants could be interested in becoming GCMs or ICMs. LMEC would provide its services to Ontario Bank Participants without establishing an office or having a physical presence in Ontario or elsewhere in Canada. LMEC intends to offer its clearing services to Ontario Bank Participants who become Members. In the event that current LMEC Members are no longer able to receive clearing services from LMEC following the UK’s withdrawal from the European Union, some of those Members may elect to access LMEC’s services indirectly through a Member in Ontario.
- 7.2 Initially LMEC does not plan to clear instruments for Ontario participants that are derivatives under OSC Rule 91-506 *Derivatives: Product Determination*. Thus, initially LMEC will not clear OTC derivatives for Ontario participants. Accordingly, LMEC does not initially intend to be subject to OSC Rule 91-507 *Trade Repositories and Derivatives Trade Reporting (OSC Rule 91-507)*, National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives (NI 94-101)* or National Instrument 94-102 *Customer Clearing and Protection of Customer Collateral and Positions (NI 94-102)*.
- 7.3 If LMEC decides it would like to provide clearing services for OTC derivatives that are derivatives under OSC Rule 91-506 *Derivatives: Product Determination*, LMEC will file an application pursuant to section 144 of the Act to vary the Exemption Order to include the clearing of OTC derivatives. In filing that application, LMEC will set out, to the satisfaction of OSC staff, the manner in which it would comply with the requirements of OSC Rule 91-507, NI 94-101 and NI 94-102 that would apply to LMEC, including, where applicable, seeking an exemption from any such requirement.

## 8. Criteria for Exemption from Recognition as a Foreign Clearing Agency

- 8.1 Section 2.1 of NI 24-102 requires a foreign clearing agency to provide the following information in its application for exemption from recognition as a clearing agency:
- (a) its most recently completed PFMI Disclosure Document together with disclosure about any material change to the information in the PFMI Disclosure Document or concerning any information in the PFMI Disclosure Document having become materially inaccurate for any reason;
  - (b) sufficient information to demonstrate that it is in compliance with the regulatory regime of the jurisdiction in which its head office or principal place of business is located; and
  - (c) any additional relevant information sufficient to demonstrate that it is in the public interest for the securities regulatory authority to exempt the applicant. According to section 2.1 of the Companion Policy to NI 24-102, this additional information is a detailed description of the regulatory regime of the clearing agency’s home jurisdiction and the requirements imposed on the clearing agency, including how such requirements are similar to the requirements in Parts 3 and 4 of NI 24-102.

LMEC’s most recent PFMI Disclosure Document, prepared in 2018, is available at:

<https://www.lme.com/en-GB/LME-Clear/Rules-and-regulations/Disclosure-and-transparency>

- 8.2 This was reviewed and validated by the Bank of England.

## PART II – Requirements Set out in Part 4 of NI 24-102

Each requirement in Part 4 of NI 24-102 is set out below in italics, followed by a description of how the requirement is comparable to EMIR and EMIR RTS 153/2013, as applicable, and LMEC compliance with EMIR and EMIR RTS 153/2013, as applicable.

1. Division 1 – Governance

**Board of directors (section 4.1 of NI 24-102)**

- (1) ***A recognized clearing agency must have a board of directors.***
- (2) ***The board of directors must include appropriate representation by individuals who are***
  - (a) ***independent of the clearing agency, and***
  - (b) ***not employees or executive officers of a participant or their immediate family members.***
- (3) ***For the purposes of paragraph (2) (a), an individual is independent of a clearing agency if he or she has no direct or indirect material relationship with the clearing agency.***
- (4) ***For the purposes of subsection (3), a “material relationship” is a relationship that could, in the view of the clearing agency’s board of directors, be reasonably expected to interfere with the exercise of a member’s independent judgment.***

Comparable provisions under EMIR

- 1.1 Article 27(1) of EMIR provides that “the senior management of a CCP shall be of sufficiently good repute and shall have sufficient experience so as to ensure the sound and prudent management of the CCP.”
- 1.2 Article 27(2) of EMIR requires that “at least one third, but no less than two, of the members of that board shall be independent [and] the compensation of the independent and other non- executive members of the board shall not be linked to the business performance of the CCP.”
- 1.3 Article 27(3) provides that “a CCP shall clearly determine the roles and responsibilities of the board and shall make the minutes of the board meetings available to the competent authority and auditors.”
- 1.4 Article 2(27) of EMIR defines “board” as an “administrative or supervisory board, or both.” Article 3(5) of EMIR RTS 153/2013 further elaborates that the responsibilities of the “board” are allocated to the supervisory board and the executive board, as appropriate.
- 1.5 Article 2(28) of EMIR provides that ““independent member of the board means a member of the board who has no business, family or other relationship that raises a conflict of interests regarding the CCP concerned or its controlling shareholders, its management or its clearing members, and who has had no such relationship during the five years preceding his membership of the board.”
- 1.6 Article 7(5) of EMIR RTS 153/2013 further requires that the governance arrangements, by which the board and senior management of a CCP operate must include processes to identify, address and manage potential conflicts of interest of members of the board and senior management. Article 5(4) of EMIR RTS 153/2013 states: “a CCP shall identify and analyse potential conflicts of law issues and develop rules and procedures to mitigate legal risk resulting from such issues. If necessary, independent legal opinions shall be sought by the CCP for the purpose of this analysis.”

Compliance by LMEC

- 1.7 The Board is solely responsible for setting the strategy of LMEC. In setting the strategy, the Board considers the views of all stakeholders including the HKEX Group, the Relevant Regulations and seeks to achieve an appropriate balance between commercial and risk mandates in determining what is appropriate for LMEC.
- 1.8 LMEC, as required under the Relevant Regulations, remains responsible and accountable for the good management and performance of LMEC and ensures that it has a competent management team to which the Board has properly and effectively delegated the day-to-day management of LMEC.
- 1.9 The Board has delegated some of its responsibilities to Board committees. The responsibilities of each committee are defined by terms of reference approved by the Board. The Board retains overall control of any matter delegated to a committee and retains responsibility for approving any decisions that could have a significant impact on the risk profile of LMEC.

- 1.10 The Board is comprised of four Executive Directors and five Non-Executive Directors. As such, Non-Executive Directors comprise a majority of the Board. Some of the Executive Directors and Non-Executive Directors are also directors elsewhere in the HKEX Group.
- 1.11 The Non-Executive Directors have been selected on the basis that they are of sufficiently good repute and have adequate expertise in financial services, risk management and clearing services. They have been selected based on the balance of skills they bring to the Board as a group.
- 1.12 The following individuals serve as a member of the Board, or on a Committee of the Board, of LMEC as well as on the board of directors of LME or a committee of such board: Matthew Chamberlain, Romnesh Lamba, Anthony Stuart and Stephen Yiu. Please see paragraphs 2.33-2.38 for details of how LMEC manages the potential conflicts of interest that may arise.
- 1.13 The Articles of Association of LMEC also contain provisions dealing with potential conflicts of interest at Board level.

**2. Documented procedures regarding risk spill-overs (section 4.2 of NI 24-102)**

**(1) *The board of directors and management of a recognized clearing agency must have documented procedures to manage possible risk spill over where the clearing agency provides services with a different risk profile than its depository, clearing and settlement services.***

- 2.1 In addition to its clearing services, LMEC operates LMEwire, which is a platform used for EMIR transaction and position reporting to the elected Trade Repository, DTCC. EMIR provides that reporting may be delegated, but regulatory responsibility remains with the original party and does not transfer to the delegate. LMEC therefore does not bear any additional regulatory risk in connection with operating the LMEwire service.
- 2.2 Under the standard contractual terms that LMEC enters into with users of the LMEwire service, LMEC agrees to use reasonable care in the performance of its reporting responsibilities, but accepts no liability for any losses suffered by users of LMEwire that may result from LMEC's acts or omissions. The only risk for LMEC, therefore, is that it could fail to exercise a reasonable standard of care in providing the LMEwire service to perform reporting functions.
- 2.3 LMEC has in place a robust set of procedures relating to the management and operation of the IT systems required to provide the LMEwire service, and the process by which that service will be provided, along with its standard overarching incident management procedures.

**3 Chief Risk Officer and Chief Compliance Officer (section 4.3 of NI 24-102)**

**(1) *A recognized clearing agency must designate a chief risk officer and a chief compliance officer, who must report directly to the board of directors or, if determined by the board of directors, to the chief executive officer of the clearing agency.***

**(2) *The chief risk officer must***

- (a) *have full responsibility and authority to maintain, implement and enforce the risk management framework established by the clearing agency,***
- (b) *make recommendations to the clearing agency's board of directors regarding the clearing agency's risk management framework,***
- (c) *monitor the effectiveness of the clearing agency's risk management framework, and***
- (d) *report to the clearing agency's board of directors on a timely basis upon becoming aware of any significant deficiency with the risk management framework.***

**(3) *The chief compliance officer must***

- (a) *establish, implement, maintain and enforce written policies and procedures to identify and resolve conflicts of interest and ensure that the clearing agency complies with securities legislation,***
- (b) *monitor compliance with the policies and procedures described in paragraph (a),***

- (c) **report to the board of directors of the clearing agency as soon as practicable upon becoming aware of any circumstance indicating that the clearing agency, or any individual acting on its behalf, is not in compliance with securities legislation and one or more of the following apply:**
  - (i) **the non-compliance creates a risk of harm to a participant,**
  - (ii) **the non-compliance creates a risk of harm to the broader financial system,**
  - (iii) **the non-compliance is part of a pattern of non-compliance, or**
  - (iv) **the non-compliance may have an impact on the ability of the clearing agency to carry on business in compliance with securities legislation,**
- (d) **prepare and certify an annual report assessing compliance by the clearing agency, and individuals acting on its behalf, with securities legislation and submit the report to the board of directors,**
- (e) **report to the clearing agency's board of directors as soon as practicable upon becoming aware of a conflict of interest that creates a risk of harm to a participant or to the capital markets, and**
- (f) **concurrently with submitting a report under paragraphs (c), (d) or (e), file a copy of such report with the securities regulatory authority.**

Comparable provisions under EMIR

- 3.1 Article 26(4) of EMIR provides that "a CCP shall maintain a clear separation between the reporting lines for risk management and those for the other operations of the CCP."
- 3.2 Article 33 of EMIR provides that "a CCP shall maintain and operate effective written organizational and administrative arrangements to identify and manage any potential conflicts of interest between itself, including its managers, employees, or any person with direct or indirect control or close links, and its clearing members or their clients known to the CCP. It shall maintain and implement adequate procedures aiming at resolving possible conflicts of interest."
- 3.3 Article 3(3) of EMIR RTS 153/2013 requires a CCP to ensure that the functions of the chief risk officer and CCO are carried out by different individuals, who must be employees of the CCP entrusted with the exclusive responsibility of performing these functions.
- 3.4 Pursuant to Article 4(6) of EMIR RTS 153/2013, the chief risk officer is required to implement the risk management framework including the policies and procedures established by the board. Article 7(6) of EMIR RTS 153/2013 requires the chief risk officer to report to the board either directly or through the chair of the risk committee.
- 3.5 Pursuant to Article 6(2) of EMIR RTS 153/2013, the responsibilities of a CCP's CCO include the following:
  - (a) monitoring and, on a regular basis, assessing the adequacy and effectiveness of the measures put in place to identify and analyze potential conflicts of law issues and to develop rules and procedures to mitigate legal risk resulting from such issues, as well as the actions taken to address any deficiencies in the CCP's compliance with its obligations;
  - (b) administering the compliance policies and procedures established by senior management and the board;
  - (c) advising and assisting the persons responsible for carrying out the CCP services and activities to comply with the CCP's obligations under EMIR and EMIR RTS 153/2013;
  - (d) reporting regularly to the board on compliance by the CCP and its employees with EMIR and EMIR RTS 153/2013;
  - (e) establishing procedures for the effective remediation of instances of non-compliance; and

- (f) ensuring that the relevant persons involved in the compliance function are not involved in the performance of the services or activities they monitor and that any conflicts of interest of such persons are properly identified and eliminated.

Article 7(6) of EMIR RTS 153/2013 requires the CCO to report directly to the board.

Compliance by LMEC

- 3.6 A new CCO, Gavin Hill joined in March 2018 and is responsible for regulatory compliance of LMEC. This includes responsibility for:
  - (a) the development, maintenance and implementation of compliance policies and procedures designed to ensure that LMEC meets its regulatory obligations under the Relevant Regulations;
  - (b) monitoring, and, on an ongoing basis, assessing the adequacy and effectiveness of policies and procedures established by senior management and the Board;
  - (c) coordinating the relationship with regulators and assist the chief executive officer with his ongoing relationship with the regulators;
  - (d) advising and assisting persons responsible for carrying out LMEC's services and activities to comply with the regulatory obligations relevant to LMEC;
  - (e) reporting to the senior management, Board and regulators on compliance by LMEC and its employees with all relevant regulatory standards; and
  - (f) establishing procedures for remediation of breaches;
- 3.7 The risk tolerance for legal and compliance risks is set out in the Risk Appetite Statement. The Ethical Conduct, Legal and Compliance Risk Policy defines how LMEC intends to minimize the risk of loss (financial and non-financial) arising from a failure to adapt to legislative and regulatory changes or comply with laws and regulations, failure to act with integrity, fairness and honesty and a failure to put in place adequate contractual protections with third party suppliers and Members. The policy sets out the roles of the Legal and Compliance Functions.
- 3.8 The CCO reports to the Head of Regulation and Compliance for the LME Group and has a reporting line into the Chief Executive Officer and separately to the Board. The CCO liaises closely with the LME Group General Counsel (see below) on a regular basis and also with the Head of Legal Services and Chief Counsel and the Chief Regulatory Officer of HKEX to provide regular updates on legal and regulatory matters impacting LMEC. This is to ensure that a global view of all legal risks is maintained at group level, to minimise risks of conflicts of interest and to ensure that LMEC's contractual arrangements with Members and suppliers protect the interests of the Group.
- 3.9 The Regulation and Compliance function is organisationally separate from any other function of LMEC.
- 3.10 The CCO is supported by five specialist compliance persons. The compliance manager is not involved in any activities or services performed by LMEC.
- 3.11 The CCO is responsible for the development, maintenance and implementation of policies and procedures designed to ensure that LMEC meets its regulatory requirements. The CCO is responsible for all compliance policies which cover matters such as:
  - (a) conflicts of interest;
  - (b) whistleblowing;
  - (c) records and retention;
  - (d) ethical conduct, legal and compliance risk;
  - (e) financial crime; and
  - (f) fraud management and bribery management.

- 3.12 The CCO officer is also be responsible for reviewing policies developed by other functions within LMEC to ensure they meet all regulatory requirements. Policies are reviewed on an annual basis and relevant changes are made by the relevant team. These are then reviewed by relevant key reviewers as well as the ExCom for sign off. Once signed off, these are presented for approval by the Board or the Audit Committee (as appropriate).
- 3.13 LMEC also has a separate Legal function which is headed by the LME Group General Counsel who is responsible for all legal matters. This includes responsibility for:
- (a) advising and assisting persons responsible for carrying out LMEC's services and activities on the application of the LMEC Rules;
  - (b) the maintenance of the LMEC Rules, ensuring that the LMEC Rules comply with all applicable regulatory and supervisory requirements and obtaining independent legal opinions in relation to the soundness of the LMEC Rules, Membership agreements and conflict of law issues (in coordination with the CCO);
  - (c) investigating any breaches of the LMEC Rules by Members in accordance with the disciplinary procedure set out in the LMEC Rules;
  - (d) investigating any complaints brought by Members in accordance with the complaints procedure set out in the LMEC Rules; and
  - (e) reviewing and advising on agreements to be signed with service providers to ensure compliance with the Risk Appetite Statement and the Ethical Conduct, Legal and Compliance Risk Policy.
- 3.14 In addition to the General Counsel, three dedicated solicitors assist on all legal matters such as legal and regulatory monitoring, contract drafting and negotiating, procurement, legal advice to business, default management and foreign legal opinions as well as issues relating to enforceability and conflicts of law. The three dedicated lawyers are part of the LME Group Legal Function, which is comprised of 9 lawyers in total.

#### 4 Board or advisory committees (section 4.4 of NI 24-102)

- (1) ***The board of directors of a recognized clearing agency must, at a minimum, establish and maintain committees on risk management, finance and audit.***
- (2) ***If a committee is a board committee, it must be chaired by a sufficiently knowledgeable individual who is independent of the clearing agency.***
- (3) ***Subject to subsection (4), a committee must have an appropriate representation by Individuals who are independent of the clearing agency.***
- (4) ***An audit or risk committee must have an appropriate representation by individuals who are:***
  - (a) ***independent of the clearing agency, and***
  - (b) ***not employees or executive officers of a participant or their immediate family members.***

#### Comparable provisions under EMIR

- 4.1 Article 28(1) of EMIR states: "A CCP shall establish a risk committee, which shall be composed of representatives of its clearing members, independent members of the board and representatives of its clients. The risk committee may invite employees of the CCP and external independent experts to attend risk-committee meetings in a non-voting capacity. Competent authorities may request to attend risk-committee meetings in a non-voting capacity and to be duly informed of the activities and decisions of the risk committee. The advice of the risk committee shall be independent of any direct influence by the management of the CCP. None of the groups of representatives shall have a majority in the risk committee."
- 4.2 Article 7(1) of EMIR RTS 153/2013 requires the board of a CCP to establish an audit committee.

Compliance by LMEC

- 4.3 The Audit Committee plays a key role in the oversight of the compliance function at LMEC. The Audit Committee is composed of at least four individuals with at least three Non-Executive Directors and one individual with relevant and recent financial experience. It is responsible for the approval of the key compliance policies. It also plays an important role in the monitoring of the effectiveness of the internal controls and the risk management framework of LMEC. The Audit Committee's responsibilities include, amongst other things:
- (a) Financial Reporting – monitoring of the integrity of the financial statements of LMEC, including its annual and interim reports and any other formal announcement relating to its financial performance;
  - (b) Internal Controls – monitoring and keeping under review the effectiveness of the Company's internal controls as well as the adequacy of LMEC's policies and procedures relating to financial, operational, IT, information security, outsourcing, legal and compliance risks;
  - (c) Risk Management – monitoring the risk management system and monitoring and reviewing of the key risks faced by, or relating to, LMEC (enterprise risk);
  - (d) Business Continuity – reviewing the adequacy of the business continuity and disaster recovery plan and monitoring its effectiveness;
  - (e) Bribery and Fraud Prevention – reviewing and approving LMEC's assessment of the corruption risks to which it is subject and the framework of controls put in place to mitigate those risks;
  - (f) Whistleblowing – reviewing the company's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters;
  - (g) Internal Audit – monitoring and reviewing the effectiveness of LMEC's internal audit function as well as reviewing and approving the annual internal audit plan and any internal audit findings;
  - (h) External Audit – overseeing the appointment of LMEC's external auditors as well as overseeing the relationship, independence and objectivity of such auditors, approving the annual external audit plan and reviewing the findings of the external audit with the external auditor; and
  - (i) LMEC has also established the Board Risk Committee, the details of which are set out at paragraphs 2.22- 2.28 of Part I – Default management.

**5 Use of own capital (section 4.5 of NI 24-102)**

***A recognized clearing agency that operates as a central counterparty must dedicate and use a reasonable portion of its own capital to cover losses resulting from one or more participant defaults.***

Comparable provisions under EMIR

- 5.1 Article 43(1) of EMIR provides that a CCP must maintain sufficient pre-funded available financial resources to cover potential losses that exceed the losses to be covered by margin requirements and the default fund. Such pre-funded financial resources must include dedicated resources of the CCP, must be freely available to the CCP, and may not be used to meet the capital required under Article 16 of EMIR.
- 5.2 Article 45(4) of EMIR provides that a CCP must use dedicated own resources before using the default fund contributions of non-defaulting clearing members. A CCP must not use the margins posted by non-defaulting clearing members to cover the losses resulting from the default of another clearing member.
- 5.3 Article 35 (2) of EMIR RTS 153/2013 defines the minimum amount a CCP must contribute to its default fund (**Dedicated Own Resources**). A CCP is required to calculate its minimum contribution to the default fund by multiplying the minimum capital, including retained earnings and reserves, held in accordance with Article 16 of EMIR by 25%.

Compliance by LMEC

- 5.4 Where there is a Default Loss remaining following the exercise of LMEC's default procedures, the Default Loss will be satisfied in the following order of priority:

- (a) first, LMEC will apply all Collateral provided by the defaulting Member in or towards the discharge of the Default Loss in accordance with the Rules;
- (b) secondly, if the Collateral provided by the defaulting Member is not sufficient to discharge the Default Loss, LMEC will apply the Default Fund contribution of the defaulting Member in or towards the discharge of the outstanding balance of the Default Loss;
- (c) thirdly, if the Default Fund contribution of the defaulting Member is not sufficient to discharge the balance of the Default Loss, LMEC will apply its Dedicated Own Resources in or towards the discharge of the outstanding balance of the Default Loss;
- (d) fourthly, if the Dedicated Own Resources of LMEC are not sufficient to discharge the outstanding balance of the Default Loss, LMEC will apply the Default Fund contributions of non-defaulting Members on a pro rata basis in or towards the discharge of the remaining balance of the Default Loss; and
- (e) fifthly, the loss allocation rules will apply.

LMEC's default waterfall is set out in LMEC Rule 10.10.

### Division 3 – Operational risk

#### 6 Systems requirements (section 4.6 of NI 24-102)

*For each system operated by or on behalf of a recognized clearing agency that supports the clearing agency's clearing, settlement and depository functions, the clearing agency must:*

- (a) ***develop and maintain***
  - (i) ***an adequate system of internal controls over that system, and***
  - (ii) ***adequate information technology general controls, including, without limitation, controls relating to information systems operations, information security, change management, problem management, network support and system software support,***
- (b) ***in accordance with prudent business practice, on a reasonably frequent basis and, in any event, at least annually***
  - (i) ***make reasonable current and future capacity estimates, and***
  - (ii) ***conduct capacity stress tests to determine the ability of that system to process transactions in an accurate, timely and efficient manner, and***
- (c) ***promptly notify the regulator or, in Québec, the securities regulatory authority of any material systems failure, malfunction, delay or security breach, and provide timely updates on the status of the failure, malfunction, delay or security breach, the resumption of service, and the results of the clearing agency's internal review of the failure, malfunction, delay or security breach.***

#### Comparable provisions under EMIR

- 6.1 Article 26(1) of EMIR provides that “a CCP shall have robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which it is or might be exposed, and adequate internal control mechanisms, including sound administrative and accounting procedures.”
- 6.2 Article 26(3) of EMIR provides in part that a CCP “shall employ appropriate and proportionate systems, resources and procedures.”
- 6.3 Article 26(6) of EMIR provides that “a CCP shall maintain information technology systems adequate to deal with the complexity, variety and type of services and activities performed so as to ensure high standards of security and the integrity and confidentiality of the information maintained.”

- 6.4 Article 26(8) of EMIR provides that “the CCP shall be subject to frequent and independent audits. The results of those audits shall be communicated to the board and shall be made available to the competent authority.”
- 6.5 Article 9(1) of EMIR RTS 153/2013 requires a CCP to design and ensure its information technology systems are reliable and secure as well as capable of processing the information necessary for the CCP to perform its activities and operations in a safe and efficient manner. It further requires systems to be designed to deal with the CCP’s operational needs and the risks the CCP faces, be resilient, including in stressed market conditions, and be scalable, if necessary, to process additional information. A CCP must provide for procedures and capacity planning as well as for sufficient redundant capacity to allow the system to process all remaining transactions before the end of the day in circumstances where a major disruption occurs.
- 6.6 Article 9(3) of EMIR RTS 153/2013 requires a CCP to maintain a robust information security framework that appropriately manages its information security risk. This framework is required to include appropriate mechanisms, policies and procedures to protect information from unauthorised disclosure, to ensure data accuracy and integrity and to guarantee the availability of the CCP’s services. Article 9(4) of EMIR RTS 153/2013 sets out features required to be included in the information security network. Pursuant to Article 9(5) of EMIR RTS 153/2013, the information technology systems and the information security framework must be reviewed at least on an annual basis and be subject to independent audit assessments, the results of which are to be reported to the board and made available to the CCP’s regulator.
- 6.7 Article 4(7) of EMIR RTS 153/2013 requires a CCP to have adequate internal control mechanisms to assist the board in monitoring and assessing the adequacy and effectiveness of its risk management policies, procedures and systems. These mechanisms must include sound administrative and accounting procedures, a robust compliance function and an independent internal audit and validation or review function.
- 6.8 Article 11(5) of EMIR RTS 153/2013 requires a CCP’s internal control mechanisms to be subject to audit, and to be performed at least on an annual basis.

Compliance by LMEC

- 6.9 LMEC has implemented the Cinnober TRADExpress Real-Time Clearing System (**LMEmercury**) which has been modified and adapted to cater for LMEC’s specific needs. LMEmercury is a real time clearing and settlement, risk management and collateral management system. LMEC has also implemented an internally developed data warehouse (**CDW**) to provide additional risk reporting and analytical capabilities.
- 6.10 The platform supports the following key business functions:
- (a) **Clearing and Settlement**
    - (i) matched trade acceptance: real time FIX feed of matched trades (from LMEsmart operated by the LME), data validated and position risk checked against collateral/limit;
    - (ii) position management: real time management using account structure supporting multiple House Accounts, OSAs and ISAs, support for position transfer and porting;
    - (iii) contract expiry: management of contract expiry process;
    - (iv) option exercise and assignment: management of automated expiry and random assignment process;
    - (v) settlement and delivery management: interface with physical settlement and delivery system (LMEsword operated by the LME) and management of cleared delivery process; and
  - (b) **Risk Management**
    - (i) margin and default fund calculation and collection, real time calculation of margin and margin cover processing;
    - (ii) stress testing and reverse stress testing of Member and Client portfolios;
    - (iii) risk analytics, including calculation of greeks and sensitivity analysis on portfolios and collateral;

- (iv) credit risk metrics for credit scoring and near real time updates of credit market data for Members and other counterparties;
  - (v) default management, ability to manage position transfer and record default processes;
  - (vi) real time risk monitoring and ability to consolidate risk exposure across market exposure, treasury investment exposure; and
  - (vii) pricing and market data management using multiple pricing sources and calculate multiple settlement prices;
- (c) **Cash and Collateral Management**
- (i) payments handling: link to Society for Worldwide Interbank Financial Telecommunication (**SWIFT**) network via SWIFT bureau service to manage payment across settlement and concentration banks; and
  - (ii) cash and securities collateral management: SWIFT processing of cash and securities to manage assets across custodians and cash investment agent.

6.11 The other key systems used by LMEC alongside LMEmercury and the data warehouse include:

- (a) Algorithmica: provided by Cinnober alongside LMEmercury, Algorithmica is used for detailed analysis of risk factors to support SPAN parameter setting; and
- (b) Bottomline: standard SWIFT bureau application used to manage interface between LMEmercury and SWIFT network.

## 7. Systems reviews (section 4.7 of NI 24-102)

- (1) ***A recognized clearing agency must annually engage a qualified party to conduct an Independent systems review and vulnerability assessment and prepare a report in accordance with established audit standards and best industry practices to ensure that the clearing agency is in compliance with paragraph 4.6(a) and section 4.9.***
- (2) ***The clearing agency must provide the report resulting from the review conducted under subsection (1) to***
  - (a) ***its board of directors, or audit committee, promptly upon the report's completion, and***
  - (b) ***the regulator or, in Québec, the securities regulatory authority, by the earlier of the 30th day after providing the report to its board of directors or the audit committee or the 60th day after the calendar year end.***

### Comparable provisions under EMIR

7.1 Article 26(8) of EMIR requires a CCP to be subject to frequent and independent audits. The results of those audits must be communicated to the board and shall be made available to its regulator.

### Compliance by LMEC

7.2 LMEC applies industry best practice for development, implementation, operations, monitoring, management and maintenance of IT systems, using industry standard hardware and processes for which experienced resources are readily available. LMEC ensures that this is tested as part of the SOC2. assessment review. The Chief Technology Officer is responsible for ensuring IT standards are applied. At the highest level, the IT standards adopted are:

- (a) New system development and project management: system development lifecycle model supported by formal project management methodology when developing large business components; and
- (b) IT Support Services: ITIL.

8. Clearing Agency technology requirements and testing facilities (section 4.8 of NI 24-102)
- (1) *A recognized clearing agency must make available to participants, in their final form, all technology requirements regarding interfacing with or accessing the clearing agency*
- (a) *if operations have not begun, sufficiently in advance of operations to allow a reasonable period for testing and system modification by participants, and*
- (b) *if operations have begun, sufficiently in advance of implementing a material change to technology requirements to allow a reasonable period for testing and system modification by participants.*
- (2) *After complying with subsection (1), the clearing agency must make available testing facilities for interfacing with or accessing the clearing agency*
- (a) *if operations have not begun, sufficiently in advance of operations to allow a reasonable period for testing and system modification by participants, and*
- (b) *if operations have begun, sufficiently in advance of implementing a material change to technology requirements to allow a reasonable period for testing and system modification by participants.*
- (3) *The clearing agency must not begin operations before*
- (a) *it has complied with paragraphs (1)(a) and (2)(a), and*
- (b) *the chief information officer of the clearing agency, or an individual performing a similar function, has certified in writing to the regulator or, in Québec, the securities regulatory authority, that all information technology systems used by the clearing agency have been tested according to prudent business practices and are operating as designed.*
- (4) *The clearing agency must not implement a material change to the systems referred to in section 4.6 before*
- (a) *it has complied with paragraphs (1)(b) and (2)(b), and*
- (b) *the chief information officer of the clearing agency, or an individual performing a similar function, has certified in writing to the regulator or, in Québec, the securities regulatory authority, that the change has been tested according to prudent business practices and is operating as designed.*
- (5) *Subsection (4) does not apply to the clearing agency if the change must be made immediately to address a failure, malfunction or material delay of its systems or equipment and if*
- (a) *the clearing agency immediately notifies the regulator or, in Québec, the securities regulatory authority, of its intention to make the change, and*
- (b) *the clearing agency discloses to its participants the changed technology requirements as soon as practicable.*

Comparable provisions under EMIR

- 8.1 Article 26(3) provides in part that a CPP “shall employ appropriate and proportionate systems, resources and procedures.”
- 8.2 Article 26(6) provides that “a CCP shall maintain information technology systems adequate to deal with the complexity, variety and type of services and activities performed so as to ensure high standards of security and the integrity and confidentiality of the information maintained.”
- 8.3 Article 26(8) provides that “the CCP shall be subject to frequent and independent audits. The results of those audits shall be communicated to the board and shall be made available to the competent authority.”

- 8.4 Article 9(1) of EMIR RTS 153/2013 requires a CCP to provide for procedures for the introduction of new technology including clear reversion plans.
- 8.5 Article 9(2) of EMIR RTS 153/2013 requires a CCP to subject its systems to stringent testing, simulating stressed conditions, before initial use, after making significant changes and after a major disruption has occurred. Clearing members and clients, interoperable CCPs and other interested parties must be involved as appropriate in the design and conduct of these tests.

Compliance by LMEC

- 8.6 LMEC has two key categories for changes that occur on its systems. These categories are Business As Usual (**BAU**) change and Major releases.
- 8.7 BAU change encompasses minor patches and small works to the system. These changes can be in response to small works requested by the LMEC business or patches required for incident and defect resolution. BAU changes are predominately internally facing with no or limited visibility to outside parties.
- 8.8 Major releases result in significant change to the system which may include impact to third parties.
- 8.9 Due to the differences in impact and visibility, the two change routes have different levels of testing and coordination applied to them.
- 8.10 LMEC aims to undertake two major releases per year dependent upon business requirements. These changes are generally considered large scale in their nature with significant member and external impact. Due to the size of these releases extensive testing is applied to each release. Testing of a release is undertaken by LMEC test and business teams. This ensures that LMEC fully reviews all releases to ensure that they are of sufficient quality and stability for deployment into production.
- 8.11 Testing of a major release includes Unit Testing, Functional Testing, User Acceptance Testing, Non-functional Testing, Regression Testing, Parallel Runs, Member Tests and Penetration Testing.
- 8.12 Unit testing is undertaken on all new code developed on the system. This is the first test applied and is undertaken by the developers of the code. This ensures that the code is good and addresses the core requirements it is intended for. If the code passes this test then it is promoted to the release for delivery to the LMEC test team.
- 8.13 Functional Testing is applied to all new releases and patches. This testing ensures that the new release or patch functionally works as expected. The functional testing is done against detailed test plans that are created prior to the code delivery. This allows the testers to execute a wide number of tests and compare against expected outcomes. If a defect is identified then it is raised with the developers for correction either via a patch or a subsequent release. All defects are tracked and reported on as part of the release project governance.
- 8.14 User Acceptance Testing is undertaken by the LMEC business teams on each element of the release. This test ensures that the LMEC business confirms that they are able to undertake their required actions and activities on the system. If a defect is identified then it is raised with the developer for correction.
- 8.15 Regression testing is undertaken on all major releases. This test runs through a detailed risk based regression test pack. The pack covers key elements of the LMEC activities to ensure all elements, regardless of whether they are being changed or not still function as expected. This test ensures that there are no unintended consequences of changes made to the system.
- 8.16 Member Testing is carried out with LMEC's external members. This is done with the use of two dedicated member test systems which are available to all LMEC members. The member test environments are setup to provide members with the ability to test against current state and future state. During a major release members are required to self-certify that they have tested against the new release.
- 8.17 Non-Functional Testing is applied to all releases. This test is focused on performance of the system with the new release. The test ensures that the system continues to perform with required trade volumes. These trade volumes include peak LME trade volume and 3x peak volume as required by EMIR. Non-functional tests also include failover and resilience testing which ensures that the system continues to meet the EMIR regulatory requirement of a 2 hour recovery period.

- 8.18 Parallel run tests are undertaken on all major releases. This test involves the pre-production system being run behind the production system with all trades and price updates experienced in production played into the test system. This test is carried out by the LMEC business team and ensures that the system continues to provide the same results as production and that functionality is as expected by the business teams.
- 8.19 Penetration testing is undertaken on each new release. This is undertaken by a third party on LMEC's behalf to ensure that there are no security flaws within the new release. If a severe security flaw is detected then this is corrected before go live of the release.
- 8.20 BAU changes are smaller in scope to the major releases and are delivered as patches to the system. This means that the changes are discrete in nature and can easily be removed if required. As a result of this, BAU changes undergo Unit Testing, Functional Testing and Pre-Prod deployment testing before deployment into production.
- 8.21 LMEC's COO and CTO meet regularly with the Bank of England and inform it of major releases planned and the expected go-live dates of these. BAU changes are made with no regulatory consultation.

**9. Testing of business continuity plans (section 4.9 of NI 24-102)**

***A recognized clearing agency must***

- (a) develop and maintain reasonable business continuity plans, including disaster recovery plans, and***
- (b) test its business continuity plans, including its disaster recovery plans, according to prudent business practices and on a reasonably frequent basis and, in any event, at least annually.***

Comparable provisions under EMIR

- 9.1 Article 34(1) of EMIR states: "A CCP shall establish, implement and maintain an adequate business continuity policy and disaster recovery plan aiming at ensuring the preservation of its functions, the timely recovery of operations and the fulfilment of the CCP's obligations. Such a plan shall at least allow for the recovery of all transactions at the time of disruption to allow the CCP to continue to operate with certainty and to complete settlement on the scheduled date."
- 9.2 Article 17 of EMIR RTS 153/2013 provides the following requirements for a CCP's business continuity plan:
  - 1. A CCP shall have a business continuity policy and a disaster recovery plan which are approved by the board. The business continuity policy and the disaster recovery plan shall be subject to independent reviews which are reported to the board.
  - 2. The business continuity policy shall identify all critical business functions and related systems, and include the CCP's strategy, policy, and objectives to ensure the continuity of these functions and systems.
  - 3. The business continuity policy shall take into account external links and interdependencies within the financial infrastructure including trading venues cleared by the CCP, securities settlement and payment systems and credit institutions used by the CCP or a linked CCP. It shall also take into account critical functions or services which have been outsourced to third-party providers.
  - 4. The business continuity policy and disaster recovery plan shall contain clearly defined and documented arrangements for use in the event of a business continuity emergency, disaster or crisis which are designed to ensure a minimum service level of critical functions.
  - 5. The disaster recovery plan shall identify and include recovery point objectives and recovery time objectives for critical functions and determine the most suitable recovery strategy for each of these functions. Such arrangements shall be designed to ensure that in extreme scenarios critical functions are completed on time and that agreed service levels are met.
  - 6. A CCP's business continuity policy shall identify the maximum acceptable time for which critical functions and systems may be unusable. The maximum recovery time for the CCP's critical functions to be included in the business continuity policy shall not be higher than two hours. End of day procedures and payments shall be completed on the required time and day in all circumstances.

7. A CCP shall take into account the potential overall impact on market efficiency in determining the recovery times for each function.”
- 9.3 Article 18 of EMIR RTS 153/2013 requires a CCP to conduct a business impact analysis that is designed to identify the business functions critical to ensuring the services of the CCP (including the criticality of these functions to other institutions and functions in the financial infrastructure) and to use scenario based risk analysis designed to identify how various scenarios affect the risks to its critical business functions. The business impact analysis and scenario analysis are required to be kept up to date, reviewed at least on an annual basis and following an incident or significant organizational changes, and taking into account all relevant developments, including market and technology developments.
- 9.4 Article 19 of EMIR RTS 153/2013 requires a CCP to have in place arrangements to ensure continuity of its critical functions based on disaster scenarios.
- 9.5 Article 20 of EMIR RTS 153/2013 provides for the following requirements regarding the testing and monitoring of a CCP’s business continuity and disaster recovery plan:
- (a) A CCP shall test and monitor its business continuity policy and disaster recovery plan at regular intervals and after significant modifications or changes to the systems or related functions to ensure the business continuity policy achieves the stated objectives including the two hour maximum recovery time objective. Tests shall be planned and documented.
  - (b) Testing of the business continuity policy and disaster recovery plan shall fulfill the following conditions:
    - (i) involve scenarios of large scale disasters and switchovers between primary and secondary sites;
    - (ii) include involvement of clearing members, external providers and relevant institutions in the financial infrastructure with which interdependencies have been identified in the business continuity policy.
- 9.6 LME Group has in place a Business Continuity Management System (**BCMS**) that is certified to the International Standard for Business Continuity ISO22301, amongst others.
- 9.7 This BCMS ensures LME Group has the capability to plan for and respond to operational disruptions, including events that could cause a wide scale or major disruption, and continue business at a pre-defined and acceptable level.

### **Business Continuity Policy**

- 9.8 Senior Management define Business Continuity Objectives within the Business Continuity Policy (**BC Policy**). This provides a framework for the creation of the Business Continuity Management System. The BC Policy is annually reviewed and approved at Board level. Accountability for the success and completeness of the BCMS is with the Chief Operating Officer. Responsibility for maintenance of the BCMS is assigned to appropriately qualified and suitably experienced management personnel.
- 9.9 BC Policy Objectives:
- (a) Ensure safety and welfare of staff, contractors and visitors throughout a business continuity incident.
  - (b) Meet statutory and regulatory requirements.
  - (c) Determine recovery time objectives for functions that are essential to the business (as documented within business impact Analysis), and develop appropriate responses.
  - (d) Maintain robust business continuity strategies and plans that are thoroughly exercised on at least an annual basis.
  - (e) Maintain communication with regulators and compliance with regulatory requirements.
  - (f) Ensure staff are fully cognisant of the importance of business continuity and understand what is expected of them should a business continuity invocation take place.

- (g) Adhere to industry best practices and standards and continually monitor and improve operational resilience and business continuity preparedness.
  - (h) Anticipate threats that could disrupt LME Group operations and prevent their occurrence from causing greater than:
    - (i) Two (2) hours disruption to electronic trading and trade matching services.
    - (ii) Two (2) hours disruption to critical LMEC clearing services.
    - (iii) A disruption beyond the same business day for regulatory services.
    - (iv) A disruption beyond 48hours for all other services that have a disaster recovery strategy.
- 9.10 Business Continuity Plan (**BC Plan**) – The BC Plan guides Senior Management in the recovery and continuation of LME Group services. It covers the procedures for how to manage a major incident which has resulted in disruption to LME and/or LMEC services beyond a predefined acceptable level. The BC Plan is annually reviewed and approved at Board level
- 9.11 In Scope for the BC Plan are:
- (i) All LME trading activities provided to the market
  - (ii) All LMEC settlement and clearing activities
  - (iii) The workplace based at LME Group Head Office
  - (iv) All personnel based in LME Group Head Office

**Business Continuity Strategy**

- 9.12 Determination and selection of Business Continuity Strategy (**BC Strategy**) is based on the output from Business Impact Analysis (BIA) and Risk Analysis (RA). BIA and RA are performed at least annually to ensure the strategy remains relevant. BC Strategy is annually reviewed.
- 9.13 BC Strategy is required for the following scenarios:
- (a) Loss of a building, E.G.:
    - (i) Power cut
    - (ii) Building access problems
  - (b) Technological failure, E.G.:
    - (i) Data Centre Failure (or partial)
    - (ii) Extensive Hardware failure
    - (iii) Extensive Software Failure
  - (c) Cyber attack
  - (d) Reduction of personnel below acceptable levels, e.g.:
    - (i) pandemic illness
    - (ii) industrial action affecting transportation
    - (iii) critical third party supplier failure
- 9.14 Business Impact Analysis (BIA) & Risk Analysis – BIA and Risk Analysis reviews the impact over time of a disruption to LME Group and its Members. These analyses identify the resources required to support the

essential functions concluded within the BIA and help define the acceptable recovery objectives for functions, processes and resources for continuance of service. BIA and Risk Analysis are annually reviewed.

9.15 The BIA:

- (a) documents the impact of loss or disruption over time to both LME Group and the market;
- (b) identifies LME Group processes that support its functions and process dependencies; and
- (c) identifies the resources required for recovery.

9.16 Risk Analysis:

- (a) identifies and manages risks in order to minimise the need to invoke business continuity; and
- (b) assesses risk by considering the likelihood of occurrence over time, and the potential impact if an event did materialise.

The impact parameters are: financial loss; damage to reputation; and, the ability to meet regulatory requirements.

### Testing & Exercising

9.17 LME Group implements an annual testing and exercising programme that covers all plans and strategies and demonstrates compliance with its Business Continuity preparedness. The programme covers a range of scenarios, including large scale disasters involving the need to switchover from the Finsbury Square office to the Disaster Recovery Site(s). Tests take place at regular intervals and after significant modifications or changes to the systems and related functions in order to ensure the Business Continuity Plan can achieve the defined objectives.

9.18 LME Group personnel, LME Members and critical service providers are included in the testing and exercising programme. A post-test report is produced to record the results of the tests against the test objectives and to determine required actions if objectives were not satisfactorily achieved.

## 10. Outsourcing (section 4.10 of NI 24-102)

***If a recognized clearing agency outsources a critical service or system to a service provider, including to an affiliated entity of the clearing agency, the clearing agency must do all of the following:***

- (a) ***establish, implement, maintain and enforce written policies and procedures to conduct suitable due diligence for selecting service providers to which a critical service and system may be outsourced and for the evaluation and approval of those outsourcing arrangements;***
- (b) ***identify any conflicts of interest between the clearing agency and the service provider to which a critical service and system is outsourced, and establish, implement, maintain and enforce written policies and procedures to mitigate and manage those conflicts of interest;***
- (c) ***enter into a written contract with the service provider to which a critical service or system is outsourced that***
  - (i) ***is appropriate for the materiality and nature of the outsourced activities,***
  - (ii) ***includes service level provisions, and***
  - (iii) ***provides for adequate termination procedures;***
- (d) ***maintain access to the books and records of the service provider relating to the outsourced activities;***
- (e) ***ensure that the securities regulatory authority has the same access to all data, information and systems maintained by the service provider on behalf of the clearing agency that it would have absent the outsourcing arrangements;***

- (f) **ensure that all persons conducting audits or independent reviews of the clearing agency under this Instrument have appropriate access to all data, information and systems maintained by the service provider on behalf of the clearing agency that such persons would have absent the outsourcing arrangements;**
- (g) **take appropriate measures to determine that the service provider to which a critical service or system is outsourced establishes, maintains and periodically tests an appropriate business continuity plan, including a disaster recovery plan;**
- (h) **take appropriate measures to ensure that the service provider protects the clearing agency's proprietary information and participants' confidential information, including taking measures to protect information from loss, thefts, vulnerabilities, threats, unauthorized access, copying, use and modification, and discloses it only in circumstances where legislation or an order of a court or tribunal of competent jurisdiction requires the disclosure of such information;**
- (i) **establish, implement, maintain and enforce written policies and procedures to monitor the ongoing performance of the service provider's contractual obligations under the outsourcing arrangements.**

Comparable provisions under EMIR

- 10.1 Article 35(1) of EMIR provides that, when outsourcing operational functions, services or activities, a CCP must at all times ensure that, among the following:
- (a) outsourcing does not prevent the exercise of supervisory and oversight functions, including on-site access to acquire any relevant information needed to fulfil those mandates;
  - (b) outsourcing does not result in depriving the CCP from the necessary systems and controls to manage the risks it faces;
  - (c) the service provider implements equivalent business continuity requirements to those that the CCP must fulfil;
  - (d) the CCP retains the necessary expertise and resources to evaluate the quality of the services provided and the organizational and capital adequacy of the service provider, and to supervise the outsourced functions effectively and manage the risks associated with the outsourcing and supervises those functions and manages those risks on an ongoing basis;
  - (e) the CCP has direct access to the relevant information of the outsourced functions;
  - (f) the service provider cooperates with the competent authority in connection with the outsourced activities; and
  - (g) the service provider protects any confidential information relating to the CCP and its clearing members and clients.

A CCP may not outsource major activities linked to risk management unless approved by its regulator.

- 10.2 Pursuant to Article 35(2) of EMIR, a CCP's regulator must require the CCP, in entering into an outsourcing arrangement, to allocate and set out its rights and obligations, and those of the service provider, clearly in a written agreement. Pursuant to Article 35(3), a CCP must make all information necessary to enable the regulator to assess the compliance of the performance of the outsourced activities available upon request.

Compliance by LMEC

- 10.3 LMEC has entered into written agreements with all its outsourced providers which meet the EMIR requirements set out above. All outsourcing arrangements have been reviewed by the Board Risk Committee and approved by the Bank. LMEC's outsourcing arrangements were recently reviewed by the Bank in 2017 and found to be compliant with the EMIR requirements. The performance of outsourced providers is regularly reviewed and the adequacy of these internal controls and polices is reviewed by the Audit Committee.

## Division 4 – Participation requirements

## 11. Access requirements and due process (section 4.11 of NI 24-102)

- (1) ***A recognized clearing agency must not***
- (a) ***unreasonably prohibit, condition or limit access by a person or company to the services offered by the clearing agency,***
  - (b) ***unreasonably discriminate among its participants or indirect participants,***
  - (c) ***impose any burden on competition that is not reasonably necessary and appropriate,***
  - (d) ***unreasonably require the use or purchase of another service for a person or company to utilize the clearing agency's services offered by it, and***
  - (e) ***impose fees or other material costs on its participants that are unfairly or inequitably allocated among the participants.***
- (2) ***For any decision made by the clearing agency that terminates, suspends or restricts a participant's membership in the clearing agency or that declines entry to membership to an applicant that applies to become a participant, the clearing agency must ensure that***
- (a) ***the participant or applicant is given an opportunity to be heard or make representations, and***
  - (b) ***it keeps records of, gives reasons for, and provides for reviews of its decisions, including, for each applicant, the reasons for granting access or for denying or limiting access to the applicant, as the case may be.***
- (3) ***Nothing in subsection (2) limits or prevents the clearing agency from taking timely action in accordance with its rules and procedures to manage the default of one or more participants or in connection with the clearing agency's recovery or orderly wind-down, whether or not such action adversely affects a participant.***

Comparable provisions under EMIR

- 11.1 Pursuant to Article 37(1) of EMIR, a CCP's criteria for admitting clearing members must be "non-discriminatory, transparent and objective so as to ensure fair and open access to the CCP" and "ensure that clearing members have sufficient financial resources and operational capacity to meet the obligations arising from participation in a CCP". Criteria that restrict access to be admitted as clearing members are permitted only to the extent that their objective is to control the risk for the CCP.
- 11.2 Article 37(4) of EMIR requires a CCP to have objective and transparent procedures for the suspension and orderly exit of clearing members that no longer meet the CCP's admission criteria.
- 11.3 Article 37(5) of EMIR provides that a CCP may only deny access to clearing members meeting its admission criteria where duly justified in writing and based on a comprehensive risk analysis.
- 11.4 Article 37(6) of EMIR allows a CCP to impose specific additional obligations on clearing members, such as the participation in auctions of a defaulting clearing member's position.
- 11.5 These additional obligations must be proportional to the risk brought by the clearing member and may not restrict participation to certain categories of clearing member.

Compliance by LMEC

- 11.6 LMEC provides services to persons who are admitted to Membership on the terms of its Rules (Rule 3.1.1). The Rules are binding on Members (Rule 2.1.1) by virtue of the Clearing Membership Agreement, which must be executed by each applicant. The applicant will become a member on the date of its acceptance by LMEC, which is set out in the Clearing Membership Agreement. This decision is taken by the Board Risk Committee. A member is accepted once LMEC is satisfied that the applicant complies with all Membership Criteria. LMEC's Membership Criteria have been designed to operate on an objective basis to all applicants. LMEC

applies its Membership Criteria to all applicants on a non-discriminatory basis, with the aim of ensuring fair and open access to its clearing system.

- 11.7 The Application Process is set out in the Membership Procedures in the LMEC Rules, which also contain the complaints, disciplinary and appeals procedures.

**12. Additional Information to Demonstrate that it is in the Public Interest for the OSC to Exempt the Applicant**

LMEC is committed to operating a clearing agency in accordance with relevant public interest considerations. The LMEC Board has overall responsibility for the management of LMEC and is governed by a Statement of Corporate Governance. LMEC ensures compliance with all applicable laws and regulatory requirements and recognises the importance of maintaining the highest standards of corporate governance. The Board seeks to promote and maintain the highest standards in relation to the operations of LMEC, and, in this, is fully supported by HKEx, the Group parent company.

**13. Certification Regarding Books and Records as well as Onsite Inspection and Examination**

Pursuant to paragraph 2.1(2)(a) of NI 24-102, LMEC hereby certifies that it will, if so requested, (a) assist the OSC in accessing LMEC's books and records and in undertaking an onsite inspection at LMEC's premises and (b) provide the OSC with an opinion of legal counsel that LMEC has, as a matter of law, the power and authority to (i) provide the OSC with prompt access to its books and records; and (ii) submit to onsite inspection and examination by the OSC.

**14. Form 24-102F1 Submission to Jurisdiction and Appointment of Agent for Service**

Pursuant to subsection 2.1(3) of NI 24-102, LMEC has submitted a Form 24- 102F1 Submission to Jurisdiction and Appointment of Agent for Service. A fully executed Form 24-102F1 (including the date of exemption) will be filed with the OSC once the order requested by this application is issued.

**15. Notice Regarding Material Change to Information Provided in Application**

Pursuant to subsection 2.1(4) of NI 24-102, LMEC agrees to inform the OSC in writing of any material change to the information provided in this application, or if any of the information becomes materially inaccurate for any reason, as soon as the change occurs or LMEC becomes aware of any material inaccuracy.

**16. Filing of Audited Financial Statements**

- 16.1 Pursuant to subsection 2.4(1) of NI 24-102, LMEC will provide audited financials for the most recently completed financial year. Such audited financial statements and the accompanying auditor's report will meet the standards prescribed in subsections 2.4(2) and (3) of NI 24-102, respectively.

Should you have any questions on this application, please contact the LME Clear Legal Team ([lmeclearlegal@lme.com](mailto:lmeclearlegal@lme.com)).

Yours faithfully,

**LMEC**

**APPENDIX "A"**

<b>"Accounts"</b>	means an account established and maintained by LMEC in respect of a Member, in accordance with LMEC Rule 4 (Accounts), including any: <ul style="list-style-type: none"><li>• House Accounts; or</li><li>• Client Accounts, which may be either:<ul style="list-style-type: none"><li>(i) an Omnibus Account; or</li><li>(ii) an ISA;</li></ul></li></ul>
<b>"Applicable Law"</b>	means (a) all regional, national and international laws, rules, regulations, standards and directions, including those imposed by any competent regulatory authority which apply from time to time to the person or activity, and (b) all other regulations applying to LMEC or a Member and any binding rules or non-binding guidance issued by a Clearing House regulator and / or a regulator of a Member, including FSMA, EMIR, the Recognition Regulations and the Settlement Finality Regulations;
<b>"Clearing System"</b>	means the formal arrangements, rules and procedures operated by LMEC and the services provided by it for the clearing and settlement of contracts, as described in the Rules and the Procedures (each as amended from time to time) as published from time to time by LMEC;
<b>"Client"</b>	means a person that has an agreement with a Member pursuant to which: <ul style="list-style-type: none"><li>(a) the Member enters into transactions with or for that person; or</li><li>(b) the Member agrees to take responsibility for the clearing via the Clearing System of transactions entered into by such person;</li></ul>
<b>"Client Account"</b>	means an Account in the books and records of LMEC established in accordance with LMEC Rule 4 (Accounts), to record respective entitlements in respect of transactions cleared by a Member for one or more of its Clients;
<b>"Collateral"</b>	means cash, securities, gold, instruments and other types of asset provided (or to be provided) by a Member to LMEC to satisfy its margin requirement;
<b>"Default Fund"</b>	means the fund maintained by LMEC, to which each Member is required to contribute under LMEC Rule 9 (Default Fund);
<b>"ExCom"</b>	means the LMEC Executive Committee;
<b>"Executive Director"</b>	means a director employed by LMEC;
<b>"House Account"</b>	means an Account in the books and records of LMEC established in accordance with LMEC Rule 4.2.1;
<b>"Indirect Client"</b>	means the client of a Client;
<b>"Index Future"</b>	means a cash-settled Exchange-traded futures contract pursuant to which the buyer and seller agree to pay or receive in cash the difference between the level of the Index on the Prompt Date and the level agreed in the Contract, multiplied by the Contract size, settled on the Settlement Business Day next following the Prompt Date and subject to daily marking to market in accordance with the Clearing House Rules and conforming to the other specifications prescribed by the Exchange;
<b>"LME Exchange-Traded Forwards"</b>	means the products listed at paragraph 2.2 of Annex 1 to the LMEC Rules;
<b>"LME Exchange Traded Futures"</b>	means the products listed at paragraph 2.3 of Annex 1 of the LMEC Rules;

<b>"LME Contract"</b>	means a transaction that is made on the LME between two Members (and that is defined as a "Contract" under the LME Rules) <sup>2</sup> ;
<b>"Member"</b>	means a person admitted to use the Clearing System in accordance with LMEC Rule 3 (Membership) and the Membership Procedure either as a GCM or an ICM (and "Membership" shall be construed accordingly);
<b>"Membership Criteria"</b>	means the criteria to be satisfied in order to qualify for, and maintain, Membership of LMEC, as specified in Membership Procedures B3, B4 and B5 which are set out in the LMEC Rules;
<b>"Non-Executive Director"</b>	means a member of the LMEC Board without executive responsibilities within LMEC;
<b>"Position"</b>	means: <ul style="list-style-type: none"><li>(a) in relation to an open contract, the consolidated rights and liabilities of the parties to that open contract at the relevant point in time; and</li><li>(a) in relation to an Account, the consolidated rights and liabilities arising out of open contracts recorded on such Account;</li></ul>
<b>"Relevant Regulations"</b>	means all Applicable Law binding on LMEC in the UK and the European Union that governs, regulates or specifies in any way the manner in which LMEC shall be required to make available and / or perform its obligations as the operator of the Clearing System including FSMA, EMIR, the Recognition Regulations and the Settlement Finality Regulations;
<b>"Risk Appetite Statement"</b>	means LME's documented tolerances for different categories of risk, as defined by, and as revised from time to time by, LMEC's Board;

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<sup>2</sup> **Explanatory Note:** This definition covers contracts between two LMEC Members and would not therefore capture a Client Trade (which is between a Member and a Client or between a Client and any other person).

IN THE MATTER OF  
THE SECURITIES ACT,  
R.S.O. 1990, CHAPTER S.5, AS AMENDED  
(THE OSA)

AND

IN THE MATTER OF  
LME CLEAR LIMITED

ORDER  
(Section 147 of the OSA)

**WHEREAS** LME Clear Limited (**LMEC**) has filed an application (**Application**) with the Ontario Securities Commission (**Commission**) pursuant to section 147 of the OSA requesting an order exempting LMEC from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA in order to provide its central counterparty (**CCP**) services to Ontario market participants;

**AND WHEREAS** LMEC has represented to the Commission that:

- 1.1 LMEC is a private company incorporated in England and Wales on April 21, 2011, under registered number 07611628. LMEC's registered office and head office is at 10 Finsbury Square, London EC2A 1AJ. All corporate documentation relating to LMEC is filed with Companies House in the United Kingdom (**UK**).
- 1.2 LMEC is 100% owned by HKEX Investment UK Limited (**HKEX UK**), a holding company which also owns 100% of the shares in the London Metal Exchange (**LME**), through LME Holdings Limited. LMEC has no subsidiaries.
- 1.3 LMEC is authorised as a CCP pursuant to Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (**EMIR**), which sets out clearing and bilateral risk-management requirements for derivative contracts, reporting requirements for derivative contracts, and uniform requirements for the performance of activities of CCPs and trade repositories. LMEC is primarily supervised by the Bank of England (the **Bank**), is regulated as a Recognised Central Counterparty in accordance with the *Financial Services and Markets Act 2000 (FSMA)* in the United Kingdom, and is a designated system under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999. Its authorisation was obtained on 3 September 2014. LMEC is also authorised to provide Automated Trading Services in Hong Kong and is the clearing organisation for the LME under its Foreign Board of Trade Licence in the US.
- 1.4 LMEC is of the opinion that it fully observes the international standards applicable to financial market infrastructures described in the April 2012 report named *Principles for financial market infrastructures (PFMI)*, having prepared a detailed assessment of its compliance against the PFMI and the associated disclosure framework as of September 2018, which has been reviewed and validated by the Bank.
- 1.5 LMEC is subject to regulatory supervision by the Bank. LMEC is required to deliver to the Bank monthly returns showing LME Clear's activities, including:
  - initial margin;
  - default fund size ;
  - cash and non-cash collateral data;
  - stress testing results for counterparty credit and liquidity risk;
  - capital data; and
  - details of any significant changes in the organisation, governance, structure or ownership of LMEC.
- 1.6 The Bank reviews LMEC's annual financial statements and auditors' reports and does an annual risk classification of LMEC, including an assessment of the adequacy of LMEC's capital and risk management procedures. In addition, the Bank may carry out site audits.

- 1.7 In addition, LME Clear provides quarterly updates to the Securities & Futures Commission of Hong Kong (SFC) as part of its Automated Trading System Licence on the total volume of all trades cleared and settled and open interest, as well as details of the margin and collateral balances, and the default fund contribution of each Hong Kong Member (if any).
- 1.8 A member of LMEC (**Member**) is a member of the London Metal Exchange who has been admitted to use the clearing system of LMEC in accordance with Rule 3 of the LMEC Rules and Procedures (**LMEC Rules**) and the membership procedures. Members may be either an Individual Clearing Member (**ICM**) or a General Clearing Member (**GCM**). ICMs are permitted to clear transactions on their own behalf only. GCMs may clear transactions on their own behalf and also in respect of transactions effected (i) by the GCM with its clients, or (ii) by its clients with other non-members. Members may elect to use either the LME Base Service, the LMEprecious Service or both.
- 1.9 LMEC anticipates that banks based in Ontario and certain other market participants that have a head office or principal place of business in Ontario may be interested in becoming Members of LMEC.
- 1.10 The LMEC Rules act as the master agreement between LMEC and its Members in respect of all transactions cleared by LMEC.
- 1.11 LMEC provides services to persons who are admitted to membership on the terms of the LMEC Rules (LMEC Rule 3.1.1). The LMEC Rules are binding on Members (LMEC Rule 2.1.1) by virtue of the LME Clear Membership Agreement. LMEC's membership criteria have been designed to operate on an objective basis to all applicants. LMEC applies its membership criteria to applicants on a non-discriminatory basis, with the aim of ensuring fair and open access to its clearing system.
- 1.12 LMEC's membership criteria covers professional qualifications, financial integrity, regulated status of an applicant, and the ability of the applicant to meet and continue to meet the standards set out by LMEC.
- 1.13 The membership criteria are set out in membership procedures which are contained in the LMEC Rules, Part B. There are some additional criteria for applicants applying to become a GCM which are summarised below.
- 1.14 The criteria to become a GCM are that the applicant must:
- (a) meet the conditions (if any) in LMEC's pro forma membership agreement;
  - (b) satisfy the minimum net capital for a Member; and
  - (c) pay its contribution to the LMEC default fund.
- 1.15 A Member clearing for the LME business must also:
- (a) be a clearing member of the LME (this status is only available to certain categories of LME member specified in the LME Rules);
  - (b) be a member of the LMEsmart system; and
  - (c) meet the minimum net capital requirement for a Member of US\$10,000,000;
- 1.16 A GCM is required be regulated in the conduct of its business under the securities and/or banking legislation of an European Economic Area State or of any other country or countries acceptable to LMEC, and must not be prohibited by such legislation or its regulator from becoming a Member or from performing the obligations of a Member under the LMEC Rules. A GCM must also have sufficient financial resources and operational capacity to clear transactions on behalf of clients.
- 1.17 The LMEC Executive Risk Committee may approve an application to become a Member upon a determination that the applicant meets the membership criteria and after conducting a risk assessment and assigning an internal credit rating to the applicant.
- 1.18 Each Member shall provide to LMEC and maintain on a daily basis for so long as it is a Member, eligible collateral with a value sufficient to satisfy its margin requirement, which shall comprise as security, cover and/or credit support for the performance by that Member of all of its present and future obligations to LMEC pursuant to the LME Rules or the operation of the LMEC's clearing system.
- 1.19 The margin requirement for each Member will be the amount which LME Clear may determine and notify the Member from time to time.

- 1.20 LMEC requires all Members posting non-cash collateral to execute one or more security deeds and/or pledge agreements granting charges in favour of LMEC over all collateral and default fund contributions held by Members with LMEC.
- 1.21 The LMEC Rules (including in particular the default procedures contained within them) govern the processes that apply to Members in the case of a clearing Member default; clearing Members remain responsible for the credit risk of their Clients. These procedures facilitate transparent and practical market action in stress situations. In broad terms LMEC will look to neutralise risk by hedging the overall house position of a defaulting Member against the most liquid market dates and roll forward any prompt physical delivery positions to manage its risk. LMEC will then seek to auction the defaulting Member's remaining house portfolio to other participants as its preferred method of disposal; however it will also be able to execute the close out of all remaining open house positions if required. A Member must successfully complete simulated default tests to demonstrate they have the appropriate expertise and operational processes in place prior to beginning clearing operations. Once live, all Members are required to participate in fire drills regularly to confirm their operational readiness to manage a Member default.
- 1.22 LMEC seeks an exemption from the clearing agency recognition requirement in relation to all products eligible to be cleared on LMEC. (**Eligible Products**). The Eligible Products as at the time of this order are as follows:
- (a) Exchange Traded Forwards relating to metals;
  - (b) Exchange Traded Futures relating to metals;
  - (c) Exchange Traded Futures relating to metal indices;
  - (d) Exchange Traded American Options relating to metals;
  - (e) Exchange Traded Average Price Options (TAPOs) relating to metals; and
  - (f) Exchange Traded Monthly Average Futures relating to metals.
- 1.23 LMEC would provide its services to participants in Ontario without establishing an office, accessing systems from, or having a physical presence in Ontario or elsewhere in Canada.
- 1.24 LMEC submits that it does not pose a significant risk to the Ontario capital markets and is subject to an appropriate regulatory and oversight regime in a foreign jurisdiction.

**AND WHEREAS** LMEC has agreed to the respective terms and conditions as set out in Schedule "A" to this order;

**AND WHEREAS** based on the Application and the representations that LMEC has made to the Commission, the Commission has determined that granting an order to exempt LMEC from the requirement to be recognized as a clearing agency would not be prejudicial to the public interest;

**AND WHEREAS** LMEC has acknowledged to the Commission that the scope of and the terms and conditions imposed by the Commission attached hereto as Schedule "A" to this order, or the determination whether it is appropriate that LMEC continue to be exempted from the requirement to be recognized as a clearing agency, may change as a result of the Commission's monitoring of developments in international and domestic capital markets, LMEC's activities, or as a result of any changes to the laws in Ontario affecting trading in or clearing and settlement of derivatives or securities;

**IT IS HEREBY ORDERED** by the Commission that pursuant to section 147 of the OSA, LMEC is exempt from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA;

**PROVIDED THAT** LMEC complies with the terms and conditions attached hereto as Schedule "A".

**DATED** this [•] day of [•], 2018.

## SCHEDULE "A"

### Terms and Conditions

Definitions:

For the purposes of this Schedule "A":

"client clearing" means the ability of a Clearing Member to clear transactions on LMEC for and on behalf of a client.

Unless the context requires otherwise, other terms used in this Schedule "A" shall have the meanings ascribed to them in Ontario securities law (including terms defined elsewhere in this order).

#### COMPLIANCE WITH ONTARIO LAW

1. LMEC will comply with Ontario securities law (as defined in the OSA) and, where applicable, Ontario commodity futures law (as defined in the *Commodity Futures Act* (Ontario)).

#### SCOPE OF PERMITTED CLEARING SERVICES IN ONTARIO

2. LMEC's activities in Ontario will be limited to the clearing of transactions described in paragraph 1.22 of LMEC's representations set out above in this order.

#### REGULATION OF LMEC

3. LMEC will maintain its status as a CCP under EMIR and FSMA or any comparable successor legislation and will continue to be subject to the regulatory oversight of the Bank or any successor supervisory authority.
4. LMEC will continue to comply with its ongoing regulatory requirements as a CCP under EMIR and FSMA or any comparable successor legislation and with the ongoing regulatory requirements of the Bank or any successor supervisory authority.

#### GOVERNANCE

5. LMEC will promote within LMEC a governance structure that minimizes the potential for any conflict of interest between LMEC and its shareholders that could adversely affect the clearing services permitted under this order or the effectiveness of LMEC's risk management policies, controls and standards.

#### FILING REQUIREMENTS

##### Filings with the Bank

6. LMEC will provide staff of the Commission the following information to the extent that it is required to provide or to file such information with the Bank or its successor:
  - (a) details of any material legal proceeding instituted against LMEC;
  - (b) notification that LMEC has failed to comply with an undisputed obligation to pay money or deliver property to a Clearing Member for a period of thirty days after receiving notice from the Clearing Member of LMEC's past due obligation;
  - (c) notification that LMEC has instituted a petition for a judgment of bankruptcy or insolvency or similar relief, or to wind up or liquidate LMEC or has a proceeding for any such petition instituted against it;
  - (d) notification that LMEC has initiated its recovery plan;
  - (e) the appointment of a receiver or the making of any voluntary arrangement with creditors;
  - (f) the entering of LMEC into any resolution regime or the placing of LMEC into resolution by a resolution authority;
  - (g) material changes to its bylaws and rules where such changes would impact the services permitted by this order to be used by Ontario residents (whether as a Clearing Member or otherwise); and

- (h) new services or clearing of new types of products to be offered to a Clearing Member having a head office or principal place of business in Ontario (Ontario Clearing Member) or services or products that will no longer be available to an Ontario Clearing Member.

**Prompt Notice**

- 7. LMEC will promptly notify staff of the Commission of any of the following:
  - (a) any material change or proposed material change to LMEC's status as a CCP under EMIR or FSMA or in its regulatory oversight by the Bank.
  - (b) any material problems with the clearing and settlement of transactions that could materially affect the safety and soundness of LMEC;
  - (c) the admission of any new Ontario Clearing Members;
  - (d) any event of default by, or removal of the ability to clear transactions through LMEC of, any Ontario Clearing Member; and
  - (e) any system failure, malfunction or delay, or security incident, at LMEC that is material and that affects an Ontario Clearing Member including cybersecurity incidents.

**Quarterly Reporting**

- 8. LMEC will maintain and submit the following information to the Commission in a manner and form acceptable to the Commission on a quarterly basis within 30 days of the end of each calendar quarter, and at any time promptly upon the request of staff of the Commission:
  - (a) current list of all Ontario Clearing Members with their corresponding legal entity identifier (**LEI**), if any;
  - (b) a list of all Ontario Clearing Members against whom disciplinary or legal action has been taken in the quarter by LMEC with respect to activities at LMEC, or to the best of LMEC's knowledge, by any other authority that has or may have jurisdiction with respect to the relevant Ontario Clearing Member's clearing activities at LMEC;
  - (c) a list of all investigations by LMEC in the quarter relating to Ontario Clearing Members;
  - (d) a list of all Ontario-resident applicants who have been denied Clearing Member status in the quarter by LMEC;
  - (e) quantitative information in respect of the services used by Ontario Clearing Members for transactions in the asset classes listed in paragraph 1.22 of LMEC's representations set out above in this order, including in particular the following:
    - (i) as at the end of the quarter, level, maximum and average daily open interest, number of transactions and notional value of transactions cleared during the quarter for each Ontario Clearing Member;
    - (ii) the percentage of end of quarter level and average daily open interest, number of transactions and the notional value cleared during the quarter for all Clearing Members that represents the end of quarter and average daily open interest, number of transactions and the notional value of transactions cleared during the quarter for each Ontario Clearing Member;
    - (iii) the aggregate initial margin amount required by LMEC ending on the last trading day during the quarter for each Ontario Clearing Member;
    - (iv) the portion of the initial margin required by LMEC ending on the last trading day of the quarter for all Clearing Members that represents the initial margin required during the quarter for each Ontario Clearing Member; and
    - (v) the aggregate total margin amount required by LMEC ending on the last trading day during the quarter for each Ontario Clearing Member;
  - (f) the default fund contribution, for each Ontario Clearing Member on the last trading day during the quarter, and its proportion to the total default fund contributions;

- (g) if known to LMEC, for each Clearing Member (identified by LEI) offering client clearing to an Ontario resident that seeks to clear transactions through such Clearing Member, the identity of the Ontario resident client (including LEI, if any) receiving such services, and the value and volume cleared by asset class or transaction type during the quarter for and on behalf of each Ontario resident client;
- (h) a summary of the risk management analysis related to the adequacy of LMEC's default funds, including but not limited to stress testing and backtesting results; and
- (i) a copy of all circulars published during the quarter that describe and show changes to the LMEC Rules made during the quarter.

**INFORMATION SHARING**

- 9. LMEC will promptly provide such information as may be requested from time to time by, and otherwise cooperate with, the Commission or its staff, subject to any applicable privacy or other laws that would prevent the sharing of such information and subject to the application of solicitor-client privilege.
- 10. Unless otherwise prohibited under applicable law, LMEC will share information relating to regulatory and enforcement matters and otherwise cooperate with other recognized and exempt clearing agencies on such matters, as appropriate.

13.3.2 Notice and Request for Comment – Application by The London Metal Exchange for Exemption from Recognition and Registration as an Exchange and Related Registration Relief

NOTICE AND REQUEST FOR COMMENT

APPLICATION BY  
THE LONDON METAL EXCHANGE FOR  
EXEMPTION FROM RECOGNITION AND REGISTRATION AS  
AN EXCHANGE AND RELATED REGISTRATION RELIEF

**A. Background**

The London Metal Exchange (**LME**) has applied to the Commission for an exemption from the requirement to be registered as an exchange pursuant to section 15 of the *Commodity Futures Act* (Ontario) (**CFA**), and the requirement to be recognized as an exchange pursuant to section 21 of the *Securities Act* (Ontario) (**OSA**).

LME is regulated as a Recognised Investment Exchange (**RIE**) by the UK Financial Conduct Authority (**FCA**), pursuant to the UK *Financial Services and Markets Act 2000* (**FSMA**). As a RIE, LME facilitates the trading in futures and options contracts in base and precious metals (**LME Contracts**).

LME proposes to offer direct access in Ontario to its trading facilities to prospective participants in Ontario (**Ontario Participants**).

As LME will be carrying on business in Ontario, it is required to be recognized as an exchange under the OSA and registered as a commodity futures exchange under the CFA or apply for exemptions from both requirements. LME has applied for an exemption from the registration and recognition requirements on the basis that it is already subject to regulatory oversight by the FCA.

**B. Related Relief**

LME intends to provide direct access to its trading facilities to Ontario Participants who will be certain Canadian financial institutions and certain other market participants that have a head office or principal place of business in Ontario, such as banks listed in Schedule I of the *Bank Act* (Canada) (**Banks**).

LME is requesting exemptive relief from the registration requirements under section 22 of the CFA for trades in LME Contracts by Ontario Participants, including Banks entering orders as principal and for only their own account, and “hedgers”, as defined in subsection 1(1) of the CFA (**Hedgers**).

**C. Application and Draft Exemption Order**

In the application, LME has outlined how it meets the criteria for exemption from recognition and from registration. The specific criteria can be found in Appendix 1 of the draft exemption order. Subject to comments received, Staff intends to recommend that the Commission grant an exemption order with terms and conditions based on the draft exemption order. The application and draft exemption order are attached as Appendices A and B, respectively, to this Notice.

**D. Comment Process**

The Commission is publishing for public comment LME’s application and the draft exemption order. We are seeking comment on all aspects of the application and draft exemption order.

Please provide your comments in writing, via e-mail, on or before **December 7, 2018**, to the attention of:

Ontario Securities Commission  
20 Queen Street West  
22nd Floor  
Toronto, Ontario M5H 3S8  
Fax: 416-593-2318  
Email: [comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)

The confidentiality of submissions cannot be maintained as the comment letters and a summary of written comments received during the comment period will be published.

Questions may be referred to:

Christopher Byers  
Senior Legal Counsel, Market Regulation  
email: [cbyers@osc.gov.on.ca](mailto:cbyers@osc.gov.on.ca)

Alina Bazavan  
Senior Analyst, Market Regulation  
email: [abazavan@osc.gov.on.ca](mailto:abazavan@osc.gov.on.ca)

APPENDIX A



5 October 2018

Ontario Securities Commission  
20 Queen Street West  
22nd Floor  
Toronto, ON M5H 3S8

Attention: Secretary to the Commission

Dear Sirs/Mesdames:

**RE: The London Metal Exchange Application for Exemption from Recognition as an Exchange and Registration as a Commodity Futures Exchange**

We are filing this application with the Ontario Securities Commission (**OSC**) for the following decisions (collectively, the **Requested Relief**):

1. An order under Section 147 of the *Securities Act* (Ontario) (**OSA**) exempting London Metal Exchange (the **Exchange** or the **LME**) from the requirement to be recognized as an exchange under Section 21(1) of the OSA (the **OSA Relief**);
2. An order under Section 80 of the *Commodity Futures Act* (Ontario) (CFA) exempting the LME from the requirement to be registered as a commodity futures exchange under Section 15(1) of the CFA (together with the OSA Relief, the **Exchange Relief**);
3. An order under Section 38 of the CFA exempting trades in contracts on the LME by a “hedger”, as defined in subsection 1(1) of the CFA (**Hedger Relief**) from the registration requirements under Section 22 of the CFA (**Hedger Relief**); and
4. an order under Section 38 of the CFA exempting trades in contracts on the LME by a bank listed in Schedule I to the *Bank Act* (Canada) (**Bank**) entering orders as principal and for its own account only from the registration requirement under Section 22 of the CFA (**Bank Relief** and, together with the Hedger Relief, **Registration Relief**).

OSC Staff has prescribed criteria in OSC Staff Notice 21-702 *Regulatory Approach for Foreign Based Stock Exchanges*, as updated, (**Staff Notice 21-702**) in relation to applications by foreign exchanges for an exemption from the exchange recognition requirement and for applications by foreign-based commodity futures exchanges for an exemption from the exchange registration requirement. These criteria are set out in Appendix A to the attached draft order.

Reference will be made in this application to the LME Rules and Regulations and Appendices thereto (the **LME Rules**) which can be found at:

<https://www.lme.com/About/Regulation/Rules/Rulebook>

For convenience, this Application is divided into the following Parts:

Part I Background

Part II Application of Approval Criteria to the Exchange

1. Regulation of the Exchange
2. Governance
3. Regulation of Products
4. Access
5. Regulation of Participants on the Exchange
6. Rulemaking
7. Due Process
8. Clearing and Settlement
9. Systems and Technology

10. Financial Viability
11. Transparency
12. Record Keeping
13. Outsourcing
14. Fees
15. Information Sharing and Oversight Arrangements
16. IOSCO Principles

Part III Submissions

Part IV Other Matters

**Part I Background**

**Description of the LME and its business**

1. The LME is a private company registered in England and Wales (registered number 2128666) whose registered office is at 10 Finsbury Square, London, EC2A 1AJ, United Kingdom (**UK**).
2. The LME is the world centre for industrial metals trading and price-risk management. The majority of all global non-ferrous trading business is conducted on the LME and the prices discovered on the Exchange's three trading platforms are used as global reference prices. In 2017 this equated to US \$12.7 trillion notional, 3.5 billion tonnes of metal and over 157 million lots.
3. The primary functions of the Exchange are to:
  - (a) provide a market where participants have the opportunity to hedge against risk arising from price fluctuations in metals;
  - (b) determine reference prices for the worldwide pricing of trades relating to non-ferrous base metals and steel; and
  - (c) regulate appropriately located storage facilities to enable market participants to make or take physical delivery of approved metal brands, which are traded on the Exchange.
4. LME operates and regulates a trusted financial market where there is always a buyer and a seller, where there is always a price and where there is always the opportunity to transfer or assume exposure to a risk. The LME does not conduct any trading on its own account.
5. Founded in 1877, the LME operates futures and options markets in thirteen industrial, base metals. Copper and tin have been traded on the Exchange since 1877; lead was introduced in 1903, zinc in 1915, primary aluminium in 1978 and nickel in 1979. The two grades of aluminium alloy (aluminium alloy for Europe and NASAAC for North America) were introduced in 1992 and 2002 respectively. In 2008, the LME launched two regional contracts for steel billet; in July 2010, these contracts merged into a single global contract. Cobalt and Molybdenum were launched in 2010. Ferrous metal contracts in cash settled steel scrap, cash settled steel rebar and four regional aluminium premium contracts, were launched in 2015. The most recent contracts are loco London precious metals contracts, LME Gold and LME Silver futures launched in 2017.
6. The LME may technically be described as an on-exchange forwards market. LME contracts are based on physical settlement by the transfer of ownership of metal stored in listed warehouses; this guarantees price convergence as the far futures settlement dates converge on the cash settlement date (i.e. two days forward). The ability to make or take delivery of metal against an LME futures contract on the settlement date acts to prevent any divergence between LME settlement price and the physical metal price.
7. Trading on the LME can take place on any one of the following three venues.
  - (a) Open Outcry: The LME trading floor (known as the **Ring**) is located in London. Ring trading is conducted by open outcry, during specified morning and afternoon sessions.
  - (b) Inter-Office Market: Inter-office trading is the bi-lateral trading of LME contracts, usually by telephone. Unlike ring trading, it can take place 24 hours a day. While only Cleared Contracts are traded in the Ring, both Cleared Contracts and Client Contracts are traded inter-office. Like ring trading, inter-office trading takes place on a 'quote driven' basis, with dealers providing bids and offers over the phone.

- (c) LMEselect: Category 1 and Category 2 Members<sup>1</sup> who have specific permission from LME may trade Cleared Contracts via LME's electronic trading system (**LMEselect**). It is expected that certain of LME's Members will wish to trade via LMEselect through persons who are physically located in Ontario<sup>2</sup> and that certain Ontario incorporated entities may wish to become Members of the LME.
8. Settlement of LME futures contracts is determined first by offsetting the positions of Members and then by delivery of LME warrants to balance the trading activities of the Members. This takes place on the settlement date such that ownership of the underlying metal changes hands on the day; there is no settlement window. The offset mechanism allows the Members who trade on the LME to reduce the number of LME warrants that are transferred in order to settle their obligations on a settlement day. For example a producer who hedges its risk to a drop in metal prices will sell for delivery on a future date on the LME. It will close out its hedge by buying back an equal amount of metal for delivery on the same date on the LME. The metal delivery obligations will offset exactly and result in no LME warrants changing hands but the price differences will produce a net cash payment on that date.
9. An LME warrant is a bearer document that represents the ownership of a specific number of tonnes of an identified brand of metal, stored in an identified shed (facility in a particular warehouse) operated by an LME approved warehouse company. The LME oversees and controls metal brand listing and warehouse approval because the quality and availability of metal stored in LME approved warehouses underpins the integrity of trading and price discovery.
10. The LME proposes to offer access its trading services and clearing services to prospective participants in Ontario. In order to obtain direct access to the Exchange, a prospective member in Ontario must execute a membership agreement in which the prospective member agrees to abide by the LME Rules and consent to submit to the jurisdiction of the Exchange. Prospective members and other participants in Ontario who are currently or will in the future be admitted by LME (**Ontario Participants**) may access the LME via LMEselect and the Inter-Office Market from Ontario, and may also apply to become ring-dealing Members if they wish. The LME Rules provide clear and transparent access criteria and requirements for all LME market participants, as well as minimum financial requirements for participants to maintain the financial integrity of the Exchange. The LME applies these criteria to all LME participants in an impartial manner.

#### Descriptions of categories of LME membership

11. LME has seven membership categories and each member category has different associated capabilities, obligations and responsibilities. Only Categories 1 to 4 have any trading rights and are eligible to have direct access to LMEselect. A summary of the membership categories is set out below:
- (a) Category 1: These members have the exclusive right to trade Cleared Contracts by open outcry in the Ring, on the telephone (i.e. inter-office) market and on LMEselect and are entitled to issue Client Contracts to their clients. As Clearing Members, they are permitted to clear trades on their own behalf and on behalf of their clients and, as a result, must be members of LME Clear. Category 1 Members must be regulated by the Financial Conduct Authority (**FCA**).
- (b) Category 2: These members are Clearing Members and are permitted to trade Cleared Contracts in the telephone market and on LMEselect and issue Client Contracts. As Clearing Members, they are permitted to clear trades on their behalf and on behalf of their customers and, as a result, must be members of LME Clear. Category 2 members must be regulated by the FCA, a competent authority of an EEA State or benefit from an exclusion under the Financial Services and Markets Act 2000 (Regulated Activities) Order (**RAO**) Article 72 such as qualifying as an Overseas Person i.e. an Unauthorised Overseas Participant.
- (c) Category 3: These members are Clearing Members and are permitted to trade Cleared Contracts in the telephone market and on LMEselect but are not permitted to issue Client Contracts, being proprietary traders. As Clearing Members, they are permitted to clear trades on their own behalf only and, as a result, must be members of LME Clear. Category 3 Members must be regulated by the FCA, a competent authority in an EEA state, or benefit from an exclusion under the RAO.
- (d) Category 4: These members are not Clearing Members and must appoint a designated Clearing Member to clear trades on their behalf. These members are permitted to trade Client Contracts in the telephone market and on LMEselect and are permitted to issue Client Contracts. Category 4 members may either be regulated by the FCA, a competent authority in an EEA State or benefit from an exclusion under the RAO such as qualifying as an Unauthorised Overseas Participant.

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<sup>1</sup> See section 11 for a description of the member categories.

<sup>2</sup> Such persons may be employed by the Member itself or may be employed by an affiliate, but all trading is carried out in the name of the Member.

- (e) Category 5: These members are customers of Category 1, 2 or 4 Members in that they receive Client Contracts but are not permitted to issue them. Category 5 members are not required to be regulated.
- (f) Category 6: Individual members are persons who wish to maintain links with the Exchange for business purposes, such as consultants and arbitrators. These members have no trading rights on LME.
- (g) Category 7: Honorary membership is conferred on individuals who have given conspicuous service to the LME at the discretion of the Exchange, e.g. former chief executives and chairmen of the LME. These members have no trading rights on the LME.

#### **Ontario Participants and Requested Relief**

- 12. The LME currently expects that Ontario Participants will be comprised of banks listed in Schedule 1 of the Bank Act (Canada) (**Ontario Banks**). The LME also services the physical market and other entities, such as industrial hedgers, may wish to join in the future.
- 13. LME intends to provide Ontario Participants with direct access to the LME. LME is requesting the Registration Relief and the Hedger Relief in order for Ontario Participants to be able to access trading on the LME directly, without having to be registered as dealers under the CFA in the case of the Registration Relief.

#### **Location**

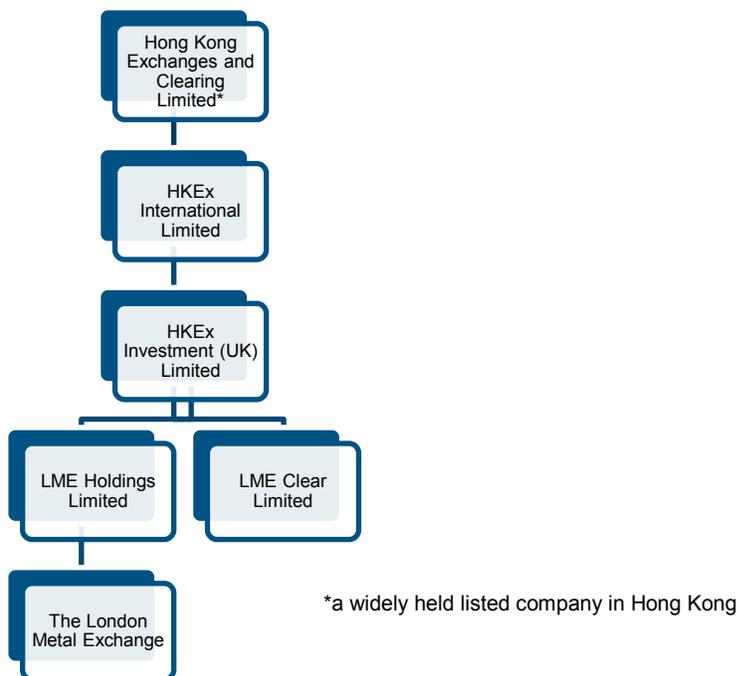
- 14. LME is based in London, England. It also had a representative office in Singapore which opened in 2010. Singapore limits the amount of time a representative office may be open. Accordingly, this office became a branch office on October 15, 2012.

#### **Size**

- 15. The LME is a highly liquid market and in 2017 achieved traded volumes of over 157 million lots, equivalent in value to US\$12.7 trillion notional. The LME is a global market with an international membership. More than 575 brands of metal from over 60 countries are approved as “good delivery” against LME contracts. There are over 550 LME approved warehouses in 14 countries and 34 locations globally.

#### **Ownership and corporate structure**

- 16. The LME is a wholly-owned subsidiary of LME Holdings Limited, a private limited company registered in England and Wales (registered number 4081218). LME Holdings Limited has no trading subsidiaries other than the LME. The LME has no subsidiaries.
- 17. LME Holdings Limited (the sole shareholder of LME) in turn is a wholly owned subsidiary of HKEx Investment (UK) Limited, which is a wholly owned subsidiary of HKEx International Limited (a private limited company) registered in Hong Kong. HKEx International Limited is wholly owned by Hong Kong Exchanges and Clearing Limited (**HKEX Group**), a publicly listed company registered in Hong Kong and listed on the Hong Kong stock exchange. The LME is managed by a board comprising independent directors, additional directors and LME’s Chief Executive Officer. Please see the organizational chart attached as Annex 1.
- 18. The following is a diagram of the chain of ownership of the LME and its affiliated clearing house, LME Clear Limited (**LME Clear**):



**LME Clear**

- 19. LME Clear was established to act as the central counterparty (**CCP**) in relation to all classes of contracts that are traded on the LME. LME Clear is an approved CCP under the European Market Infrastructure Regulation (**EMIR**) and is supervised by the Bank of England (the **Bank**) in the UK. LME Clear is also applying to the OSC for an exemption at this time.

**Products traded on the Exchange**

- 20. Futures contracts are contracts for delivery of a particular metal on a specified date (Prompt Date) of a prescribed quantity of metal, the specification for which is in accordance with LME's special contract rules (covering quality of material, its shape and weight, the size of each lot and the currency in which the price is quoted). The lot size for primary aluminium, copper, zinc and lead is 25 tonnes; for aluminium alloy and NASAAC, it is 20 tonnes; for nickel is 6 tonnes; for tin is 5 tonnes; for steel billet is 65 tonnes; for cobalt is 1 tonne; and for molybdenum is 6 tonnes. Futures contracts for metals are deliverable for all London business days out to 3 months (i.e. daily settlement). Other Prompt Dates at less frequent intervals are available out to 27 months and beyond this for certain metals up to a maximum of 10 years.
- 21. LME offers trading in futures contracts in the eleven metals listed in paragraph 5 above. In addition, LME offers:
  - (a) traded options contracts which give the right to buy or sell the underlying futures contracts for primary aluminium, copper, zinc, lead, nickel, tin, NASAAC, aluminium alloy and LMEX (see (iii) below) until a specified date in the future;
  - (b) contracts known as Traded Average Price Options which provide a hedging tool for participants in the metals industry that price contracts on the basis of a monthly average price;
  - (c) a contract known as the LMEX which is an index contract based on a basket of metals (this has not traded for a number of years but remains available to trade);
  - (d) mini-contracts in primary aluminium, copper and zinc;
  - (e) contracts known as Monthly Average Futures which are monthly average price futures contracts and are available for primary aluminium, aluminium alloy, copper, zinc, lead, nickel, NASAAC and tin; and

- (f) daily and monthly futures contracts for both gold and silver, known as LMEprecious.
22. Traded options contracts give the right to buy or sell the underlying futures contracts for all LME metals. They are traditional 'American' style options (options that may be exercised on any day in its life) and can be purchased against a short or long futures contract.
23. Traded Average Price Options provide a hedging tool for participants in the metals industry that price contracts on the basis of a monthly average price. Traded Average Price Options are 'Asian' style options (options exercised at the average underlying price over a period) giving the right to buy or the right to sell metal at the average LME price for a given month.
24. The LMEX is an index contract based on the index weighted values of copper, primary aluminium, zinc, nickel, tin and lead, as traded on the LME. Only futures are available on the index as options were suspended in April 2013.
25. LMEminis are smaller contracts traded in lots of five. Unlike other LME products, the LMEX and LMEminis are cash cleared.
26. Monthly Average Futures are monthly futures contracts settled in cash against the monthly average of the daily cash settlement price of the relevant metal during the relevant month. The amount payable on maturity is the difference between the 'fixed' price agreed at the time of the contract and the average price for the relevant month.

### LME Contracts

27. All LME contracts (i.e. contracts under which metal is traded in accordance with the LME Rules) are entered into on a principal to principal basis. Regulation 1.4 of Part 3 of the LME Rules specifies that LME contracts may only be written by a Category 1 Member, Category 2 Member or Category 4 Member (each of which are brokers regulated by the FCA), the effect of which being that all LME contracts will have at least one party being a Member of LME. Members who enter into LME contracts therefore deal off their own book, entering into an equivalent contract with customers for whom they are acting. In addition, the Members will typically have entered into a separate contractual arrangement with their customers setting out the basis on which trades will be executed on the instructions of customers.
28. LME contracts take one of two forms: Cleared Contracts and Client Contracts. Participants located in Ontario will be able to be trade through LMEselect and access the Inter-office market and trade on the Ring<sup>3</sup> (provided that the relevant membership requirements are met).
29. LME operates an open offer model under which Contingent Agreements to Trade on the exchange result in Cleared Contracts at the CCP. These terms are defined in the LME Rules. Cleared Contracts are contracts between LME Clear, as the CCP, and the buyer and seller, as the case may be. There will be no initial contract between the trading parties. Instead LME Clear makes an offer to each party to the trade: it will offer to act as the buyer to the party who wishes to be the seller, and it will offer to act as the seller to the party who wishes to be the buyer.
30. Client Contracts are contracts between a Member entitled to handle customer business and its customers. These contracts are not made with LME Clear and therefore the contractual obligations remain with the original parties. Members are required to enter details into the LME's matching system (**LMESmart**) and contracts arise between either the Clearing Member and the CCP or the Member and the Client. However Clearing Members are not obliged to enter into a trade with another Clearing Member to "back off" the Client Contract. Failure to enter trades into matching could result in disciplinary action by the LME.
31. The LME Rules provide that any dispute as to the existence, completion or validity of any LME contract, as well as any dispute arising out of such a contract, will be referred to arbitration proceedings administered by LME. Parties entering into LME contracts are deemed to waive any immunity from suit or arbitration or the execution of any judgment or award on the ground of sovereignty, nationality, domicile, residence or otherwise.

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<sup>3</sup> Given that Ring trading takes place physically in London on the LME trading floor, the only way that an Ontario participant could take part in Ring trading would be if an Ontario-incorporated entity established a London presence and became a Category 1 member.

**Part II Application of Approval Criteria to the Exchange**

**1 REGULATION OF THE LME**

**1.1 Regulation of the Exchange – The exchange is regulated in an appropriate manner in another jurisdiction by a foreign regulator (the Foreign Regulator).**

1.1.1 The LME is subject to a comprehensive regulatory regime in the UK and Europe and is a Recognised Investment Exchange (**RIE**) regulated by the Financial Conduct Authority (**FCA**). This regulatory structure includes: financial and other fitness criteria for Members of LME; reporting and record-keeping requirements; procedures governing the treatment of customer funds and property; conduct of business standards; provisions designed to protect the integrity of the markets; and statutory prohibitions on fraud, abuse and market manipulation.

1.1.2 Responsibility for financial services legislation and broad policy in the UK lies with Her Majesty's Treasury, which is answerable to UK's Parliament. Responsibility for regulating the conduct of investment business, providing investor protection and preventing market manipulation in the UK rests with the FCA, the successor to the Financial Services Authority (**FSA**) which became responsible for the supervision of UK RIEs on April 1, 2013 as part of the UK's program of regulatory reform. Additional authority rests with the UK's Department for Business, Energy and Industrial Strategy which is responsible for modernising company law and reforming corporate governance and investigates the conduct of companies and the Serious Fraud Office, which investigates and prosecutes serious and complex fraud, bribery and corruption and so maintains confidence in the probity of business and financial services in the UK. The Prudential Regulatory Authority, created as a part of the Bank by the *Financial Services Act 2012*, is responsible for the prudential regulation and supervision of around 1,700 banks, building societies, credit unions, insurers and major investment firms. It does not have authority in relation to RIEs.

1.1.3 The principal legal provisions for investor protection in the UK's financial services sector are contained in, or derived from, the UK *Financial Services and Markets Act 2000 (FSMA)* and the FCA fulfils its regulatory responsibilities within the framework established by FSMA and related legislation.

1.1.4 The FCA is an independent non-governmental body, given statutory powers by FSMA. It is a company limited by guarantee (registered in England and Wales with number 1920623) whose registered office is at 12 Endeavour Square, London, England, E20 1JN.

1.1.5 As a non-governmental body, the FCA is operationally independent of government. It is accountable to the ministers within Her Majesty's Treasury and through the Ministers in this department, to UK's Parliament. It is also subject to the scrutiny of the National Audit Office, Treasury Select Committee and Parliamentary Accounts Committee.

1.1.6 The board of the FCA sets its overall policy. Board members are appointed by the Treasury. The majority of the board members are non-executive. The non-executive directors check that the FCA operates efficiently and economically. They oversee the FCA's mechanisms of financial control and set the pay of the executive members of the board.

1.1.7 General strategic and policy matter decisions are taken by the FCA board and/or its Executive Committee. Other major regulatory decisions (including appeals in respect of disciplinary matters and warning) are taken, on behalf of the FCA board, by the Regulatory Decisions Committee which comprises current and recently retired practitioners and non-practitioners, all of whom represent the public interest.

1.1.8 The FCA has an objective to promote effective competition in consumers' interests in regulated financial services. In addition to this, the organisation also has a competition duty. In April 2015, the FCA were given concurrent powers to enforce against breaches of competition law, alongside the Competition and Markets Authority for the provision of financial services generally.

1.1.9 The FCA is an independent body which does not receive any funding from Her Majesty's Government. To finance its work, the FCA charges fees to the entities that it regulates, including the LME.

1.1.10 The general powers of the FCA to raise these fees are set out in Schedule 1, Part III, paragraph 17 of FSMA. FSMA also gives the FCA the power to maintain sufficient reserves. In the latest annual report of the FCA, anticipated funding for 2017/18 is £508m as set out in the FCA's Business Plan a copy of which can be found at:

<https://www.fca.org.uk/publications/corporate-documents/our-business-plan-2017-18>.

1.1.11 The FCA currently has staff costs of £316.8m rising to £324.2 for 2017/18. Staffing represents the highest cost to the FCA.

- 1.2 **Authority of the Foreign Regulator – The Foreign Regulator has the appropriate authority and procedures for oversight of the exchange. This includes regular, periodic oversight reviews of the exchange by the Foreign Regulator.**

**Scope of authority**

- 1.2.1 The FCA has three specific, and equal, operational objectives set by UK's Parliament. These are to: secure an appropriate degree of protection for consumers; protect and enhance the integrity of the UK financial system; and promote effective competition in the interests of consumers. In practice, this means that the FCA wants to make markets work effectively to deliver benefits to firms and consumers.
- 1.2.2 The FCA regulates some 73,000 businesses. The firms range from global investment banks to very small businesses. It operates a risk-based approach concentrating on the significant risks and accepting that some failure neither can, nor should, be avoided. Potential risks are prioritized, using an impact and probability analysis, and the FCA will then decide on an appropriate regulatory response – in other words, what approach it should take and what resources it will allocate to mitigating risk.
- 1.2.3 The FCA's risk-based regulatory approach to the supervision of exchanges includes regular risk assessments designed to identify the main risks to its statutory objectives as they arise and to help it plan how to address these risks. This process involves drawing on a wide range of sources. The FCA uses this information to assess the level of risk posed to its statutory objectives and to decide on what approach is needed (if any) to mitigate risk.

**Authorizing statutes**

- 1.2.4 The FCA was created by the *Financial Services Act 2012* which amended FSMA, the primary piece of legislation from which it derives its powers and functions. Rules and guidance made in the FCA Sourcebook for Recognised Investment Exchanges (**REC**) are made pursuant to powers granted under FSMA.
- 1.2.5 Her Majesty's Treasury has the power to enact secondary legislation under FSMA, which affects the way the FCA operates. The most important piece of secondary legislation is the Financial Services and Markets Act (Regulated Activities) Order 2001 (**RAO**). The RAO sets out the specific activities for which firms must receive FCA permission (known as a Part IV permission) to carry on investment business, or where they can avail themselves of an exemption or exclusion, as the case may be.
- 1.2.6 The FCA is the designated competent authority under the European single market directives for banking, insurance, investment business, payment services, collective investment schemes and other financial services, including insurance intermediation. It is also the competent authority under many other EU directives, including the Market Abuse and Prospectus Directives. As a result, it is the UK representative within the relevant EU regulatory bodies such as the European Securities and Markets Authority. European legislation affecting the FCA in regulated financial services is implemented through the FCA Handbook and/or Her Majesty's Treasury regulations.
- 1.2.7 Other main areas of FCA regulation include personal pension schemes and activities relating to regulated mortgage contracts. It has authorisation, enforcement, supervision and rule-making functions for firms (some prudential supervision is now undertaken by a subsidiary of the Bank, the Prudential Regulation Authority (**PRA**)). It also has registration functions under the various legislation applicable to mutual societies and related functions under other legislation applicable to financial services and listing. FSMA also provides the FCA with powers over unregulated firms and persons regarding market abuse, breaches of money laundering regulations and short selling. The FCA also has the power to prosecute unauthorized firms or persons carrying on regulated activities.

**Source of its authority to supervise the foreign exchange**

- 1.2.8 LME is an RIE in accordance with section 285 of FSMA. As an RIE, LME is exempt from the general prohibition in respect of any "regulated activity" which is carried on as part of LME's business as an investment exchange.
- 1.2.9 To acquire and maintain recognition status as an RIE, LME must satisfy several statutorily-prescribed recognition requirements set out in the Financial Services and Markets Act 2000 (FSMA Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 (SI 2001/995) as amended by the Financial Services and Markets Act 2000 (FSMA Recognition Requirements for Investment Exchanges and Clearing Houses) (Amendment) (Regulations) 2006 (the **FSMA Recognition Requirements**). The FSMA Recognition Requirements for RIEs can be found at: <https://www.handbook.fca.org.uk/handbook/REC/2.pdf>.

- 1.2.10 LME must continue to fulfil these obligations to maintain its recognition status. Among other things, LME is required to:
- (a) have systems and controls in place to monitor transactions on the LME;
  - (b) retain sufficient financial resources for the performance of its functions as an RIE;
  - (c) operate its markets with due heed to the protection of investors;
  - (d) ensure that trading is conducted in an orderly and fair manner;
  - (e) maintain suitable arrangements for trade reporting;
  - (f) maintain suitable arrangements for the clearing and settlement of contracts;
  - (g) monitor compliance with the LME Rules;
  - (h) enforce the LME Rules;
  - (i) investigate complaints with respect to its business;
  - (j) maintain rules to deal with the default of its Members;
  - (k) co-operate with other regulatory bodies through the sharing of information or otherwise;
  - (l) maintain high standards of integrity and fair dealing; and
  - (m) prevent abuse.
- 1.2.11 On 25 April 1988, the FCA's predecessor organization, the Securities and Investments Board, declared The LME (under its former name, The London Metal Exchange Limited) to be an RIE. The recognition status of RIEs that were recognised by predecessor organizations was grandfathered when the FCA was established in 2013. LME remains compliant with the FSMA Recognition Requirements as demonstrated by its continued status as an RIE. As an RIE, the LME is also a regulated market under the Markets in Financial Instruments (MiFID II) - Directive 2014/65/EU FCA, which has been implemented directly into UK law and applies to RIEs. The FCA is responsible for maintaining the list of regulated markets for which the UK is the Home Member State, which is contained at
- [https://register.fca.org.uk/shpo\\_searchresultspage?preDefined=RM&TOKEN=3wq1nht7eg7tr](https://register.fca.org.uk/shpo_searchresultspage?preDefined=RM&TOKEN=3wq1nht7eg7tr)
- This lists LME as a regulated market. A market may ask to be added to the list of regulated markets if it satisfies the requirements set out in Title III of MiFID. The relevant requirements of Title III of MiFID II have been incorporated directly into the FSMA Recognition Requirements.
- 1.2.12 The FCA has provided guidance on the FSMA Recognition Requirements in its Handbook that sets out the FCA's interpretation of how those obligations might be met in practical terms.
- 1.2.13 The FCA is the authority charged with ensuring that RIEs (such as the LME) continue to comply with the recognition criteria. The FCA has the power to direct any RIE that is failing, or had failed, to comply with the FSMA Recognition Requirements to take action to remedy such non-compliance. It also has the power to censure and /or to revoke the recognition of any RIE that fails to meet the FSMA Recognition Requirements. Accordingly, the LME is subject to the oversight of the FCA.
- 1.2.14 The FCA exercises its supervisory responsibility by conducting an ongoing assessment of whether the LME's rules, procedures and practices are adequate for the protection of investors and for the maintenance of an orderly market in accordance with the FSMA Recognition Requirements (**REC**). For this purpose, the FCA requires LME to report to it, among other things, financial information and changes in its constitution (see REC 3 of the FCA Handbook (<https://www.handbook.fca.org.uk/handbook/REC/3/?view=chapter>)). Further, LME is required to notify the FCA of all rule changes and keeps the FCA notified of significant changes to its rules or procedures before such changes become effective.
- 1.2.15 The formal interaction structure between LME and FCA includes:
- (a) monthly meetings between the FCA and the LME Market Operations department;

- (b) quarterly meetings between the FCA and the LME Head of Compliance;
- (c) quarterly meetings between the FCA and the LME physical operations department;
- (d) half-yearly meetings between the FCA and the LME Business Development department;
- (e) half-yearly meetings between the FCA and the LME Head of IT;
- (f) annual meetings between the FCA and the LME Finance department;
- (g) annual meetings between the FCA and the LME Head of Risk;
- (h) annual meetings between the FCA and the Head of Internal Audit;
- (i) half-yearly meetings between the FCA and the LME Chief Executive Officer;
- (j) half-yearly meetings between the FCA and the Chairman of LME; and
- (k) annual meetings between the FCA and the independent board directors. Informally there are frequent ad hoc contacts between the FCA and the LME. In addition to the LME's formal obligations to notify the FCA, LME consults with the FCA on all material matters.

#### **Rules and policy statements**

- 1.2.16 The FCA Handbook is the primary source of rules and policy statements issued by the FCA with respect to the authorisation and continuing oversight of markets, electronic trading systems and clearing organizations. A copy of the full FCA Handbook is available at <https://www.handbook.fca.org.uk/handbook/>. The key rules and policy statements relevant to LME are set out in the FCA's REC Sourcebook.

#### **Financial protections afforded to customer funds**

- 1.2.17 The FCA (and other home state regulators in jurisdictions where LME has access) are responsible for regulating the financial soundness and conduct of Members' business.
- 1.2.18 The Client Asset (**CASS**) section of the FCA Handbook sets out the requirements on authorized firms in relation to customer funds. These include requirements such as segregation of customer funds from a firm's own funds and the rules around the distribution of client money in the event that an authorized firm (or third party who holds money on behalf of an authorised firm) fails.

#### **Authorization, licensure or registration of the foreign exchange**

- 1.2.19 LME has a statutory obligation to ensure that business conducted by means of its facilities is conducted in an orderly manner and so as to afford proper protection to investors. Failure to comply with this obligation may mean that LME ceases to be an RIE and therefore ceases to be allowed to operate an exchange under FSMA (and therefore also operate as a regulated market under MiFID II).
- 1.2.20 The FCA expects the Audit & Risk Committee of the LME, on behalf of the LME Board, to satisfy itself formally on an annual basis that the LME continues to meet its requirements as a RIE. In order to assist the Audit & Risk Committee in this process, a checklist has been developed, listing all of the FSMA Recognition Requirements and, for each, identifying the systems, procedures and policies in place to demonstrate how each requirement has been met. The Executive Committee reviews and, if content, approves that LME continues to meet the FSMA Recognition Requirements. The Audit & Risk Committee does the same. The FSMA Recognition Requirements for RIEs can be found at: <https://www.handbook.fca.org.uk/handbook/REC/2.pdf>.

#### **1.3 The foreign regulator's approach to the detection and deterrence of abusive trading practices, market manipulation, and other unfair trading practices or disruptions of the market**

- 1.3.1 In the UK, the primary term used to describe abusive trading practices, market manipulation and other unfair trading practices or disruptions of the market is "market abuse". In December 2001 the provisions of FSMA relating to market abuse came into force. FSMA prohibited market abuse and gave the FCA the power to issue unlimited fines to penalise market abuse, subject to a right of appeal to the Upper Tribunal.

- 1.3.2 FSMA, as originally enacted, set out three types of market abuse: misuse of non-public material information, the creation of false or misleading market impressions and market distortion. FSMA required the FCA to publish a code describing behaviour which, in its opinion, amounts to market abuse and behaviour which does not (**Code of Market Conduct**). The Code of Market Conduct was implemented on December 1, 2001.
- 1.3.3 In addition to legislation originating from the UK, the LME is subject to EU legislation. The European Market Abuse Regulation (**MAR**) came into effect on 3 July 2016 with the aim of increasing market integrity, investor protection and enhancing the attractiveness of securities markets for capital raising. MAR strengthens the previous UK market abuse framework by extending its scope to new markets, new platforms and new behaviours. It contains prohibitions of insider dealing, unlawful disclosure of inside information and market manipulation, and provisions to prevent and detect these.
- 1.3.4 A key aspect of MAR requires trading venues, such as the LME, to report suspicious transactions and orders (**STORs**). A suspicious transaction or order is one where there are 'reasonable grounds' to suspect it might constitute market abuse.
- 1.3.5 For commodity derivatives, as traded on the LME, the major threat of market abuse is market manipulation. The steps the LME takes to ensure its markets are not easily manipulated are set out in section 5 below. The FCA can also independently enforce the prohibition on market abuse set out in FSMA and the Market Abuse Directive. In order to ensure there is no duplication of effort between LME and the FCA, the FCA has published operating arrangement guidelines which clarify how the LME and the FCA will co-ordinate and co-operate in preventing suspected market abuse.

**Laws, rules, regulations and policies that govern the authorization and ongoing supervision and oversight of market intermediaries in the UK**

- 1.3.6 The UK has a comprehensive financial services supervision regime. The laws, rules, regulations and policies that govern the authorization and ongoing supervision and oversight of market intermediaries are primarily set out in FSMA and the FCA Handbook.
- 1.3.7 Of the Members that have trading rights, and could therefore deal with customers located in Ontario, the vast majority are companies incorporated in England and Wales. Irrespective of the jurisdiction of incorporation, no Member may undertake any regulated activity in relation to the LME unless it is authorized by the FCA to carry on such regulated activity (see regulation 4.2 of Part 2 of the LME Rules). As a result, all of the trading Members of the LME must comply with FCA rules and are subject to the supervision and oversight of the FCA.
- 1.3.8 The FCA supervises firms according to the risks they present to its statutory objectives. It assesses risks in terms of their impact (the scale of the effect these risks will have on consumers and the market if they were to happen) and probability (the likelihood of the particular issue occurring). The nature and extent of its supervisory relationship with an individual firm depends on how much of a risk it considers that firm could pose to its statutory objectives.
- 1.3.9 Work is co-ordinated through a supervisor with a fixed portfolio of one or more firms that are deemed to carry some risk to the FCA's statutory objectives, who carry out a regular risk assessment (on a cycle of one to four years) and determines a risk mitigation program proportionate to the risks identified. The precise volume and type of work undertaken will depend on the size and riskiness of the firm concerned. Baseline monitoring activities are undertaken for each firm. This involves analysing a firm's financial and other returns, and checking compliance with notification requirements. Breaches and other indicators of risk may be followed up by the supervisory team. For high impact firms, a closer monitoring regime is used (called "close and continuous" work). This is essentially a planned schedule of visits to the firm throughout the regulatory period. This allows the supervisory team to meet the firm's senior management and control functions regularly, and understand and mitigate risk on a real time basis.
- 1.3.10 The FCA and OSC are party to a Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to the Supervision of Cross-Border Regulated Entities (**OSC-FCA MOU**) as shown on the OSC's website: [http://www.osc.gov.on.ca/en/About\\_mou\\_20130711\\_nmou-osc-asc-bcsc-uk-fca.htm](http://www.osc.gov.on.ca/en/About_mou_20130711_nmou-osc-asc-bcsc-uk-fca.htm).

**1.4 The protection of customer funds by market intermediaries who may deal with members and other participants located in Canada**

- 1.4.1 The UK has a comprehensive regime for the protection of client monies held by investment firms. The FCA's client money rules can be found in CASS Chapter 7 of the FCA Handbook. These rules implement the requirements of MiFID and Article 51 of European Union Directive 2006/73/EC.

**Procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk for market intermediaries who may deal with members and other participants located in Canada**

- 1.4.2 Cleared Contracts and Client Contracts are “market contracts” under the *Companies Act 1989*. As such, LME Clear and the LME deal with them under their respective default rules in the event of the default of a Member. LME Clear’s Rules and Procedures (the **LME Clear Rules**) apply to Cleared Contracts and the LME Rules apply to Client Contracts.
- 1.4.3 By virtue of section 159 of the *Companies Act 1989*, LME’s default rules, together with those of other recognized investment exchanges and recognized clearing houses (such as LME Clear), take precedence over normal UK insolvency procedures following a default by a Member under an LME contract. This provision is designed to safeguard the operation of the United Kingdom’s financial markets.
- 1.4.4 The default rules of LME are contained in Part 9 of the LME Rules and set out, among other things, the circumstances under which LME may declare a Member to be in default, the actions that LME may take in the event of a default, the type of resources that may be used to satisfy the defaulting Member’s obligations and the sequence in which such resources may be used.
- 1.4.5 Under the Rule 10 of the LME Clear Rules and the LME Clear Default Procedures, LME Clear has a range of options. LME Clear may allow contracts between the defaulting Member and LME Clear to settle or LME Clear can transfer them to another Clearing Member with the consent of the Client and the Member transferee. LME Clear may also conduct an auction of the Defaulting Member’s positions and may ultimately close out the positions themselves.
- 1.4.6 Following the administration of Lehman Brothers, the UK enacted legislation designed to improve UK insolvency law in relation to investment banks, subsequently extended to investment firms. This legislation is known as the Investment Bank Special Administration Regulations 2011 (**SAR**) and came into force in the UK on 8 February 2011. The SAR applies to investment banks which are defined in the *Banking Act 2009* as institutions which: (a) have permission under Part 4 of FSMA to carry on at least one of the following regulated activities: (i) safeguarding and administering investments; (ii) dealing in investments as principal; or (iii) dealing in investments as agent; (b) hold client assets (whether or not on trust); and (c) are incorporated or formed in the UK. SAR sets out specific measures designed to improve the timeliness of the return of client assets. It also requires the special administrator to work with market infrastructure operators (such as the LME and LME Clear).

## **2 GOVERNANCE**

### **2.1 Governance – The governance structure and governance arrangements of the exchange ensure:**

#### **(a) Effective oversight of LME,**

- 2.1.1 The governance structure of LME provides for a number of sub-committees, the majority of which report to the board of the LME either directly or through the Executive Committee (**EXCOM**).
- 2.1.2 **EXCOM:** EXCOM is a sub-committee of the board of directors of the LME (the **LME Board**). The LME Board has delegated the running of the day to day operations of the LME to EXCOM.
- 2.1.3 **Operational Committee:** The function of each of the Operational Committees (the metals committees, the Trading Committee, the Traded Options Committee, the Ring Dealers Committee and the Warehousing Committee) is to advise EXCOM in accordance with their terms of reference. These committees contribute to the good governance of the LME, the orderly operation of the market and a close understanding of its participants’ needs. The LME Board has delegated to EXCOM the initial consideration of those recommendations and the power to give effect to a number of those recommendations.
- 2.1.4 **Corporate Governance Committee:** The Audit & Risk Committee and Nomination Committee report directly to the LME Board. The LME User Committee was established to represent the interests and views of the Exchange’s stakeholders and also reports directly to the LME Board. In addition, the Physical Market Committee was established to represent the interests and views of the LME of the physical metals trade and industry and reports to the LME User Committee.
- 2.1.5 **Regulation and Enforcement Committees:** The Arbitration Panel Committee, the Special Committee, the Enforcement Committee and the Quotations Committee are established by the LME Rules. The LME Rules and the terms of reference for these committees set out the functions of these committees and identify those powers that the committees exercise on behalf of the LME Board.

Full details of LME committees and their terms of reference are contained at:

<https://www.lme.com/en-GB/About/Corporate-information/Committees#tabIndex=0>

**(b) The LME's business and regulatory decisions are in keeping with its public interest mandate,**

- 2.1.6 The Exchange provides the trading environment and regulates the market for the trading of its contracts. Approved as an RIE and a regulated market and conforming with UK and other international regulatory requirements, the LME offers, through price and volume transparency and audit trails, a legally safe forum for metals trading. As an RIE, the Exchange comes under the direct jurisdiction of the FCA.
- 2.1.7 The LME has a statutory requirement to ensure that business on its markets is conducted in an orderly manner, providing proper protection to investors. Regulation of the market is largely carried out by the LME, while the majority of members' business is regulated by the FCA or their home regulator.
- 2.1.8 Beyond this, both the LME and its members are subject to regulatory controls and input from various UK bodies and government offices, as well as EU directives. In international trading, rules applied by overseas regulatory bodies such as the US Commodity Futures Trading Commission (CFTC) also have to be taken into account.

**(c) fair, meaningful and diverse representation on the board of directors and any committees of the board of directors, including:**

**(i) appropriate representation of independent directors, and**

- 2.1.9 Best practice in the UK is set by the UK Corporate Governance Code, which requires large UK companies should have at least 50% independent representation on the LME Board. Though the LME is not considered to be a large company the LME complies with best practice and follows this principle. Five of the nine members of the LME Board are independent directors, including the Chairman. There are also extensive requirements relating to the management body of an RIE in the Recognition Requirements, which the LME must demonstrate to the FCA that it meets: see <https://www.handbook.fca.org.uk/handbook/REC/2/4A.html>.
- 2.1.10 Similarly the LME's Audit and Risk Committee and Nomination Committee are comprised of predominantly Independent Directors to ensure sufficient independent judgement on these Committees.

**(ii) a proper balance among the interests of the different persons or companies using the services and facilities of the exchange,**

- 2.1.11 The LME maintains close links with the market through its Committee structure. Operational Committees have been formed to represent the views of the various sectors that participate in the LME. The Operational Committee advise and make recommendations to the LME's Executive Committee on the working of the Exchange. In addition, the User Committee is a sub-committee of the Board and is charged with representing the users of the LME's direct or indirect services and advising the Board on strategic issues. Further information on the LME's Committee structure can be found on our website (<https://www.lme.com/en-GB/About/Corporate-information/Committees#tabIndex=0>)

**(d) The LME has policies and procedures to appropriately identify and manage conflicts of interest, and**

- 2.1.12 Under section 175 of the UK Companies Act 2006, a director has a statutory duty to avoid any situation in which he has, or could have, a direct or indirect interest that conflicts, or could conflict, with the interests of the company. Section 175 (2) emphasises the applicability of the duty to the exploitation of any property, information or opportunity and confirms that it is irrelevant whether the company itself could have taken advantage of that property, information and opportunity. There are also provisions regarding the identification and management of conflicts of interest in the Recognition Requirements (see <https://www.handbook.fca.org.uk/handbook/REC/2/5.html>).
- 2.1.13 The LME takes potential conflicts of interest and the associated consequences extremely seriously. It has in place appropriate procedures to mitigate the risk of such occurrences. These procedures supplement the statutory duties on directors set out in the UK *Companies Act 2006*.
- 2.1.14 The articles of association for the LME set out explicit procedures to deal with such scenarios as do the terms of reference for each committee. These procedures are followed as a matter of course.
- 2.1.15 The terms of reference for EXCOM explicitly address the risk of a conflict of interest arising. In addition, the contracts of employment for each of the members of EXCOM address this.

2.1.16 LME Group has also implemented an LME Group Conflicts of Interest Policy which provides employees with an overview of LME's key obligations and the controls implemented in order to identify, manage and disclose actual conflicts of interest.

(e) ***There are appropriate qualifications, remuneration, limitation of liability and indemnity provisions for directors, officers and employees of the exchange.***

2.1.17 The Chief Executive Officer of the LME is appointed as a Director. Up to two individuals, who are selected by the Nomination Committee, and approved by the Board, are appointed as independent directors. A further six directors are appointed by the holder of the majority of shares in the LME. Each director is appointed on merit based on skills, qualification and experience. Remuneration is set at Group level and is based on a specific fee structure. Directors' remuneration is solely based on the Boards and Committees they belong to. To avoid a conflict of interest Independent Directors' remuneration is set as a base payment only and does not include performance-related elements. Every Director is entitled to be indemnified by the Company against all costs, charges, losses, expenses and liabilities incurred by him or her in the execution and discharge of his or her duties to the Company or in relation thereto. The Directors' and Officers' Liability Insurance in place provides the Directors with such protection.

2.1.18 Background checks are undertaken against new Directors to ensure that they are fit and proper and eligible to act as a Director. All Directors are also subject to SIF interviews with the FCA, with the regulator providing non-objection to the appointment. The Board is subject to periodic evaluations to ensure that the members, and the Board as a whole, remains fit for purpose and any recommended changes are considered and implemented where appropriate.

2.2 **Fitness – The exchange has policies and procedures under which it will take reasonable steps, and has taken such reasonable steps, to ensure that each director and officer is a fit and proper person.**

2.2.1 Executive Directors are selected from key senior personnel within the HKEX Group and therefore their qualification is through their position. Up to two individuals, who are selected by the Nomination Committee and approved by the Board, are appointed as independent directors. A further six directors are appointed by the holder of the majority of shares in the LME. Each director is appointed on merit based on skills, qualifications and experience. Remuneration is set at Group level and is based on a specific fee structure. Director's remuneration is solely based on the boards and Committees they belong to. To avoid a conflict of interest Independent Directors' remuneration is set as a base payment only and does not include performance-related elements. Every Director is entitled to be indemnified by the Company against all costs, charges, losses, expenses and liabilities incurred by him or her in the execution and discharge of his or her duties to the Company or in relation thereto. The Directors' and Officers' Liability Insurance in place provides the Directors with such protection.

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### **3 REGULATION OF PRODUCTS**

3.1 ***Review and Approval of Products – The products traded on the Exchange and any changes thereto are reviewed by the Foreign Regulator, and are either approved by the Foreign Regulator or are subject to requirements established by the Foreign Regulator that must be met before implementation of a product or changes to a product.***

***Product Specifications – The terms and conditions of trading the products are in conformity with the usual commercial customs and practices for the trading of such products.***

3.1.1 The FSMA Recognition Requirements and MIFID II establish a range of requirements that must be met before implementation of a product or changes to a product, and on an ongoing basis. In particular, any product admitted to trading on the LME must be capable of being traded in a fair, orderly and efficient manner and must be designed so as to allow for its orderly pricing as well as for the existence of effective settlement conditions. The FCA has adopted guidance in the FCA Handbook which elaborates on the FSMA Recognition Requirements and MIFID II requirements. This guidance sets out principles which the FCA will take into account to determine if the relevant requirements have been satisfied. This guidance are set out at REC 2.12 of the FCA Handbook.

3.1.2 The close and continuous nature of the supervisory interaction with RIEs means that, in practice, the FCA is aware of all proposed new contracts well before they are admitted to trading, and if there is a regulatory concern, then this will be built into the formulation of the contract specifications at that time. LME must confirm in writing to the FCA that any new contract complies with the relevant requirements and provides a regulatory analysis to evidence how such

compliance will be achieved. The FCA will then perform an internal review and, subject to any questions or concerns it may wish to discuss with the LME, it provide its non-objection ahead of launch.

3.2 ***Risks Associated with Trading Products – The Exchange maintains adequate provisions to measure, manage and mitigate the risks associated with trading products on the exchange, including, but not limited to, margin requirements, intra-day margin calls, daily trading limits, price limits, position limits, and internal controls.***

3.2.1 Trades on the LME are cleared through LME Clear (see paragraph 29 of Part I). Each Member provides LME Clear with, and maintains on a daily basis for so long as it is a Member, eligible collateral with a Collateral Value sufficient to satisfy its Margin Requirement, which comprises of:

- (a) the End of Day Margin Requirement;
- (b) the Intra-Day Margin Requirement(s); and
- (c) any other margin requirements (which excludes a Default Fund Contribution) required at any time by LME Clear pursuant to the Rules and the Procedures,

as security, cover and/or credit support for the performance by that Member of all of its present and future obligations to LME Clear pursuant to the Rules or the operation of the Clearing System.

#### 4 ACCESS

##### 4.1 Fair Access

(a) ***The exchange has established appropriate written standards for access to its services including requirements to ensure:***

- (i) ***Participants are appropriately registered as applicable under Ontario securities laws or Ontario commodity futures laws, or exempted from these requirements,***
- (ii) ***The competence, integrity and authority of systems users, and***
- (iii) ***Systems users are adequately supervised.***

(b) ***The access standards and the process for obtaining, limiting and denying access are fair, transparent and applied reasonably.***

(c) ***The exchange shall not unreasonably prohibit, condition or limit access by a person or company to services offered by it.***

(d) ***The exchange does not***

- (i) ***permit unreasonable discrimination among participants, or***
- (ii) ***impose any burden on competition that is not reasonably necessary and appropriate.***

##### **Access requirements**

4.1.1 As a UK Recognised Investment Exchange, the LME is subject to UK regulatory requirements that are closely aligned with those outlined above. The LME is obligated under the Financial Services and Markets Act 2000 (Recognition Requirements) Regulation 2001 (SI2001/995) (the **Recognition Regulations**) and (b) the FCA rules applicable to recognised investment exchanges (the **REC handbook**), to ensure that access to its facilities is fair and non-discriminatory. In particular, the LME is required to “make transparent and non-discriminatory rules, based on objective criteria, governing access to, or membership of, its facilities” (REC 2.7.1A). Any new LME initiative is assessed in detail against the Recognition Regulations and such assessment provided to the FCA so the FCA can provide non-objection.

4.1.2 LME's admittance criteria are publicly available and are applied equally to all applicants. Access requirements for prospective LME participants are set out in Part 2 of the LME Rules. Part 2 specifies the requirements that are applicable to each category of Member, including for instance the prospective Member's legal structure, regulatory status, capital holdings, AML and financial crime procedures, This is supplemented by a jurisdictions document published on the LME website which specifies additional requirements or constraints that are applicable to Members

located in specific jurisdictions in order to ensure compliance with applicable law (see paragraph 4.1.8 below for further detail in relation to this document).

- 4.1.3 The LME has in place a process for appealing decisions to deny or limit access to its services (see Regulations 5.7 to 5.9 of the LME Rules). Necessary electronic and physical records in relation to any such appeals are held in confidence and for the appropriate period of time in accordance with our record retention policy, in accordance with our legal, compliance and regulatory requirements.
- 4.1.4 No Member may undertake any regulated activity in relation to the LME unless it is authorized (including by exemption – e.g. in relation to Members based outside of the UK, in other countries, states and provinces and territories, who have been authorized by their home regulator) by the FCA to carry on such regulated activity (see regulation 4.2 of Part 2 of the LME Rules). As a result, all trading (Category 1, 2, 3 and 4) Members must comply with the FCA rules. Members must inform LME immediately of any variation, cancellation or permission to carry on a regulated activity (regulation 4.3 of Part 2 of the LME Rules).
- 4.1.5 The ability to handle customer business through the issue of Client Contracts means that Category 1, 2 and 4 Members must at all times be regulated for this specific purpose by the FCA or an equivalent regulator. When an applicant applies for membership of LME, the applicant must confirm its regulatory status and FCA registration number (where applicable), and this is validated by LME. A similar process will be implemented for Members based in Ontario.
- 4.1.6 No person may apply or continue to be a Category 1, 2, 3 or 4 Member unless such person is:
- (a) an authorized person or exempt person within the meaning of Part III of the FSMA; or
  - (b) an investment firm authorized under Article 5 of MiFID by the competent authority of an European Economic Area (**EEA**) state other than the UK (include a branch established in the UK of such a firm); or
  - (c) a credit institution authorized under the Banking Consolidation Directive by the competent authority of an EEA State other than the UK (including a branch established in the UK of such an institution); or
  - (d) a person whose activities in relation to the Exchange as a Member would not constitute regulated activities (as defined in FSMA) on the basis of an appropriate exclusion under the RAO.
- 4.1.7 No Member may undertake any regulated activity (as defined in the FSMA) in relation to the Exchange unless the Member is:
- (a) authorized, including through exemption, by the FCA to carry on such a regulated activity; or
  - (b) a person whose activities in relation to the Exchange as a Member would not constitute regulated activities (as defined in FSMA) on the basis of an appropriate exclusion under the RAO.
- 4.1.8 The LME Rules do not allow a person to enter into a Client Contract unless he or the other party to the Contract is a Category 1, 2 or 4 Member that can validly enter into Client Contracts in accordance with the law of the UK and any other applicable law or regulation.
- 4.1.9 In relation to ensuring that participants are appropriately registered as applicable under Ontario securities laws or Ontario commodity futures laws, or exempted from these requirements: the LME is regulated by a number of overseas regulators in a manner similar to that sought in Ontario (including in the US by the CFTC, in Australia by ASIC, in Singapore by MAS, and in Hong Kong by the SFC, amongst others). It is therefore familiar with local regulators imposing particular requirements as a result of local law and regulation. The LME ensures that its participants comply with these requirements through its jurisdictions document, which is can be found on the website at <https://www.lme.com/About/Regulation>. Members are obliged to comply with the jurisdictions document by virtue of Regulation 12.6(h) of Part 2 of the LME Rules, which states that “A Member shall observe the requirements relating to participants from jurisdictions other than the UK, as set out in the document headed “Jurisdictions” which shall be available on the website of the Exchange, as such document is updated from time to time”.
- 4.1.10 Once it obtains exemption in Ontario, the LME will incorporate the specific requirements relating to Ontario into the jurisdictions document, in particular those relating to participants on its market which are set out in the proposed terms and conditions to the draft exemption order.

### Due diligence and on-going supervision

- 4.1.11 The LME conducts a robust due diligence procedure to ensure that its Members are fit and proper, in order to protect the integrity of the LME and the orderliness of its market. In relation to systems access, pre-admittance requirements are in place in relation to systems training, conformance, testing and accreditation. Once a Member has been admitted, controls are also applied to any additional system users. System users are also subject to supervision on an on-going basis, in particular in the form of oversight by the Trading Operations and Post-Trading Operations and Market Surveillance teams).
- 4.1.12 Annual due diligence is performed as a mechanism for monitoring qualifying members' continued suitability. This takes the form of a risk-based approach using a Member risk assessment model. This is updated annually and targeted assessments are performed according to the determined risk ratings. A real-time due diligence screening tool is also used to ensure continued suitability. Member audits are also conducted to ensure that all Members have appropriate systems and controls to ensure ongoing compliance with the LME Rules and Notices. Such reviews may be either desk based or on-site visits.

## 5 REGULATION OF PARTICIPANTS ON THE EXCHANGE

***Regulation – The Exchange has the authority, resources, capabilities, systems and processes to allow it to perform its regulation functions, whether directly or indirectly through a regulation services provider, including setting requirements governing the conduct of its participants, monitoring their conduct, and appropriately disciplining them for violations of exchange requirements.***

### 5.1 Members and other participants are required to demonstrate their compliance with these requirements

- 5.1.1 The LME Rules state Contracts may be written only by Category 1, 2 and 4 Members and accordingly at least one party to every Contract must be such a Member; non-Members of the LME cannot have direct access to LMEselect. Whatever the form of the electronic connection, orders placed by non-Members will always be routed through a Member and the counterparty risk to non-Members will always be carried by an LME Category 1, 2 or 4 Member.
- 5.1.2 All Members are required by LME to satisfy the membership criteria on an ongoing basis. Members are required to notify the LME of anything the LME might reasonably expect to be disclosed to it (see regulation 9.6(d) of Part 2 of the LME Rules). This would include all legal, financial and regulatory matters that are material to their standing as Members.
- 5.1.3 Under the LME Rules, trades on LMEselect will always be routed through an LME Category 1, 2 or 4 Member. As such, other than Members, there are no other participants to which separate requirements for participation on LMEselect may apply.
- 5.1.4 Regulation of the market is carried out by the LME, while the FCA is responsible for regulating the financial soundness and conduct of Members' business (unless the Member is not FCA authorized such as an unauthorised overseas person (UOP). The FCA (or other regulatory bodies if the Member benefits from the UOP exemption) and LME monitor Members on an ongoing basis to confirm that Members are in full satisfaction of their respective regulatory obligations. UOPs are required to provide a legal opinion for the benefit of the LME confirming that they will benefit from the exemption and this opinion will be refreshed periodically, including in response to a material change in the LME Rules.
- 5.1.5 The FCA rules require relevant personnel of FCA authorized firms to have applicable demonstrable experience in relation to the regulated activities which the firm is permitted to perform. The FCA monitors these authorized firms and the quality of the personnel in key operations and compliance functions. For more information on the rights and obligations of Members towards the FCA, please refer to the above sections 4.1.4 to 4.1.7.
- 5.1.6 The financial resource requirements, standards, guides or thresholds required of Members are set out at Part 2 of the LME Rules. Regulation 9.1.1 of Part 2 of the LME Rules requires each Member to submit annual audited accounts within four months of the end of the financial year as well as for those of its ultimate parent undertaking. This information is used to verify that Members have complied with the financial resource requirements set out in the LME Rules.
- 5.1.7 LME Clear (which has counterparty risk exposure to Category 1, 2 and 3 Members through the clearing of Cleared Contracts) constantly monitors the collateral requirements for Members. The FCA (whose rules each Category 1, 2, 3 and 4 Members must comply with, unless the Member is a UOP) monitors the financial soundness of Members on an ongoing basis. The FCA is responsible for regulating the financial soundness and conduct of Members' business, unless the Member is a UOP. The admission process for becoming an FCA regulated firm includes a fit and proper person test.

## 5.2 Client Advisory and Member Services

- 5.2.1 The LME Market Access Department (**Market Access**) is responsible for the on-boarding of new entities into the LME Base Service, LMEprecious, LMEshield and LMEbullion (the **Services**). A description of each of those Services is set out in paragraphs 5.2.3-5.2.7 below. The Market Access function is, in addition, responsible for confirming the on-going suitability of members within the Services. Applicants for LME membership are required to meet the relevant eligibility criteria as set out in Part 2 of the LME Rulebook (Membership, Enforcement and Discipline).
- 5.2.2 Members must provide the information necessary to confirm their continued compliance with the eligibility criteria set out in the LME Rulebook. Market Access conduct a risk based approach in respect of reviews demonstrating that the LME discharges its obligations with respect to the UK Money Laundering Regulations and the LME's Financial Crime Policy.
- 5.2.3 The LME Base Service refers to the availability of the facilities of the London Metal Exchange for the trading of contracts relating to non-precious metals.
- 5.2.4 LMEprecious refers to the availability of the facilities of the LME for the trading of LMEprecious Futures. An LMEprecious future is a cleared, physically settling exchange-traded futures contract which has any Precious Metal as its underlying (namely, Gold or Silver).
- 5.2.5 LMEshield refers to the LME's central electronic register that provides global off-warrant commodity receipting. LMEshield immobilises paper receipts and uses electronic versions in the system. This facilitates lending by addressing uncertainties surrounding commodity receipts as collateral and reducing the risk of fraud on financed material.
- 5.2.6 LMEbullion refers to the LME's custom-built electronic auction system for platinum and palladium, which was launched in December 2014. It was designed in close consultation with the precious metals community to combine the best elements of an electronic platform with Platinum Group Metals (PGM) fixing methodologies. LMEbullion delivers fully automated price display auctions enabling twice-daily price discovery and price dissemination via licenced data distributors.

## 5.3 Enforcement of LME Rules on Members

- 5.3.1 The LME Market Surveillance function consists of approximately ten staff. The Enforcement function is undertaken by members of the LME Legal team.
- 5.3.2 The primary role of the LME Market Surveillance team is to protect the integrity of the LME's markets by monitoring activity across all LME trading venues for behaviour which could be indicative of possible market abuse under the Market Abuse Regulation (**MAR**). The MAR contains prohibitions on insider dealing, unlawful disclosure of inside information and market manipulation. LME Market Surveillance utilises a bespoke electronic surveillance system (referred to as the **EDW** surveillance system) which is alert based, allowing the team to monitor for behaviour that may be abusive, manipulative or undermine the integrity of the Exchange. This monitoring covers market orders and trades through all LME trading venues (LMEselect, the Ring and the Interoffice market) on a T+1 (trade date plus one business day) basis. The Market Surveillance team also utilises a case management tool to document all alerts generated by the electronic surveillance system and provide a full audit trail of all analysis and communications. In addition, the Compliance Monitoring System (**CMS**) market replay function allows the team to play back historical order book activity to review market conditions at a given point in time. The system gives a comprehensive view of the order book.
- 5.3.3 The LME Market Surveillance team is also responsible for enforcing the LME Lending Rules. Category 1, 2, 3 and 4 Members are required to report, on a daily basis by way of the LME's Daily Position Reporting System, all holdings and positions for both house and client accounts. The LME Market Surveillance team examines data relating to Members' and their clients' futures, options and warrant positions, as electronically reported by Members each day. The information is analysed in conjunction with data on underlying trends in supply and demand and on traded prices in order to detect any potential tightness, squeezes or anomalies in the market. For this purpose, LME Market Surveillance uses a system referred to as Client Support System (**CSS**). CSS is used by the LME Market Surveillance team to monitor the positions of Members and their clients and to assist with the administration of the Lending Rules. It provides the LME Market Surveillance function with the key information it needs to ensure the LME maintains an orderly market. The information in CSS is used to verify information submitted by Members via the Daily Position Reporting System. CSS is a local client application which receives detailed position reporting files before 8.30am London time each morning, reflecting positions as of the close of business the previous day. It therefore provides an overview of positions of Members and clients down to one lot.

- 5.3.4 The Lending Rules require that Members holding positions above a certain level be prepared to lend to the market, thereby providing liquidity. This prevents dominant holders from squeezing the market, taking advantage of price movements caused by that dominant position and damaging market integrity.
- 5.3.5 The LME Market Surveillance team also receives and investigates referrals of unusual activity from other areas of the LME. For example, the LME Market Surveillance team works closely with the LMEsmart and LMEselect teams. The 'LMEselect team' in this context refers to Trading Operations. Trading Operations establish the LME's reference prices and have responsibility for monitoring the market in real-time on LMEselect. This includes, for instance, enforcement of the LME's policies in relation to error trades and erroneous submissions. Trading Operations may identify activity or behaviour which may warrant further investigation and this is escalated to the Market Surveillance team as appropriate. The 'LMEsmart team' in this context refers to Post Trade Operations, who are the Business Owners of the LME's matching service (LMEsmart). LMEsmart provides a post-trade registration and matching service for all LME trading venues. The Post Trade Operations team also own the LME's matching rules and has additional governance over further LME systems such as LMEsword (the LME's secure electronic transfer system for LME warrants) and LMEshield (which is the LME's central electronic register providing global off-warrant commodity receipting). Post Trade Operations work closely with Market Surveillance regarding the member audit process to ensure that Members are registering transactions within the spirit of the LME matching rules.. Post Trade Operations will also escalate concerns that have been observed when interacting with the membership that might require further investigation by Market Surveillance.LME Market Surveillance also monitors stock movements and trade matching performance.
- 5.3.6 As stated above, the EDW surveillance system monitors trading and order book data on a T+1 (trade date plus one business day) basis and is used by Market Surveillance to detect market patterns or trading strategies which may be deemed abusive or manipulative and may require further investigation. The system is designed to meet the standards required under the European Securities and Markets Authority (**ESMA**) Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities.
- 5.3.7 The EDW surveillance system processes all order and trade data across of trading platforms operated by the LME. Specifically, there are six separate EDW alert engines which use alerting algorithms to interrogate the data and generate electronic surveillance alerts across 18 different alert scenarios. These scenarios include but are not limited to insider trading and different types of possible manipulation. The team also utilises the CMS Market Replay tool which enables the user to recreate the electronic order book at any given point in time.
- 5.3.8 Following analysis by LME Market Surveillance, suspicions of possible market abuse are escalated to the LME Referrals Committee for discussion to determine whether the activity should be submitted to the UK FCA as a Suspicious Transaction and Order Report (**STOR**). If considered appropriate, LME Market Surveillance can also instigate a formal investigation into the activity of a Member which may result in possible enforcement action and sanction.
- 5.3.9 Furthermore, all trade data is stored in a web based database tool called Trade Analytics. This includes enriched data such as reference fields and customer account fields. Where required, the data can be presented at trade-half level, i.e. each buy and sell side contains unique data. With this structure Trade Analytics is able to present data at a granular level, illustrating information such as position movements of an individual client across several brokers. This level of granularity is necessary to be able to reconstruct trade flow and assist surveillance and investigation.
- 5.3.10 The Market Surveillance team also assesses Member compliance with the LME Rules and associated Notices. This is achieved through a risk based Member Audit Programme via a series of thematic desk-based reviews. An annual Member audit plan is agreed with senior management to ensure that there is appropriate coverage of the LME Member base and that all required Rules and Notices are included in the review programme. In determining the plan, team members take into account issues raised by other areas of LME Market Surveillance and the wider Market Operations department so that a holistic approach can be taken. At the commencement of an audit, Members are required to provide information or data so that a desk based review can be conducted. LME Market Surveillance also has the power to conduct a site visit if required. If considered appropriate, LME Market Surveillance can also instigate a formal investigation into a Member should the audit determine that the Member's systems and controls are not adequate. The Member Audit Programme therefore contributes to ensuring that Members uphold the expected standards and that the integrity of the market is maintained.
- 5.3.11 The LME Member Audit programme also covers systems access which ensures that Members only grant LMEselect access to relevant personnel and maintain the necessary records in accordance with LME requirements. Breaches of LME Rules may result in formal investigation and possible enforcement action.
- 5.3.12 Possible breaches of LME Rules may be subject to formal investigation by the LME Market Surveillance and Legal teams. In the event that a breach of LME Rules has taken place, the matter may be further investigated for possible consideration by the LME Enforcement Committee. The LME Enforcement Committee will consider the case presented

and in the event that it determines that enforcement action is appropriate, determine what sanction should be imposed on the Member. The LME has brought a number of successful enforcement actions against members in recent years, see for example:

<https://www.lme.com/en-GB/Search?keywords=citigroup>

<https://www.lme.com/en-GB/Search?keywords=disciplinary%20action>

- 5.3.13 The LME compliance and surveillance functions are divided as a matter of policy by means of information barriers from the rest of the LME so as to preserve the confidentiality of sensitive Member and client commercial information that is required for regulatory purposes.
- 5.3.14 The LME has certain summary powers to deal with market emergencies that apply in addition to the Lending Rules. In the event of a suspected undesirable or improper trading practice such as an attempt to squeeze the market, the LME's Special Committee may take any steps necessary to resolve the situation. These steps include ordering a Member to trade out of positions. The Special Committee is comprised of independent non-conflicted persons appointed by the LME Board. This ensures that no directors who may have a conflict of interest are involved in decisions made about any market aberrations. The powers of the Special Committee to intervene in the market in emergencies are set out in Regulation 17 of Part 3 of the LME Rules (<https://www.lme.com/About/Regulation/Rules/Rulebook>).

#### **LME's capacity to detect, investigate, and sanction persons who violate LME Rules**

- 5.3.15 Regulations 9 to 12 of Part 2 of the LME Rules set out the capacity of LME to investigate and sanction persons who violate LME Rules. This function, along with the detection of such violations, is performed by LME Market Surveillance functions as set out above.
- 5.3.16 Regulations 9.6 and 9.7 of Part 2 of the LME Rules prohibit fraud and abuse (including, but not limited to, wash sales and trading ahead) as well as other trading practices and market abuses. UK and European legislation supplement these prohibitions.
- 5.3.17 LME Market Surveillance has sufficient personnel, and sufficient software tools, to monitor the trading venues operated by the LME. The Trading Operations team also monitors the real time market, including the enforcement of orderly trading in the Ring (open outcry). The LMEselect Trading Operations team also monitors for orderly trading on LMEselect and enforces the LME's order to trade ratio and message throttling policies. Analysis of trading in the Ring, on LMEselect and in the Inter-office market (telephone) for potential market abuse is conducted by LME Market Surveillance. Trading Operations establish the LME's reference prices and monitor the market in real-time on LMEselect. Part of this monitoring includes enforcement of the LME's policies in respect of error trades and erroneous submissions, and its dynamic price banding. As a result of daily monitoring of the real-time market, Trading Operations may identify activity or behaviour which warrants further investigation or analysis (examples include but are not limited to: unusual price movements in the real-time market, or order behaviour which may be detrimental to the integrity of the market). Such activities or behaviours are escalated to Market Surveillance as appropriate. Market Surveillance receives referrals of such activity from Trading Operations for further analysis and information gathering (including requesting further information directly from the Member). Such referrals and the results of analysis are also escalated to the weekly LME Referrals Committee (which consists of senior staff from Market Operations and Legal) to determine whether the behaviour should be the subject of a formal investigation and / or referred to the appropriate regulatory body. The resourcing of the LME Legal and Regulation, Risk and Compliance team is kept under constant review. Oversight of the Market Surveillance teams is undertaken by the Head of Market Surveillance, who reports directly to the Chief Operating Officer. The surveillance team is comprised of approximately twelve staff. Internal compliance and regulatory policy is undertaken by the Regulation, Risk and Compliance department, which has approximately ten staff in total.
- 5.3.18 Regulation 9 of Part 2 of the LME Rules sets out comprehensive obligations on Members to provide the LME access to information, including in relation to Over-The-Counter transactions and information held by third parties. Regulation 10.5 of Part 2 of the LME Rules supplements this obligation, but this regulation will only apply where there is an investigation.
- 5.3.19 Members must submit to the regulation of the LME as a condition of access to the LME market. Regulation 2.4 of Part 1 of the LME Rules stipulates that the LME Rules shall be binding on all members. Regulation 1.4 of Part 3 of the LME Rules specifies that all Client Contracts may only be written by Category 1, Category 2 or Category 4 Members, the effect of which is that all client contracts will have at least one party being a Member. Regulation 1.5 of Part 3 of the LME Rules specifies that all client contracts shall be governed by the LME Rules.

**6 RULEMAKING****Purpose of Rules**

- (a) *The exchange has rules, policies and other similar instruments (“Rules”) that are designed to appropriately govern the operations and activities of participants.*
- (b) *The Rules are not contrary to the public interest and are designed to*
- (i) *ensure compliance with applicable legislation,*
  - (ii) *prevent fraudulent and manipulative acts and practices,*
  - (iii) *promote just and equitable principles of trade,*
  - (iv) *foster co-operation and co-ordination with persons or companies engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in products traded on the exchange,*
  - (v) *provide a framework for disciplinary and enforcement actions, and*
  - (vi) *ensure a fair and orderly market.*

6.1 The LME Rules are available on the LME website (<https://www.lme.com/About/Regulation/Rules/Rulebook>) (the **LME Rules**). The LME Rules are separated into 13 parts and each part focuses on a specific area. In addition, the LME has the power to issue Notices, which, pursuant to Regulation 2.2 of Part 1 of the LME Rules, have the force of rules. The key notices which are related to Member compliance are set out on the LME website at

<https://www.lme.com/About/Regulation/Rules/Notices>.

6.2 The LME Rulebook and Notices are binding on all Members. In order to become a member, applicants must sign a membership agreement with the LME undertaking to be bound by the LME Rules.

6.3 As a RIE under FSMA, the LME is obliged to adhere to the FSMA Recognition Requirements. The FSMA Recognition Requirements specify that the LME must ensure that appropriate procedures are adopted for it to make rules, for keeping its rules under review and for amending them. The FCA has adopted guidance in the FCA Handbook which elaborates on the Recognition Requirements. This guidance sets out principles which the FCA will take into account to determine if the above requirement has been satisfied. This guidance is set out at REC 2.14 of the FCA Handbook (see <https://www.handbook.fca.org.uk/handbook/REC/2/>).

6.4 Pursuant to section 293(5) of FSMA, whilst there is no formal approval requirement for rules, if the LME alters or revokes any of its rules or guidance, or makes new rules or issues new guidance it must give written notice to the FCA. Further, the combination of a legal requirement to consult on rule changes, and the ‘close and continuous’ nature of the supervisory interaction with RIEs means that, in practice, the FCA is aware of all material proposed rule changes well before they are made, and if there is a regulatory concern, then this will be built into the formulation of those rules. For example as part of the monthly meetings between the FCA and the LME Market Operations department, the LME notifies the FCA of any forthcoming changes to the LME Rules that relate to trading rules of the LME. The FCA also receives copies of all Notices issued by the LME. Should the FCA wish to review proposed changes to the LME Rules, it will request further information from the LME, which the LME will provide. In such instances, the FCA and the LME will work closely to produce a form of wording that is acceptable to both entities. In addition, section 300A of FSMA (introduced by the Investment Exchanges and Clearing House Act 2006) gives further powers to the FCA in respect of rules which may amount to an “excessive regulatory provision”, requiring a formal notification process and right for the FCA to disallow any such rules. Finally, for any major changes to the LME Rules (such as new contracts, structural and other changes) and other significant initiatives, the LME will prepare a detailed regulatory analysis, referred to as a “REC analysis”, which details how the LME will comply with all relevant provisions of REC following the change.

6.5 The LME Rules have been designed to ensure compliance with all applicable legislation and to ensure a fair and orderly market. The LME has an internal Compliance department which, amongst other things, monitors the LME’s compliance with all applicable legislation. The Compliance Monitoring Programme (**CMP**), which is maintained by Compliance, lists all legislation applicable to the Exchange on a line-by-line basis and explains how the LME complies with such legislation.

6.6 The LME Rules have extensive provisions regarding the conduct of Members. These include provisions relating to “prohibited practices” (see Regulation 14 of Part 3 of the LME Rules), which are designed to prevent fraudulent and manipulative acts and practices. More generally, the provisions of Part 3 (Trading Regulations) and Part 4 (Contract Regulations) are designed to set out how trading on the LME should take place in a fair and orderly manner and have been designed to ensure just and equitable principles of trade and to foster co-operation and co-ordination with persons or companies engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in products traded on the Exchange.

6.7 Part 2 of the LME Rulebook sets out the requirements for admission to membership, as well as provisions relating to provision of information and discipline / enforcement. Regulation 12 of Part 2 of the LME Rules sets out the obligations of Members to promptly provide information reasonably requested by the exchange. Part 2 also sets out the ability of the LME to investigate and take disciplinary action against members for suspected breaches of the Rules. The provisions relating to investigations are set out at Regulation 13 of Part 2, and the provisions relating to discipline are set out at Regulation 14 of Part 2. Pursuant to Regulation 14.22, a Disciplinary Committee has broad powers to impose penalties on members, including a reprimand, a fine, an order that the Member make restitution to any person when the Member has profited from an act of misconduct at that person's expense, a requirement to comply with such terms and conditions as appropriate, and suspension or expulsion from membership.

#### **Enforcement of the LME Rules**

6.8 The LME has extensive compliance and surveillance functions which ensure that LME Rules are being followed. The surveillance function is split between two divisions; the Market Surveillance team, and Market Access (see paragraphs 5.2.1-5.2.2 above). The surveillance functions consist of approximately ten staff, whilst the Market Access division consists of approximately three staff. The LME also has an enforcement team made up of members of the Legal team.

6.9 The primary role of the LME Market Surveillance team is to protect the integrity of the LME's markets by monitoring that trading is fair and transparent. The LME Market Surveillance staff analyse confidential data relating to members' and their clients' futures, options and warrant positions, as electronically reported by members each day. The information is analysed in conjunction with data on underlying trends in supply and demand and on traded prices in order to detect any potential tightness, squeezes or anomalies in the market. Any concerns about suspected abuses of the market will be discussed with the member(s) concerned and, if necessary, referred to the enforcement team for further review and scrutiny (see paragraph 5.3 above).

6.10 The LME Market Surveillance team also ensures that the market remains orderly. As part of this, it is responsible for the application of Position Management through administering the Lending Rules, Position Monitoring and Accountability Levels. It also monitors the registration and matching of trades to ensure this takes place within the time frames prescribed by the LME. Furthermore, it monitors intra-day trading activities through EDW, alongside the LMEselect and LMEsmart system teams, in close liaison with LME Clear. In so far as LMEselect is concerned, the LME Market Surveillance team oversees that all trading on LMEselect takes place in accordance with the LME Rules.

6.11 The Market Surveillance team also utilizes the bespoke trade surveillance system, EDW. The system is alert and report based, allowing the surveillance team to monitor for behaviour that may be abusive, manipulative or undermine the integrity of the exchange. The monitoring covers market orders and trades through LMEselect, the Ring, the inter-office market and trades entered into LMEsmart on a T+1 (trade date plus one business day) basis. The Market Surveillance team utilizes Jira as the case management tool to investigate and document all alerts generated by the EDW alert engine. In addition the Compliance Monitoring System (**CMS**) market replay function allows the team to playback historical market activity to review market conditions at a given point in time. The system gives a comprehensive view of the market and enables the LME to react to changes in market conditions.

6.12 The Market Surveillance team also assesses Member compliance with the LME Rules and associated notices. This is done through the Member Audit Programme (**MAP**) via a series of desk-based reviews. This programme allows the Market Surveillance team to focus on any particular rule or theme it feels may be pertinent in conjunction with EDW, the LME Market Surveillance team and its wider view of the market. In so doing, the MAP allows the Market Surveillance team to have a holistic approach in ensuring members are upholding the standards expected from the exchange and maintaining the integrity of the market.

6.13 Market Access (formerly Client Advisory and Membership Services): Market Access works closely with the LME Market Surveillance team to review members' controls, procedures and general compliance with the LME Rules on application for membership of the LME. In addition, the LME compliance and surveillance functions together review the controls and procedures put in place by LMEselect participants to ensure that only accredited users access LMEselect and LMEselect participants maintain the necessary records in accordance with LME and FCA requirements. Breaches of LME Rules will be referred to the enforcement team for further scrutiny.

## Rule Changes

- 6.14 The FSMA Recognition Requirements specify that the LME must ensure that appropriate procedures are adopted for it to make rules, for keeping its rules under review and for amending them. The FCA has adopted guidance in the FCA Handbook which elaborates on the FSMA Recognition Requirements. This guidance sets out principles which the FCA will take into account to determine if the above requirement has been satisfied. This guidance is set out at REC 2.14 of the FCA Handbook.
- 6.15 Pursuant to section 293(5) of the FSMA, while there is no formal approval requirement for rules, if LME alters or revokes any of its rules or guidance, or makes new rules or issues new guidance it must give written notice to the FCA. Further, the combination of a legal requirement to consult on rule changes, and the close and continuous nature of the supervisory interaction with RIEs means that, in practice, the FCA is aware of all material proposed rule changes well before they are made, and if there is a regulatory concern, then this will be built into the formulation of those rules. For example as part of the monthly meetings between the FCA and the LME Market Operations department, LME notifies the FCA of any forthcoming changes to the LME Rules that relate to trading rules of LME. The FCA receives copies of all notices issued by LME. Should the FCA wish to review proposed changes to the LME Rules, it will request further information from the LME, which LME will provide. In such instances, the FCA and LME will work closely to produce a form of wording that is acceptable to both entities. In addition, section 300A of FSMA (introduced by the Investment Exchanges and Clearing House Act 2006) gives further powers to the FCA in respect of rules which may amount to an “excessive regulatory provision”, requiring a formal notification process and right for the FCA to disallow any such rules. Therefore, as noted above, for any major changes to the LME Rules (such as new contracts, structural and other changes) and other significant initiatives, the LME will prepare a detailed regulatory analysis, referred to as a ‘REC analysis’, which details how the LME will comply with all relevant provisions of REC following the change.

## 7 DUE PROCESS

***Due Process – For any decision made by the exchange that affects a participant, or an applicant to be a participant, including a decision in relation to access, exemptions, or discipline, the exchange ensures that:***

- (a) parties are given an opportunity to be heard or make representations, and***
- (b) it keeps a record of, gives reasons for, and provides for appeals or reviews of its decisions.***

- 7.1 The Market Surveillance and enforcement teams (as referenced above in section 5 above) are governed by the following procedures:
- 7.2 Regulations 13 and 14 of Part 2 of the LME Rules respectively set out the investigatory and disciplinary procedures of the LME. The LME has wide powers to investigate suspected acts of misconduct by members. Any suspected act of misconduct will be investigated by the Market Operations and Legal functions. A report detailing the findings of the investigation shall be passed to the Head of Market Operations who may, or may not, recommend to the Enforcement Committee that disciplinary proceedings should be commenced. Where the Enforcement Committee decides to institute disciplinary proceedings, a Notice, approved by it setting out the alleged act of misconduct together with a summary of the facts relied upon (“the **Notice**”) shall be served on the Member concerned. The Member has twenty working days from service of the Notice in which to serve a statement of defence (the **Defence**) responding to all or any of the allegations, stating its intended pleas and what admissions of fact, if any, it makes. Generally in practice the LME and the Member will settle the enforcement action (pursuant to Regulations 14.36 to 14.41) prior to the service of the Defence. However, if the matter is not settled, the matter may proceed to a Disciplinary Committee.
- 7.3 A Disciplinary Committee drawn from the Disciplinary Panel will determine the outcome of the proceedings (Regulations 14.16 to 14.21 of Part 2 of the LME Rules). Regulations 14.22 to 14.26 of Part 2 empower a Disciplinary Committee to impose penalties on a member, including to fine, suspend or expel any Member pursuant to fair and clear standards.
- 7.4 A Member may appeal the decision of the Disciplinary Committee to an Appeal Committee drawn from the Appeal Panel (Regulations 14.27 to 14.35 of Part 2 of the LME Rules).
- 7.5 The membership and composition of a Disciplinary Committee and Appeal Committee is set out by Regulations 14.47 to 14.60 of Part 2 of the LME Rules. The Disciplinary Panel and the Appeal Panel are staffed by independent and impartial experts, who are generally former senior members of the judiciary of the English courts or experienced former senior regulators or business people. The members of the Disciplinary Panel and Appeal Panel are set out on the LME website: <https://www.lme.com/en-GB/About/Corporate-information/Committees#tabIndex=0>

- 7.6 There is no explicit power for the LME to issue warning letters to Members. Despite this, the LME does issue such letters in relation to infractions of the LME Rules such as a failure to comply with Regulation Rule 12.6 of Part 2 of the LME Rules (organising and control of a Member's internal affairs). These letters are usually issued with a view to evidencing at a later date a systematic failure to maintain such controls through repeated breaches. The FCA is kept fully abreast of all instances in which such warnings are issued.
- 7.7 Pursuant to English administrative law, the outcome of a Disciplinary Appeal Committee may be subject to judicial review by the English Courts.
- 7.8 The Head of Market Operations may publish the findings of an investigation where some or all of the findings may be of relevance to the market (Regulation 10.7 of part 2 of the LME Rules). The outcome of disciplinary proceedings may be notified to the relevant parties (Regulation 11.42 to 11.45 of Part 2 of the LME Rules). The definition of the relevant parties depends on the facts of each disciplinary proceeding. However, since 1998, the LME has made public the outcome of all disciplinary proceedings.
- 7.9 Provisions relating to applications for membership are set out in the LME Rulebook at Regulation 5 of Part 2. Applications for membership are considered by EXCOM, to whom the LME Board of Directors has delegated authority to consider such applications. The applications are considered objectively against the criteria set out in the LME Rulebook at Part 2. If the LME decides not to admit a Candidate to Membership, it must notify him with a statement of reasons for the refusal and the Candidate may within 14 days of being notified of the Directors' decision lodge notice of appeal with the Secretary. Provisions for appeal to a single arbitrator are set out at Part 2 Regulation 5.8.

## **8 CLEARING AND SETTLEMENT**

- 8.1 ***Clearing Arrangements – The exchange has appropriate arrangements for the clearing and settlement of transactions through a clearing house.***
- 8.1.1 Clearing services are provided to the LME by LME Clear. Each LME Clearing Member (Categories 1, 2 and 3) must also be a member of LME Clear. As such, the clearing arrangements for all LME Clearing Members (as required by LME Clear Rules and the specific terms of the participant agreement(s) between LME Clear and each Clearing Member) include requirements for the maintenance of appropriate bank accounts, payment facilities, documentation and the provision of collateral.
- 8.1.2 LME Clear is in the process of applying for an order exempting LME Clear from the requirement to be recognized by the OSC as a clearing agency under Section 21.2 of the OSA. Accordingly, subject to the above order being granted with respect to LME Clear, the appropriate arrangements that are regulated by the OSC would exist for the clearing and settlement of LME contracts.
- 8.2 ***Regulation of the Clearing House – The clearing house is subject to acceptable regulation.***
- 8.2.1 LME Clear is a limited company incorporated in England and is subject to the regulations of a clearing house recognized by the Bank. If LME Clear's application to become an exempt clearing organization in Ontario is granted, LME Clear will comply with the terms and conditions imposed by the OSC in its requested order, and compliance with these requirements are overseen by the OSC. As part of its oversight, the OSC reviews required filings and reviews any new substantive rules or substantive changes to current rules relating to access criteria, default management that are specific to the clearing services utilized by Ontario clearing members.
- 8.3 ***Authority of Regulator – A foreign regulator has the appropriate authority and procedures for oversight of the clearing house. This includes regular, periodic regulatory examinations of the clearing house by the foreign regulator.***
- 8.3.1 LME Clear is regulated in the UK as an approved CCP under Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (**EMIR**) and is subject to the FSMA. LME Clear is supervised by the Bank. Its authorisation was obtained on September 3, 2014.
- 8.3.2 The Bank is the responsible body for authorising and supervising CCPs in the UK. Under the EMIR regime, a College of European regulators (the College) is also formed to authorize and supervise the CCPs. The day to day supervision role is therefore delegated to the national regulator (being the Bank in the UK) but the authorization, as well as the extension of the authorization to include additional services or activities not covered by the initial authorization, must involve the College.

- 8.3.3 The Bank exercises its supervision of CCPs within the framework of the UK legal regime. Part 18 of FSMA is the main UK legislation relating to the regulation of CCPs. The standards that UK CCPs must meet to be recognized are set out in the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations. CCPs must continue to meet these standards to maintain their recognized status. The Bank oversees CCPs' continuing compliance with the recognition requirements. The UK legal regime sits within the applicable European Union regulations, being specifically EMIR, together with the related technical standards adopted by the European Securities and Markets Authority.
- 8.3.4 The Principles for Financial Market Infrastructures (**PFMIs**), published by the Committee on Payment and Market Infrastructure (**CPMI**) and the International Organization of Securities Commissions (**IOSCO**), form the keystone for the Bank's supervisory approach. The UK regulatory framework is therefore consistent with the minimum standards set out in the PFMIs.
- 8.4 **Access to the Clearing House**
- (a) *The clearing house has established appropriate written standards for access to its services.*
- (b) *The access standards for clearing members and the process for obtaining, limiting and denying access are fair, transparent and applied reasonably.*
- 8.4.1 The LME Clear Rules act as the master agreement between LME Clear and Members in respect of all transactions cleared by LME Clear. A copy of the current LME Clear Rules can be found at:  
<http://lme.com/~media/Files/LME%20Clear/Rules%20and%20regulation/LME%20Clear%20Rules%20and%20Procedures%20CLEAN%20Published%20Version.pdf>
- 8.4.2 The application process for LME Clear is set out in Membership Procedure Part B of the LME Clear Rules and on the LME Clear section of the Website.
- 8.4.3 There are two categories of LME Clear Membership:
- (a) Individual Clearing Members (**ICMs**) are permitted to clear transactions on their own behalf only;
- (b) General Clearing Members (**GCMs**) may clear transactions on their own behalf and also in respect of transactions effected (i) by the GCM with its Clients or (ii) by its Clients with other non-Members.
- 8.4.4 There are no other participant types. Only Members, in their capacity of ICMs or GCMs, can set up accounts with LME Clear and access the system for clearing services. All Members are subject to the same Membership Criteria applicable to their membership category described under LME Clear Rule 3. Once admitted as Members, all Members have access to the same range of accounts and services as described in the LME Clear Rules. There are no clearing privileges available to some Members only.
- 8.5 ***Sophistication of Technology of Clearing House – The exchange has assured itself that the information technology used by the clearing house has been adequately reviewed and tested and provides at least the same level of safeguards as required of the exchange.***
- 8.5.1 LME Clear applies industry best practice for development, implementation, operations, monitoring, management and maintenance of IT systems, using industry standard hardware and processes for which experienced resources are readily available. LME Clear ensures that a bi-annual ITIL assessment review is completed by its key IT providers. The Chief Technology Officer is responsible for ensuring IT standards are applied. At the highest level, the IT standards adopted are:
- (a) new system development and project management: system development lifecycle model supported by formal project management methodology when developing large business components; and
- (b) IT Support Services: ITIL.
- 8.5.2 LME Clear has two key categories for changes that occur on its systems. These categories are Business As Usual (**BAU**) change and major releases.
- 8.5.3 BAU change encompasses minor patches and small works to the system. These changes can be in response to small works requested by the LME Clear business or patches required for incident and defect resolution. BAU changes are predominately internally facing with no or limited visibility to outside parties.

8.5.4 Major releases result in significant change to the system which may include impact to third parties.

**Testing**

8.5.5 Due to the differences in impact and visibility, the two change routes have different levels of testing and coordination applied to them. LME Clear aims to undertake two major releases per year, dependent upon business requirements. These changes are generally considered large scale in their nature with significant Member and external impact. Due to the size of these releases extensive testing is applied to each release, testing of a release is undertaken by LME Clear test and business teams. This ensures that LME Clear fully reviews all releases to ensure that they are of sufficient quality and stability for deployment into production.

8.5.6 Testing of a major release includes: Unit Testing, Functional Testing, User Acceptance Testing, Non-functional Testing, Regression Testing, Parallel Runs, Member Tests and Penetration Testing.

- (a) Unit testing is undertaken on all new code developed on the system. This is the first test applied and is undertaken by the developers of the code. This ensures that the code is good and addresses the core requirements it is intended for. If the code passes this test then it is promoted to the release for delivery to the LME Clear test team.
- (b) Functional Testing is applied to all new releases and patches. This testing ensures that the new release or patch functionally works as expected. The functional testing is done against detailed test plans that are created prior to the code delivery. This allows the testers to execute a wide number of tests and compare against expected outcomes. If a defect is identified then it is raised with the developers for correction either via a patch or a subsequent release. All defects are tracked and reported on as part of the release project governance.
- (c) User Acceptance Testing is undertaken by the LME Clear business teams on each element of the release. This test ensures that the LME Clear business confirms that they are able to undertake their required actions and activities on the system. If a defect is identified then it is raised with the developer for correction.
- (d) Regression testing is undertaken on all major releases. This test runs through a detailed risk based regression test pack. The pack covers key elements of the LME Clear activities to ensure all elements, regardless of whether they are being changed or not still function as expected. This test ensures that there are no unintended consequences of changes made to the system.
- (e) Member Tests are carried out with LME Clear's external members. This is done with the use of two dedicated Member test systems which are available to all LME Clear members. The Member test environments are setup to provide members with the ability to test against current state and future state. During a major release members are required to self-certify that they have tested against the new release.
- (f) Non-Functional Testing is applied to all releases. This test is focused on performance of the system with the new release. The test ensures that the system continues to perform with required trade volumes. These trade volumes include peak LME trade volume and 3x peak volume as required by EMIR. Non-functional tests also include failover and resilience testing which ensures that the system continues to meet the EMIR regulatory requirement of a 2 hour recovery period.
- (g) Parallel Run Tests are undertaken on all major releases. This test involves the pre-production system being run behind the production system with all trades and price updates experienced in production played into the test system. This test is carried out by the LME Clear business team and ensures that the system continues to provide the same results as production and that functionality is as expected by the business teams.
- (h) Penetration testing is undertaken on each new release. This is undertaken by a third party on LME Clear's behalf to ensure that there are no security flaws within the new release. If a severe security flaw is detected then this is corrected before go live of the release.

8.5.7 BAU changes are smaller in scope to the major releases and are delivered as patches to the system. This means that the changes are discreet in nature and can easily be removed if required. As a result of this, BAU changes undergo Unit Testing, Functional Testing and pre-production deployment testing before deployment into production.

8.5.8 LME Clear's COO and CTO meet regularly with the Bank and inform it of major releases planned and the expected go-live dates of these. BAU changes are made with no regulatory consultation.

8.6 ***Risk Management of Clearing House – The exchange has assured itself that the clearing house has established appropriate risk management policies and procedures, contingency plans, default procedures and internal controls***

8.6.1 Clearing services are provided by LME Clear and the relationship is governed by the Clearing Services Agreement. Please see paragraph 8.3.1 above for a description of LME Clear's regulatory status and its supervision by the Bank.

#### **ERM Framework**

8.6.2 LME Clear operates a comprehensive Enterprise Risk Management (**ERM**) framework. The approach to capture all risks is twofold; a top-down management led assessment of risks for each of the risk types identified in the Risk Appetite Statement and also a 'bottom-up' process led approach through the Operational Risk Management Policy that ensures all operational risks are identified and mapped against the key risk types. This provides a full picture of the risks to which LME Clear is exposed and allows for the measurement, monitoring and management of these risks.

8.6.3 The management of each of the risk types is assigned to a member of the extended Management Team within LME Clear as the first line. The operational risks are assessed on an ongoing basis and are the subject of a dedicated resource to ensure comprehensive coverage and to identify trends and solutions. The ERM is updated on an ongoing basis and is subject to formal review by the EXCOM and the Audit Committee on at least a quarterly basis.

#### **Risk Appetite Statement**

8.6.4 The Risk Appetite Statement lays out how the Board wishes to manage risk; this includes details of policy review cycles and the need to review each policy at least annually. In addition, the Board Risk Committee or Audit Committee (as the case may be) receives quarterly reporting on each of the policies and performance. In addition, the EXCOM receives monthly reporting on operational issues and reporting on performance.

8.6.5 The Audit Committee is responsible for (amongst other things):

- (a) Monitoring and reviewing the effectiveness of internal controls
- (b) Enterprise Risk Management
- (c) Operational Risk

#### **Risk Models**

8.6.6 LME Clear conducts an independent review of all of its models that are used as part of its day-to-day risk management. The review process encompasses a theoretical review and assessment of the model methodology including:

- (a) model and methodology coverage;
- (b) theoretical properties and assumptions underlying the models;
- (c) the adequacy of the models for their underlying products and markets and the purpose for which they were developed; and
- (d) the theoretical conditions under which model assumptions may be violated and result in a potential understatement of risk.

8.6.7 Validation testing is also performed to ensure that:

- (a) the model has been correctly and comprehensively tested and assessed;
- (b) the model produces results that are aligned to expectations under the test scenarios and validation procedures that have been performed;
- (c) the model has been tested over a sufficiently long history and range of market regimes and appropriate environments; and
- (d) the adequacy and appropriateness of the validation methodology and testing.

- 8.6.8 Risk policies are reviewed at least on an annual basis. All material changes to the underlying model or methodologies, liquidity risk framework, policies or the validation process require independent validation, advice from the Board Risk Committee and approval from the Bank.

## 9 SYSTEMS AND TECHNOLOGY

- 9.1 ***Systems and Technology – Each of the exchange’s critical systems has appropriate internal controls to ensure completeness, accuracy, integrity and security of information, and, in addition, has sufficient capacity and business continuity plans to enable the exchange to properly carry on its business. Critical systems are those that support the following functions:***

- (a) ***order entry,***
- (b) ***order routing,***
- (c) ***execution,***
- (d) ***trade reporting,***
- (e) ***trade comparison,***
- (f) ***data feeds,***
- (g) ***market surveillance,***
- (h) ***trade clearing, and***
- (i) ***financial reporting.***

### **Description of the matching system**

- 9.1.1 LMEselect uses the TRADExpress platform owned by Cinnober Financial Technology AB. We understand this platform is widely used by various multinational exchanges throughout the world, including several exchanges that are headquartered in the United States. LMEselect is a customised version of this platform. This customisation is primarily required to tailor the platform to suit the LME’s unique daily Prompt Date structure.
- 9.1.2 A comprehensive description of how Members may connect to LMEselect is set out in the connectivity guide which is attached at Annex 2. There are two primary methods of access: (i) via a graphical user interface (**GUI**); and (ii) by way of the FIX API, which Members use to develop an interface between their in-house systems and LMEselect. The FIX API interface permits Members to route orders from their in-house systems to LMEselect. In addition to this, a number of independent software vendors (**ISVs**) offer off-the-shelf software solutions to members using the FIX API. Members and ISVs must have entered into software licences with LME prior to accessing LMEselect.
- 9.1.3 As non-Members of LME cannot have direct access to LMEselect, trades will always be routed through a Member and the counterparty risk to non-members will always be carried by a Clearing Member. This principle is imposed on the two primary forms of access to LMEselect as follows:
- (a) GUI: Any trader using the GUI to access LMEselect must be an accredited user. Each accredited user of LMEselect must be an employee of a Member or a person authorized by the FCA to trade on behalf of that Member; customers of Members cannot access LMEselect via the GUI. Once authorized, each accredited user is given a unique user login that is the responsibility of the Member to maintain. Each Member must ensure that necessary and proportionate pre and post-trade risk controls are in place with regards to use of GUI and certain functionality of the GUI may be customised such that use of the GUI can be restricted or limited for a particular user.
  - (b) FIX API: Where a Member wishes to access LMEselect via the FIX API, it will submit a request for a FIX key to LME. As a client of a Member is able to order route its trades via a Member into LMEselect, each request for a FIX key must specify who will access LMEselect via that FIX key. Each Member must ensure that any necessary and proportionate pre and post-trade risk controls are in place with regards to access using the FIX key. It is the responsibility of the Member to notify LME of any change of user associated with a particular FIX key. Members must ensure that a tag field is populated within LMEselect with a code produced by the Member’s own system that will identify a client. LME’s Market Operations department is able to identify which

Member or client account is represented by that code. This condition of access enables the LME to monitor order routing through the FIX API.

- 9.1.4 Irrespective of the means of access to LMEselect, Members are responsible for ensuring that all activity on LMEselect is conducted in accordance with the LME Rules and with all other applicable regulatory requirements. A Member to which a GUI login or FIX key is provided is responsible for all activity in relation to that GUI login or FIX key, including ensuring that necessary and proportionate pre and post-trade risk controls are in place. In the case of a FIX key, this applies irrespective of whether a Member or client account is trading through that FIX key. Members are financially accountable for any trading activity undertaken on LMEselect via a GUI log-in or FIX key in their name and may be subject to disciplinary action, if such Member fails to ensure compliance with the LME Rules.
- 9.1.5 In respect of all other overseas regulatory relationships (US CFTC, Australia ASIC, Hong Kong SFC, Singapore MAS), the GUI is considered the only method of direct access to the LME's trading system, and therefore the volume generated on LMEselect by individuals who are notified to the Exchange as having access through the GUI from the relevant jurisdiction (i.e. US, Australia, Hong Kong, Singapore) is the volume we report to the relevant regulator. So for example in the US we report all participants who have access to the GUI from the US (i.e. who are physically located in the US) as "US Participants" but we do not report participants who have access via the API because they are not accessing the LME's systems directly (they are using their own systems to access the market). In the same way, we would propose to report any individuals who are physically located in Ontario and accessing the GUI as "Ontario Participants" for the purposes of paragraph 20(g)(i) and (ii) of the terms and conditions of the draft exemption order.

***Description of the architecture of the systems, including hardware and distribution network, as well as any pre- and post-trade risk-management controls***

- 9.1.6 The FCA considers the LME's pre-trade and post-trade systems and controls to comply with the requirements of ESMA's "Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities" issued in December 2011. LME's pre and post-trade risk management controls are well aligned to the business which takes place through its markets and are robust enough to ensure continuity and regularity in the performance of these markets. The LME's pre and post-trade risk management controls include:
- (a) Order to trade ratio: LME's order to trade ratio policy has been designed to ensure orderly conduct of trading on LMEselect and to protect LME and Member systems. It applies to each individual market participant (Member user or Member client, identified by the unique client identifier code via FIX order entry and the LMEselect GUI user name) that enters 50,000 or more orders on a trading day between 00:45 and 19:00. The policy stipulates that a fee of £10,000 will be charged to the relevant Member in respect of any LMEselect FIX client or GUI user that exceeds a ratio of orders to lots generated of 50:1 as an average via a single FIX key or aggregate across two or more FIX keys during a trading day (00:45 - 19:00). The Exchange will waive the fee for the first event each month. It should be noted that the LME reserves the right to restrict or suspend access to LMEselect if the LME determines in its absolute discretion that the message usage generated from any LMEselect order routing client, GUI user or from any Member connection becomes capable of impairing the orderly conduct of trading on LMEselect.
  - (b) Trade cancellation: The LMEselect Error Trade Policy came into effect on 15th February, 2016. The LME's Policy for the treatment of orders that have been executed at prices not representative of the market is to generally adjust the price of an error trade rather than invalidate it. The Policy includes 'No Cancellation Ranges' (NCR) and any erroneous trade is subject to price adjustment using the full range of the NCR. The Policy includes the ability to invalidate transactions where the LME determines, in its absolute discretion, that it would be more appropriate for the market if the transactions in question were invalidated.
  - (c) Throttling policy: The maximum number of order or entries updates that can take place on LMEselect is 40 per second for each LMEselect FIX key. Order or entry updates submitted in excess of this in any given second will be queued and smoothed over the following seconds according to the throttling limit maximum. Order or entry updates are not rejected.
  - (d) User-level permissions: The trading ability of each GUI or FIX key user can be restricted so that only a certain type or types of contract can be traded. Members can also set bespoke volume and price deviation limits for each user.
  - (e) Volume and price limiting functionality: LME sets hard limits for the maximum order volume. For price limiting LME uses a dynamic price banding mechanism to constrain the allowable prices accepted on new or modified orders. This mechanism dynamically calculates a price reference curve and configurable price bands are applied to control the permitted order price. These dynamic price band limits are constantly monitored to

ensure that they are set at appropriate levels with reference to the market at that time. These levels are publicly available so that all LMEselect users are aware of the limits at any given time.

- (f) In April 2014 LME introduced pre-trade risk management (**PTRM**) functionality to LMEselect. As well as enabling a more secure market for all, PTRM provides greater visibility when onboarding new clients. More specifically, PTRM provides Members with the ability to set limits for their own trader users and order-routing clients. All orders sent to the LMEselect system pass through this pre-trade risk system regardless of whether specific limits have been set for a particular user account or not.

9.1.7 LME stays abreast of technological advancements and trends in the use of technology by its members and their clients by liaising directly with other exchanges and attending and participating in industry working groups and roundtable events. In line with the implementation of MiFID II, the LME has introduced additional pre and post-trade risk controls including dynamic price limits and an interval price limit (automated circuit breaker).

9.1.8 Members and ISVs may also add additional pre and post-trade risk management functionality to the trading systems that are used to connect to LMEselect via the FIX API. The GUI also has certain in-built controls as set out in the LMEselect user guide.

#### **Market continuity provision**

9.1.9 For the LME, any stoppages that may occur are mitigated by the failover to its parallel markets: the telephone market and the Ring. As a result, any interruptions that may occur to LMEselect are less significant than those faced by purely electronic exchanges given that trading can continue on these parallel markets.

9.1.10 In 2017 the availability of LMEselect was 99.76% during its trading hours. LME has in place robust contractual arrangements with its third party service providers to ensure extremely high availability of its entire core IT infrastructure.

9.1.11 LME has detailed business continuity and disaster recovery plans and procedures for all of its business operations. The FCA regularly reviews LME's business continuity and disaster recovery procedures. LMEselect has a highly available design architecture that includes a dual data centre failover capability. If there is a fault with the primary data centre where LMEselect is hosted, the secondary data centre will be utilised. These installations replicate each other in real time so that the trading information on both is up to date at all times. LME routinely validates this failover capability to ensure continued service if there is a fault. Disaster Recovery Tests of all services are performed annually.

9.1.12 Members who access LMEselect are recommended to have two network lines diversely routed using the LMEselect service provided by COLT Technology Services in order to ensure resilient connectivity to LMEselect.

9.1.13 All LMEselect system data is backed up on a daily basis and stored off site; additionally, LMEselect current data is housed in two geographically separate data centres which are synchronised in real-time, providing a real-time backup of critical data.

#### **9.2 *Information Technology Risk Management Procedures – The exchange has appropriate risk management procedures in place including those that handle trading errors, trading halts and circuit breakers.***

9.2.1 Under REC, the LME must always be able to take any reasonable step to “ensure that business conducted by means of its facilities is conducted in an orderly manner and so as to afford proper protection to investors.” In particular, the guidance in REC 2.6.29 (3) confirms that the FCA will have regard to whether the LME's arrangements and practices “include procedures which enable [it] to influence trading conditions or suspend trading promptly when necessary to maintain an orderly market”.

9.2.2 The LME takes steps to ensure that a fair and orderly market is maintained with regard to the submission of orders, and to protect both the LME and Members' own systems and infrastructure from inappropriate activity. The LME performs ongoing monitoring of the LMEselect, including, without limitation, performance and capacity, orders sent by Members on an individual and aggregated basis, message flow, and the concentration flow of orders, to detect potential threats to the orderly functioning of the market.

9.2.3 In addition to measures stated in paragraph 9.1, the LME has arrangements to prevent disorderly trading and breaches of capacity limits:

- (a) throttle limit, which limits the maximum number of order entries/updates sent per Member per second;

- (b) mechanisms to manage volatility; and
- (c) pre-trade controls.

9.2.4 The dynamic price band functionality enables the LME to manage volatility which may include, where appropriate, the temporary suspension of the matching of orders in LMEselect. The LME may, at its absolute discretion, acting reasonably, suspend trading on LMEselect for such periods it considers necessary in the interests of maintain a fair and orderly market. The LME will keep such suspension under constant review, and trading will be resumed as soon as reasonably practicable following any such suspension of LMEselect.

9.2.5 The LME may suspend access to LMEselect or any of its systems, either at the individual Member or dealer level or for the whole market. This action may be taken at the initiative of the LME or at the request of the relevant Member or where required by the LME Clear Rules, or by the FCA or any other relevant regulatory authority.

#### **Trade Halts**

9.2.6 The 'kill switch' or 'trade halt' is a feature of the LME's Pre Trade Risk Management functionality and enables relevant staff in Trading Operations to halt trading across the market as a whole, in a particular contract, a prompt date of a contract, or access to trading by individual users in LMEselect.

9.2.7 A trade halt can be applied by Trading Operations if LMEselect is experiencing one of the following issues:

- (a) Network or technical issues;
- (b) Incorrect uploaded reference data;
- (c) Any other scenario when a trade halt would be deemed to be in the best interests of the market.

9.2.8 The decision to apply a trade halt must be authorised by two members of EXCOM and recorded. In the event that the underlying of a derivative has been suspended, any related derivative that is completely dependent on the former must also be suspended. An example of this is an option that is linked to a derivative whose underlying has been suspended.

#### **Error Trades**

9.2.9 For every LME contract, the LME will specify a no-cancellation range (NCR) which is published on the website. This governs the price range in which the LME deems a trade acceptably-priced, or not acceptably-priced. The Error Trade Policy (please see Ref 17/344 - Appendix 1 at <https://www.lme.com/About/Regulation/Rules/Notices>) sets out the following circumstances:

- (a) the NCR which Members are not permitted to cancel error trades;
- (b) the LME permits cancellation of error trades outside the NCR where both parties agree to cancel; and
- (c) the LME may price-adjust the rate of the trade, rather than invalidate it.

9.2.10 The LME Order Cancellations and Controls Policy can be found at Appendix 3 of Notice 17/344 which is available at <https://www.lme.com/About/Regulation/Rules/Notices>. Paragraph 10 of this policy refers to the LME's throttle limit per user, which limits the number of order entries and updates to 40 per second.

#### **Members' Controls**

9.2.11 The LME Rules require Members to comply with all relevant regulatory requirements including, but not limited to, those set out in MiFID II. In particular Members must have policies in place for the following:

- (a) Pre-trade controls on price, volume, value and usage of LMEselect, and post-trade controls on the Member's trading activities across both LMEselect and the Matching System;
- (b) these policies should set out the process by which the configuration for each control is determined; the process for revising such configuration, and any over-ride or emergency process;
- (c) the technical and functional conformance testing that must be undertaken prior to deployment of all third-party systems and/or applications that interface with LMEselect and/or the Matching System.

- (d) in addition to any over-ride or emergency policy referred to in b) above, Members must have a policy relating to the use of kill functionality with regard to business executed on LMEselect.

9.2.12 Members must ensure that the above policies are also reflected in relevant “Business Continuity/Disaster Recovery Plans” maintained and followed by Members, such that the invocation of either does not result in any reduction in the level of control exercised over the business conducted through the LME’s systems. Members must ensure that all staff in key positions at Members are suitably qualified.

## **10 FINANCIAL VIABILITY AND REPORTING**

10.1 ***Financial Viability – The exchange has sufficient financial resources for the proper performance of its functions and to meet its responsibilities.***

10.1.1 The FSMA Recognition Requirements specify that the LME must have financial resources sufficient for the proper performance of its functions as an RIE. In considering whether this requirement is satisfied, the FCA must take into account all the circumstances, including the LME’s connection with any person, and any activity carried on by LME, whether or not it is an exempt activity.

10.1.2 The FCA has adopted guidance in the FCA Handbook at REC 2.3 which elaborates on the FSMA Recognition Requirements. This guidance sets out principles which the FCA will take into account to determine if the above requirement has been satisfied. This guidance states that a UK RIE which at any time holds:

- (a) eligible financial resources not less than the greater of:
  - (i) an amount calculated under the standard approach (equal to six months of operating costs); and
  - (ii) an amount calculated under a risk-based approach (which involves the undertaking of an annual financial risk assessment); and
- (b) net capital not less than the amount eligible financial resources determined under (a);

will, at the time, be considered to have sufficient financial resources in respect of operational and other risks unless there are special circumstances indicating otherwise.

10.1.3 LME maintains the current minimum capital amounts needed, and will maintain any future minimum capital amounts needed to meet FCA requirements.

## **11 TRANSPARENCY**

11.1 ***Transparency – The Exchange has adequate arrangements to record and publish accurate and timely trade and order information. This information is provided to all participants on an equitable basis.***

11.1.1 The LME complies with the relevant MiFID II Regulatory Technical Specifications on pre- and post-trade transparency requirements. The LME Rules describe sound trading practices and the accuracy of market information provided by participants to ensure the transparency of market behavior of all market participants.

11.1.2 The LME’s Real Time Market Data feed (**LMEselectMD**) provides detailed, real-time, historic and summary reports of trading activity within LME for external data vendors and market participants. The system is supported on a 24x5 basis and is fundamental to the operation of the LME and the market. The data feed is monitored by IT to detect any potential disruption to the provision of the data, which would be investigated and resolved.

11.1.3 The commercial terms for market data apply in a non-discriminatory way and are published on the LME website and via notice. Information on the fee schedule more widely is also publically available. The Market Data model has been built to reflect MIFID II requirements on publication of pre- and post-trade data.

### **Pre-trade Publication**

11.1.4 Bids and offers made via open outcry in the Ring are captured by LME’s Trading Operations team and published to the market via LMEselect MD. All orders submitted to LMEselect (the LME’s electronic order book), are published on a near real-time basis via LMEselect MD, the LME’s market data feed. Every half trade instruction that is submitted to the LME’s matching system (**LMEsmart**) on the inter-office market is published on a near real-time basis via LMEselect MD.

## Post-trade Publication

- 11.1.5 Where orders match in LMEselect so the resulting trades are published to the market on a near real-time basis via LMEselect MD. Trades executed via open outcry in the Ring are captured by LME's Trading Operations team and published to the market via LMEselect MD. Half-trade instructions matched on the inter-office market are then published on near real-time on LMEselect MD.

## 12 RECORD KEEPING

- 12.1 ***Record Keeping – The exchange has and maintains adequate systems in place for the keeping of books and records, including, but not limited to, those concerning the operations of the exchange, audit trail information on all trades, and compliance with, and/or violations of exchange requirements.***

- 12.1.1 MiFID imposes a broad obligation upon investment firms to retain records for a minimum of five years. The FCA Handbook requires authorized firms to retain certain records for longer periods.

- 12.1.2 All persons that have been authorized to conduct investment business in the UK are subject to the audit trail and conduct of business rules imposed by the FCA. FCA authorized firms are required to maintain records of any written communication between the firm and its customers concerning regulated business and to retain copies of contract notes, confirmation notes, and exercise notices.

- 12.1.3 LME Rules set forth similar audit trail requirements – see for example regulation 9.6 of Part 2 of the LME Rules in particular. All dealings by Members must be properly documented and then reconciled with LME Clear. For every contract traded, Members must use a specific code indicating the nature of each transaction. Additionally, the LME's IT infrastructure ensures that all material information regarding: (i) the activity of LME participants; (ii) all orders placed, varied or cancelled by Members; and (iii) all transactions executed by Members, is recorded, processed and stored in a manner that enables the information to be reviewed by LME and other entities that have a regulatory interest in the information. Regulation 9 of Part 2 of the LME Rules requires Members to permit access to their premises and to relevant records; the Member surveillance team exercises these powers during its audit program. In addition pursuant to Regulation 9 of Part 2 of the LME Rules, Members are required to forward information about their activity to LME, and procure their clients to do the same, upon request.

- 12.1.4 All relevant data relating to orders and trades is captured in LMEselect. This information can be exported by appropriately authorized Member users and LME users of LMEselect and therefore retained indefinitely.

- 12.1.5 The LME has a detailed record retention policy which details how all relevant records must be kept, and for how long. This ensures that the LME remains in compliance with all relevant regulatory requirements, which include REC and also relevant UK and European data protection requirements (including the UK Data Protection Act and the forthcoming General Data Protection Regulation or "GDPR").

## 13 OUTSOURCING

***Outsourcing – Where the Exchange has outsourced any of its key services or systems to a service provider, it has appropriate and formal arrangements and processes in place that permit it to meet its obligations, and that are in accordance with industry best practices.***

The LME does not outsource any of its key services or systems.

## 14 FEES

### 14.1 Fees

(a) ***All fees imposed by the exchange are reasonable and equitably allocated and do not have the effect of creating unreasonable condition or limit on access by participants to the services offered by the exchange.***

(b) ***The process for setting fees is fair and appropriate, and the fee model is transparent.***

- 14.1.1 The LME's fees are set out on the website at <https://www.lme.com/Trading/Access-the-market/Fees>. The LME's fees have been designed to be fair, transparent and non-discriminatory, as required by applicable legislation, including the Recognition Requirements and MiFID II.

- 14.1.2 There are two types of contracts traded on the LME – Cleared Contracts and Client Contracts. A Cleared Contract is a contract agreed between two Clearing Members of the LME (Categories 1-3) and a Client Contract is a contract agreed between a Client and a Category 1, 2, or 4 Member. The LME operates three trading venues, the Ring, the inter-office market and LMEselect. All Member-to-Member trades and Client trades executed on any of the three venues are submitted to the LME matching system, LMEsmart, for matching and registration. All trades entered into LMEsmart are then automatically transmitted to the clearing system, LMEmercury.
- 14.1.3 EDW houses the LME fee calculator. The LME Fee calculator assigns each trade a transaction fee according to certain criteria, i.e. whether it is a Member-to-Member or Client trade, an outright, long-dated, medium dated or short-dated carry, a Ring, Basis Ring, Inter-Office or Select trade, or a Give-Up trade. All fees imposed by the exchange are reasonable and equitably allocated and do not have the effect of creating unreasonable conditions or limiting access by participants to the services offered by the exchange.
- 14.1.4 The LME's fees are set by the Board. In setting fees, the LME takes into account the fees charged by competitors for equivalent transactions to ensure that fees are fair and non-discriminatory.

## **15 INFORMATION SHARING AND OVERSIGHT ARRANGEMENTS**

### **15.1 *Information Sharing and Regulatory Cooperation – The exchange has mechanisms in place to enable it to share information and otherwise co-operate with the OSC, self-regulatory organizations, other exchanges, clearing agencies, investor protection funds, and other appropriate regulatory bodies.***

- 15.1.1 The Chief Executive of LME warrants to notify OSC staff promptly if any of the representations made in connection with or related to this application for LME's registration cease to be true or correct in any material respect, or become incomplete or misleading.
- 15.1.2 Additional information relevant to LME, LMEselect and market participants will be available to the OSC and its staff through the OSC-FCA MOU.
- 15.1.3 LME Clear does not have any existing arrangements in place with the OSC but has applied for an order seeking exemption from the requirements to be recognized as a clearing agency in Ontario and thus it is expected that, if the order is granted, as part of its terms and conditions, there will be appropriate reporting requirements prescribed by the OSC.
- 15.1.4 The FCA is party to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, as is the OSC.
- 15.1.5 The FCA is party to the Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations.

### **15.2 *Oversight Arrangements – Satisfactory information sharing and oversight agreements exist between the Ontario Securities Commission and the Foreign Regulator.***

- 15.2.1 The OSC, together with the Autorité des marchés financiers, Alberta Securities Commission and British Columbia Securities Commission, have entered into a Memorandum of Understanding with the Bank and FCA concerning regulatory cooperation related to the supervision and oversight of regulated entities that operate in both the UK and Canada (the **Supervisory MOU**). The Supervisory MOU provides a comprehensive framework for consultation, cooperation and information-sharing related to the day-to-day supervision and oversight of cross-border regulated entities and enhances the OSC's ability to supervise these entities. The Supervisory MOU became effective on August 21, 2013.

## **16 IOSCO PRINCIPLES**

### **16.1 *IOSCO Principles – To the extent it is consistent with the laws of the foreign jurisdiction, the exchange adheres to the standards of the International Organization of Securities Commissions (IOSCO) including those set out in the "Principles for the Regulation and Supervision of Commodity Derivatives Markets" (2011).***

- 16.1.1 The LME adheres to the IOSCO principles by virtue of the fact that it must comply with the FCA rules and regulations, which reflect the IOSCO standards. The UK was on the working group that developed these Principles and the predecessor organization to the FCA (the FSA) endorsed them.

- 16.1.2 The LME adheres to the IOSCO principles set out in the “Objectives and Principles of Securities Regulation” (2003) applicable to exchanges and trading systems. The LME maintains operations to achieve the following and works closely with LME Clear to:
- (a) ensure the integrity of trading through fair and equitable rules that strike an appropriate balance between the demands of different market participants;
  - (b) promote transparency of trading;
  - (c) detect and deter manipulation and other unfair trading practices;
  - (d) ensure proper management of large exposures, default risk and market disruption; and
  - (e) ensure that clearing and settlement of transactions are fair, effective and efficient, and that they reduce systemic risk.

**Part III Submissions by LME**

**1. Submissions Concerning the Exchange Relief**

- A. All contracts traded on the LME fall under the definitions of “commodity futures contract” or “commodity futures option” set out in section 1 of the CFA. The LME is therefore considered a “commodity futures exchange” as defined in section 1 of the CFA and is prohibited from carrying on business in Ontario unless it is registered or exempt from registration under section 15 of the CFA. LME seeks to provide Ontario market participants with direct, electronic access to trading in LME contracts and may therefore be considered to be “carrying on business as a commodity futures exchange” in Ontario.
- B. LME is not registered with or recognized by the OSC as a commodity futures exchange under the CFA and no LME contracts have been accepted by the Director (as defined in the OSA) under the CFA. Therefore, LME contracts are considered “securities” under paragraph (p) of the definition of “security” set out in subsection 1(1) of the OSA and the LME is considered an “Exchange” under the OSA. Therefore, LME is prohibited from carrying on business in Ontario unless it is recognized or exempt from recognition under subsection 21(1) of the OSA. The LME seeks to provide Ontario market participants with direct, electronic access to trading in LME contracts and may therefore be considered to be “carrying on business as an Exchange” in Ontario.
- C. LME satisfies all the criteria for registration or exemption from registration as a commodity futures exchange and recognition or exemption from recognition as an exchange set out by OSC Staff, as described under Part II of this application. Ontario market participants that trade in commodity futures would benefit from the ability to trade on the LME, as they would have access to a range of exchange-traded metal products which are not currently available in Ontario. The LME would offer its Ontario Participants a transparent, efficient and liquid market to trade LME contracts. LME uses sophisticated information systems and has adopted rules and compliance functions that will ensure that Ontario users are adequately protected in accordance with international standards set by IOSCO. We therefore submit that it would not be prejudicial to the public interest to grant the Requested Relief.
- D. Provided that the OSC exempts LME from the requirement to be registered as a commodity futures exchange under the CFA, LME will be an “exempt exchange” as defined in 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)* and the LME contracts will be “exempt exchange contracts” under OSC Rule 91-503. We submit that OSC Rule 91-503 applies to the LME as the LME is “situated outside Ontario” and that separate exemptive relief for trades in LME contracts is not required from the registration requirement in Section 25 of the OSA and prospectus requirement in section 53 of the OSA pursuant to Part II of OSC Rule 91-503.

**2. Submissions Concerning the Hedger Relief**

- A. LME seeks to provide direct access to trading on the LME by Ontario Participants that may be “hedgers” as defined in subsection 1(1) of the CFA. Section 32(1)(a) of the CFA provides an exemption from registration for trades “by a hedger through a dealer,” which will not be available to Ontario resident hedgers because they will have direct access to LME and will not be considered to be executing “through a dealer”.
- B. To become Members, Ontario Participants must comply with the LME Rules and all applicable law pertaining to the use of LME. As well, the relevant LME Clear Member with which an Ontario Participant seeks to open an account for the purpose of trading on LME will complete credit, know-your-client and anti-money laundering checks, suitability analyses and other account supervision procedures prior to entering into clearing agreements with all clients and on an ongoing

basis in accordance with FCA and LME requirements. Furthermore, because the LME Clear Members are ultimately responsible for the trading activity of any Ontario Participants that they agree to guarantee, they can be expected to ensure that they themselves, and other such Ontario Participants, will have the regulatory permissions, requisite sophistication, and proficiency in the trading of LME contracts to satisfy investor protection concerns associated with having direct access to the LME.

- C. LME intends to confirm that Ontario Participants that seek to rely on the Hedger Relief are “hedgers” (as defined in subsection 1(1) of the CFA) by obtaining a representation stating such from the Ontario resident hedgers as part of their onboarding documentation. The documentation will specify that this representation is deemed to be repeated by the Ontario Participant each time it enters an order for a contract on the LME and that the Ontario Participant must be a “hedger” for the purposes of each trade resulting from such an order.
- D. The requested Hedger Relief will allow sophisticated Ontario residents who meet the definition of “hedger” to become Ontario Participants and gain the benefits of direct access to the LME. Given the sophistication of such Ontario Participants and the fact that the financial responsibility for their trading activity ultimately lies with the LME Clearing Member that guarantees their trades, it is not necessary for the protection of other investors or the integrity of the market to require such Ontario Participants to trade in LME contracts through a dealer rather than having direct access to LME.

### 3. Submissions Concerning the Bank Relief

- A. Section 35.1 of the OSA (the **Section 35.1 Exemption**) provides that financial institutions, such as Ontario Banks, are exempt from the requirement to be registered under the OSA to act as dealers provided that the conditions of the exemption are met. However, there is no corresponding exemption from registration for trades by financial institutions, such as Ontario Banks, in the CFA. For this reason, the LME is seeking the OSC’s approval for the Bank Relief.
- B. The LME intends to confirm that Ontario Participants that seek to rely on the Bank Relief are banks listed in Schedule 1 to the *Bank Act* (Canada), or are otherwise exempt from the requirement to be registered in Ontario, by obtaining a representation from the Ontario resident applicants for membership in their onboarding documentation. The documentation will specify that this representation is deemed to be repeated by the Ontario Participant each time it enters an order for a contract on the LME.
- C. The Registration Relief will allow sophisticated Ontario residents who are banks listed in Schedule 1 to the *Bank Act* (Canada) to become Ontario Participants and gain the benefits of direct access to the LME. Given the sophistication and heavy regulation of such Ontario Participants, it is not necessary for the protection of other investors or the integrity of the market to require such Ontario Participants to send their orders through a registered dealer rather than accessing the LME directly.
- D. If the Bank Relief is granted, it would suggest the OSC agrees that the policy basis that underlies the Section 35.1 Exemption from the dealer registration requirements of the OSA would also be a valid policy basis for an order exempting Ontario Banks from the dealer registration requirements under the CFA. As well, if the Exchange Relief is granted, the LME will be exempt from the requirements to be recognized as a stock exchange under the OSA and to be registered as an exchange under the CFA and the OSC will effectively be authorising the LME to carry on business as a commodity futures exchange in Ontario. The granting of the Exchange Relief would also mean that the LME has satisfied the OSC’s criteria for recognition (or exemption from recognition) of an exchange as set out in Staff Notice 21-702 and under the approval criteria discussed above. However, because the CFA does not contemplate that the OSC may exempt exchanges from its registration and/or recognition requirements, it does not include contracts traded on an exchange that has been exempted from the registration and/or recognition requirements as a category of “permitted contract” under Section 33 of the CFA. As a result, Ontario Participants will not be permitted to trade contracts on the LME even though (i) the LME would be authorized to carry on business in Ontario by virtue of the Exchange Relief being granted, and (ii) Ontario Banks would be exempt from the requirement to be registered as dealers under the CFA by virtue of the Bank Relief being granted. Since the LME expects its prospective participants will be Ontario Banks currently, as an extension of the above logic the LME requests the Bank Relief so that Ontario Banks that become Ontario Participants can trade contracts on the LME.

### 3. Similar Relief has been Granted

The LME notes that exemptive relief similar to the Requested Relief has been granted by the OSC in (i) *In the Matter of ICE Futures* (September 1, 2006), (ii) *In the Matter of Onechicago, LLC* (October 14, 2016), and (iii) *In the Matter of Nodal Exchange, LLC* (October 7, 2014).

**Part IV Other Matters**

LME consents to the publication of this Application for public comment in the OSC Bulletin.

Should you have any questions on this application, please contact the LME Legal team..

Yours faithfully,

**LME**

## APPENDIX 1

### CRITERIA FOR EXEMPTION

#### PART 1 REGULATION OF THE EXCHANGE

##### 1.1 Regulation of the Exchange

The exchange is regulated in an appropriate manner in another jurisdiction by a foreign regulator (**Foreign Regulator**).

##### 1.2 Authority of the Foreign Regulator

The Foreign Regulator has the appropriate authority and procedures for oversight of the exchange. This includes regular, periodic oversight reviews of the exchange by the Foreign Regulator.

#### PART 2 GOVERNANCE

##### 2.1 Governance

The governance structure and governance arrangements of the exchange ensure:

- (a) effective oversight of the exchange,
- (b) that business and regulatory decisions are in keeping with its public interest mandate,
- (c) fair, meaningful and diverse representation on the board of directors (Board) and any committees of the Board, including:
  - (i) appropriate representation of independent directors, and
  - (ii) a proper balance among the interests of the different persons or companies using the services and facilities of the exchange,
- (d) the exchange has policies and procedures to appropriately identify and manage conflicts of interest, and
- (e) there are appropriate qualifications, remuneration, limitation of liability and indemnity provisions for directors, officers and employees of the exchange.

##### 2.2 Fitness

The exchange has policies and procedures under which it will take reasonable steps, and has taken such reasonable steps, to ensure that each director and officer is a fit and proper person.

#### PART 3 REGULATION OF PRODUCTS

##### 3.1 Review and Approval of Products

The products traded on the exchange and any changes thereto are reviewed by the Foreign Regulator, and are either approved by the Foreign Regulator or are subject to requirements established by the Foreign Regulator that must be met before implementation of a product or changes to a product.

##### 3.2 Product Specifications

The terms and conditions of trading the products are in conformity with the usual commercial customs and practices for the trading of such products.

##### 3.3 Risks Associated with Trading Products

The exchange maintains adequate provisions to measure, manage and mitigate the risks associated with trading products on the exchange including, but not limited to, margin requirements, intra-day margin calls, daily trading limits, price limits, position limits, and internal controls.

## **PART 4 ACCESS**

### **4.1 Fair Access**

- (a) The exchange has established appropriate written standards for access to its services including requirements to ensure
  - (i) participants are appropriately registered as applicable under Ontario securities laws or Ontario commodity futures laws, or exempted from these requirements,
  - (ii) the competence, integrity and authority of systems users, and
  - (iii) systems users are adequately supervised.
- (b) The access standards and the process for obtaining, limiting and denying access are fair, transparent and applied reasonably.
- (c) The exchange does not unreasonably prohibit, condition or limit access by a person or company to services offered by it.
- (d) The exchange does not
  - (i) permit unreasonable discrimination among participants, or
  - (ii) impose any burden on competition that is not reasonably necessary and appropriate.

## **PART 5 REGULATION OF PARTICIPANTS ON THE EXCHANGE**

### **5.1 Regulation**

The exchange has the authority, resources, capabilities, systems and processes to allow it to perform its regulation functions, whether directly or indirectly through a regulation services provider, including setting requirements governing the conduct of its participants, monitoring their conduct, and appropriately disciplining them for violations of exchange requirements.

## **PART 6 RULEMAKING**

### **6.1 Purpose of Rules**

- (a) The exchange has rules, policies and other similar instruments (Rules) that are designed to appropriately govern the operations and activities of participants.
- (b) The Rules are not contrary to the public interest and are designed to
  - (i) ensure compliance with applicable legislation,
  - (ii) prevent fraudulent and manipulative acts and practices,
  - (iii) promote just and equitable principles of trade,
  - (iv) foster co-operation and co-ordination with persons or companies engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in the products traded on the exchange,
  - (v) provide a framework for disciplinary and enforcement actions, and
  - (vi) ensure a fair and orderly market.

## **PART 7 DUE PROCESS**

### **7.1 Due Process**

For any decision made by the exchange that affects a participant, or an applicant to be a participant, including a decision in relation to access, exemptions, or discipline, the exchange ensures that:

- (a) parties are given an opportunity to be heard or make representations, and
- (b) it keeps a record of, gives reasons for, and provides for appeals or reviews of its decisions.

## **PART 8 CLEARING AND SETTLEMENT**

### **8.1 Clearing Arrangements**

The exchange has appropriate arrangements for the clearing and settlement of transactions through a clearing house.

### **8.2 Regulation of the Clearing House**

The clearing house is subject to acceptable regulation.

### **8.3 Authority of Regulator**

A foreign regulator has the appropriate authority and procedures for oversight of the clearing house. This includes regular, periodic regulatory examinations of the clearing house by the foreign regulator.

### **8.4 Access to the Clearing House**

- (a) The clearing house has established appropriate written standards for access to its services.
- (b) The access standards for Clearing Members and the process for obtaining, limiting and denying access are fair, transparent and applied reasonably.

### **8.5 Sophistication of Technology of Clearing House**

The exchange has assured itself that the information technology used by the clearing house has been adequately reviewed and tested and provides at least the same level of safeguards as required of the exchange.

### **8.6 Risk Management of Clearing House**

The exchange has assured itself that the clearing house has established appropriate risk management policies and procedures, contingency plans, default procedures and internal controls.

## **PART 9 SYSTEMS AND TECHNOLOGY**

### **9.1 Systems and Technology**

Each of the exchange's critical systems has appropriate internal controls to ensure completeness, accuracy, integrity and security of information, and, in addition, has sufficient capacity and business continuity plans to enable the exchange to properly carry on its business. Critical systems are those that support the following functions:

- (a) order entry,
- (b) order routing,
- (c) execution,
- (d) trade reporting,
- (e) trade comparison,
- (f) data feeds,
- (g) market surveillance,
- (h) trade clearing, and
- (i) financial reporting.

## **9.2 Information Technology Risk Management Procedures**

The exchange has appropriate risk management procedures in place including those that handle trading errors, trading halts and circuit breakers.

## **PART 10 FINANCIAL VIABILITY**

### **10.1 Financial Viability**

The exchange has sufficient financial resources for the proper performance of its functions and to meet its responsibilities.

## **PART 11 TRANSPARENCY**

### **11.1 Transparency**

The exchange has adequate arrangements to record and publish accurate and timely trade and order information. This information is provided to all participants on an equitable basis.

## **PART 12 RECORD KEEPING**

### **12.1 Record Keeping**

The exchange has and maintains adequate systems in place for the keeping of books and records, including, but not limited to, those concerning the operations of the exchange, audit trail information on all trades, and compliance with, and/or violations of exchange requirements.

## **PART 13 OUTSOURCING**

### **13.1 Outsourcing**

Where the exchange has outsourced any of its key services or systems to a service provider, it has appropriate and formal arrangements and processes in place that permit it to meet its obligations and that are in accordance with industry best practices.

## **PART 14 FEES**

### **14.1 Fees**

- (a) All fees imposed by the exchange are reasonable and equitably allocated and do not have the effect of creating an unreasonable condition or limit on access by participants to the services offered by the exchange.
- (b) The process for setting fees is fair and appropriate, and the fee model is transparent.

## **PART 15 INFORMATION SHARING AND OVERSIGHT ARRANGEMENTS**

### **15.1 Information Sharing and Regulatory Cooperation**

The exchange has mechanisms in place to enable it to share information and otherwise co-operate with the Commission, self-regulatory organizations, other exchanges, clearing agencies, investor protection funds, and other appropriate regulatory bodies.

### **15.2 Oversight Arrangements**

Satisfactory information sharing and oversight agreements exist between the Ontario Securities Commission and the Foreign Regulator.

## **PART 16 IOSCO PRINCIPLES**

### **16.1 IOSCO Principles**

To the extent it is consistent with the laws of the foreign jurisdiction, the exchange adheres to the standards of the International Organization of Securities Commissions (**IOSCO**) including those set out in the "Principles for the Regulation and Supervision of Commodity Derivative Markets" (2011).

APPENDIX B

IN THE MATTER OF  
THE SECURITIES ACT,  
R.S.O. 1990, CHAPTER S. 5, AS AMENDED  
(THE OSA)

AND

IN THE MATTER OF  
THE COMMODITY FUTURES ACT,  
R.S.O. 1990, CHAPTER C.20, AS AMENDED  
(THE CFA)

AND

IN THE MATTER OF  
THE LONDON METAL EXCHANGE

ORDER

(Section 147 of the OSA and sections 38 and 80 of the CFA)

**WHEREAS** London Metal Exchange (**LME**) has filed an application (**Application**) with the Ontario Securities Commission (**OSC**) requesting:

- (a) an order under Section 147 of the OSA exempting the LME from the requirement to be recognized as an exchange under Section 21(1) of the OSA (the **OSA Relief**);
- (b) an order under Section 80 of the CFA exempting the LME from the requirement to be registered as a commodity futures exchange under Section 15(1) of the CFA (the **Section 15 Relief**);
- (c) an order under Section 38 of the CFA exempting trades in contracts on the LME by a “hedger”, as defined in subsection 1(1) of the CFA (Hedger), from the registration requirements under Section 22 of the CFA (**Hedger Relief**); and
- (d) an order under Section 38 of the CFA exempting trades in contracts on the LME by a bank listed in Schedule I to the *Bank Act* (Canada) (**Bank**) entering orders as principal and for its own account only from the registration requirement under Section 22 of the CFA (**Bank Relief** and, together with the Hedger Relief, **Registration Relief**) (the OSA Relief, the Section 15 Relief and the Registration Relief, together the **Requested Relief**).

**AND WHEREAS** OSC Rule 91-503 *Trades in Commodity Futures Contracts and Commodity Futures Options Entered into on Commodity Futures Exchanges Situate Outside of Ontario* exempts trades of commodity futures contracts or commodity futures options made on commodity futures exchanges not registered with or recognized by the OSC under the CFA from sections 25 and 53 of the OSA;

**AND WHEREAS** the deemed rule titled *In the Matter of Trading in Commodity Futures Contracts and Commodity Futures Options Entered into on Commodity Futures Exchanges Situate Outside Canada Other Than Commodity Futures Exchanges in the United States of America* provides that section 33 of the CFA does not apply to trades in certain contracts made on the LME;

**AND WHEREAS** LME has represented to the OSC that:

1. The LME is a private company registered in England and Wales (registered number 2128666) whose registered office is at 10 Finsbury Square, London, EC2A 1AJ, United Kingdom (**UK**). The LME has no subsidiaries;
2. The LME is a wholly-owned subsidiary of LME Holdings Limited, a private limited company registered in England and Wales (registered number 4081218). LME Holdings Limited has no trading subsidiaries other than the LME;
3. LME Holdings Limited (the sole shareholder of the LME) in turn is a wholly owned subsidiary of HKEx Investment (UK) Limited, which is a wholly owned subsidiary of HKEx International Limited (a public limited company) registered in Hong Kong. HKEx International Limited is wholly owned by Hong Kong Exchanges and Clearing Limited, a publicly listed company registered in Hong Kong and listed on the Hong Kong stock exchange;

4. The LME receives a majority of its revenue from transaction fees for contracts executed through the LME;
5. The LME is subject to a comprehensive regulatory regime in the UK and Europe. As a UK Recognized Investment Exchange (**RIE**), the LME is subject to the UK *Financial Services and Markets Act 2000* (**FSMA**) and is regulated by the Financial Conduct Authority (**FCA**). The FCA fulfils its regulatory responsibilities within the framework established by FSMA and related legislation. As an RIE, the LME is also exempt from the general prohibition in respect of any “regulated activity” which is carried on as part of the LME’s business as an investment exchange;
6. The LME operates futures and options markets in thirteen industrial, base metals: (1) copper, (2) tin, (3) lead, (4) zinc, (5) primary aluminium, (6) nickel, (7) aluminium alloy, (8) NASAAC, steel billet, (9) cobalt, (10) molybdenum, (11) cash settled steel scrap, (12) cash settled steel rebar, and (13) regional aluminium. LME also offers London precious metal contracts in gold and silver futures (LMEprecious). The majority of all global non-ferrous trading business is conducted on the LME and the prices discovered on the LME’s trading platforms are used as global reference prices;
7. The LME may be described as an on-exchange forwards market. LME contracts (i.e. contracts under which metal is traded in accordance with the LME rules and regulations (**LME Rules**)) are based on physical settlement by the transfer of ownership of metal stored in listed warehouses; this guarantees price convergence as the far futures settlement dates converge on the cash settlement date (i.e. two days forward);
8. London Metal Exchange members (**Members**) who have specific permission from LME may trade LME contracts. All LME contracts are entered into on a principal to principal basis. LME contracts have at least one party being a Member of LME. LME participants who enter into LME contracts therefore deal off their own book, entering into an equivalent contract with customers for whom they are acting. In addition, organizations or an individual admitted to membership of the LME in accordance with the LME Rules will typically have entered into a separate contractual arrangement with their customers setting out the basis on which trades will be executed on the instructions of customers;
9. LME Clear Limited (**LME Clear**) has been established to act as the central counterparty in relation to all classes of contracts that are traded on the LME. LME Clear was incorporated on 21 April 2011 by LME as part of its global strategy to expand its clearing activities. LME Clear is also applying to the OSC for exemptive relief from recognition as a clearing agency under Section 21.2 of the OSA.
10. The LME does not have any offices or maintain other physical installations in Ontario or any other Canadian province or territory;
11. The LME proposes to offer prospective participants in Ontario access to the LMEselect system, the Inter-office Market and to Ring-dealing on the LME and to clearing support services. To obtain direct access to the LME, a prospective member in Ontario must execute a membership agreement in which the prospective member agrees to abide by the LME Rules and consent to submit to the jurisdiction of the Exchange. Prospective members in Ontario once admitted as members by LME (**Ontario Participants**) may access the Exchange. The LME Rules provide clear and transparent access criteria and requirements for all market participants, as well as minimum financial requirements for participants to maintain the financial integrity of the LME. The LME applies these criteria to all participants in an impartial manner;
12. LME is requesting the Hedger Relief and the Bank Relief in order for Ontario Participants (who are either Hedgers or Banks) to be able to access trading on the LME directly, without having to be registered as dealers under the CFA;
13. All contracts traded on the LME fall under the definitions of “commodity futures contract” or “commodity futures option” set out in section 1 of the CFA. The LME is therefore considered a “commodity futures exchange” as defined in section 1 of the CFA and is prohibited from carrying on business in Ontario unless it is registered or exempt from registration under section 15 of the CFA. The LME seeks to provide Ontario market participants with direct, electronic access to trading in LME contracts and may therefore be considered to be “carrying on business as a commodity futures exchange” in Ontario;
14. The LME is not registered with or recognized by the OSC as a commodity futures exchange under the CFA and no LME contracts have been accepted by the Director (as defined in the OSA) under the CFA. Therefore, LME contracts are considered “securities” under paragraph (p) of the definition of “security” set out in subsection 1(1) of the OSA and the LME is considered an “Exchange” under the OSA. Therefore, LME is prohibited from carrying on business in Ontario unless it is recognized or exempt from recognition under subsection 21(1) of the OSA. The LME seeks to provide Ontario market participants with direct, electronic access to trading in LME contracts and may therefore be considered to be “carrying on business as an Exchange” in Ontario;
15. The LME ensures that all applicants to become Members must satisfy certain criteria, including, among other things: validly organized and in good standing, good reputation, business integrity and adequate financial resources to assume the responsibilities and privileges of being a Member. Members are responsible for, among other things, compliance

with the LME Rules, as those rules relate to the entering and executing of transactions, and to comply with all applicable laws pertaining to the use of the LME;

**AND WHEREAS** the OSC will monitor developments in international and domestic capital markets and the LME's activities on an ongoing basis to determine whether it is appropriate for the OSC to continue to grant the Requested Relief and, if so, whether it is appropriate for the Requested Relief to continue to be granted subject to the terms and conditions set out in Schedule A to this order;

**AND WHEREAS** the LME has acknowledged to the OSC that the scope of the Requested Relief and the terms and conditions imposed by the OSC set out in Schedule A to this order may change as a result of its monitoring of developments in international and domestic capital markets or the LME's activities, or as a result of any changes to the laws in Ontario affecting trading in derivatives, commodity futures contracts, commodity futures options or securities;

**AND WHEREAS** based on the Application, together with the representations made by and acknowledgements of the LME to the OSC, the OSC has determined that:

- a. The LME satisfies the criteria for exemption set out in Appendix 1 of Schedule A; and
- b. The granting of the Requested Relief would not be prejudicial to the public interest.

**IT IS HEREBY ORDERED** by the OSC that:

- a. Pursuant to Section 147 of the OSA, the LME is exempt from the requirement to be recognized as an exchange under Section 21(1) of the OSA;
- b. Pursuant to Section 80 of the CFA, the LME is exempt from the requirement to be registered as a commodity futures exchange under Section 15(1) of the CFA;
- c. Pursuant to Section 38 of the CFA, trades in contracts on the LME by Hedgers who are Ontario Participants are exempt from the registration requirements under Section 22 of the CFA; and
- d. Pursuant to Section 38 of the CFA, trades in contracts on the LME by Banks who are Ontario Participants entering orders as principal and only for their own accounts are exempt from the registration requirements under Section 22 of the CFA.

**PROVIDED THAT**

- a. LME complies with the terms and conditions attached hereto as Schedule A; and
- b. The Bank Relief shall expire on the earliest of:
  - (i) The expiry of any transition period as may be provided by law, after the effective date of the repeal of the CFA;
  - (ii) Six months, or such other transition period as may be provided by law, after the coming into force of any amendment to Ontario commodity futures law (as defined in the CFA) or Ontario securities law (as defined in the OSA) that affects the dealer registration requirements in the CFA; and
  - (iii) Five years after the date of this order.

DATED \_\_\_\_\_, 2018.

## SCHEDULE A

### TERMS AND CONDITIONS

#### Meeting Criteria for Exemption

- 1 LME will continue to meet the criteria for exemption included in Appendix 1 to this Schedule A.

#### Regulation and Oversight of the LME

- 2 The LME will maintain its registration as a Recognised Investment Exchange (**RIE**) in accordance with the UK Financial Services and Markets Act (**FSMA**) and will continue to be subject to the regulatory oversight of the UK Financial Conduct Authority (**FCA**).
- 3 The LME will continue to comply with the ongoing requirements applicable to it as an RIE.
- 4 The LME must do everything within its control, which would include cooperating with the OSC as needed, to carry out its activities as an exchange exempted from recognition under subsection 21(1) of the OSA, as a commodity futures exchange exempted from registration under subsection 15(1) of the CFA, and in compliance with Ontario securities law and Ontario commodity futures law.

#### Access

- 5 LME will maintain and operate an electronic trading system where Members trade on a principal-to-principal basis. Members may also trade on the LME's inter-office market or in the LME's open-outcry dealing floor (the **Ring**).
- 6 The LME will not provide direct access to an Ontario Participant unless the Ontario Participant is appropriately registered to trade in LME contracts, is a Hedger or is a Bank; in making this determination, LME may reasonably rely on a written representation from the Ontario Participant that specifies that it is appropriately registered to trade in LME contracts or that it is a Hedger, or is a Bank and LME will notify such Ontario Participant that this representation is deemed to be repeated each time it enters an order for a LME contract.
- 7 Each Ontario Participant that intends to rely on the Hedger Relief will be required to, as part of its application or continued access to trading in LME contracts:
  - (a) represent that it is a Hedger;
  - (b) acknowledge that LME deems the Hedger representation to be repeated by the Ontario Participant each time it enters an order for a LME contract and that the Ontario Participant must be a Hedger for the purposes of each trade resulting from such an order;
  - (c) agree to notify LME if it ceases to be a Hedger;
  - (d) represent that it will only enter orders for its own account;
  - (e) acknowledge that it is a market participant under the CFA and is subject to applicable requirements; and
  - (f) acknowledge that its ability to continue to rely on the Hedger Relief in accessing trading on LME will be dependent on the OSC continuing to grant the relief and may be affected by changes to the terms and conditions imposed in connection with the Hedger Relief or by changes to Ontario securities laws or Ontario commodity futures laws pertaining to derivatives, commodity futures contracts, commodity futures options or securities.
- 8 Each Ontario Participant that intends to rely on the Bank Relief will be required to, as part of its application documentation or continued access to trading in LME contracts:
  - (a) represent that it will only enter orders as principal and for its account only;
  - (b) represent that it is a Bank (the **Canadian Bank Representation**);
  - (c) acknowledge that LME deems the Canadian Bank Representation to be repeated by the Ontario Participant each time it enters an order for a LME contract and that the Ontario Participant must be a Bank for the purposes of each trade resulting from such an order;

- (d) agree to notify LME if it ceases to be a Bank;
  - (e) acknowledge that the Bank Relief may be affected by changes to the terms and conditions imposed in connection with the Bank Relief or by changes to Ontario securities laws or Ontario commodity futures laws pertaining to derivatives, commodity futures contracts, commodity futures options or securities; and
  - (f) represent that it is not engaging in activities prohibited by its governing legislation.
- 9 The LME will require Ontario Participants to notify LME if their applicable registration has been revoked, suspended or amended by the OSC (if applicable) or if they have ceased to be a Bank and, following notice from the Ontario Participant or the OSC and subject to applicable laws, LME will promptly restrict the Ontario Participant's access to the LME if the Ontario Participant is no longer appropriately registered with the OSC or is no longer a Bank.
- 10 The LME must make available to Ontario Participants appropriate training for each person who has access to trade in LME contracts.

#### **Trading by Ontario Participants**

- 11 The LME will not provide access to an Ontario Participant to trading in exchange-traded products of an exchange other than those of the LME, unless such other exchange has sought and received appropriate regulatory standing in Ontario.
- 12 The LME will not provide access to an Ontario Participant to trading in LME contracts other than those that meet the definition of "commodity futures contract" or "commodity futures option" as defined in subsection 1(1) of the CFA, and which also fall under paragraph (p) of the definition of "security" in subsection 1(1) of the OSA, without prior OSC approval or pursuant to the Requested Relief.

#### **Submission to Jurisdiction and Agent for Service**

- 13 With respect to a proceeding brought by the OSC arising out of, related to, concerning or in any other manner connected with the OSC's regulation and oversight of the activities of the LME in Ontario, the LME will submit to the non-exclusive jurisdiction of (i) the courts and administrative tribunals of Ontario and (ii) an administrative proceeding in Ontario.
- 14 The LME will file with the OSC a valid and binding appointment of Norton Rose Fulbright Canada LLP as the agent for service in Ontario upon which the OSC may serve a notice, pleading, subpoena, summons or other process in any action, investigation or administrative, criminal, quasi-criminal, penal or other proceeding arising out of or relating to or concerning the OSC's regulation and oversight of the LME's activities in Ontario.

#### **Disclosure**

- 15 The LME will provide to its Ontario Participants disclosure that states that:
- (a) rights and remedies against the LME may only be governed by the laws of England and Wales, rather than the laws of Ontario, and may be required to be pursued in England and Wales rather than in Ontario;
  - (b) the rules applicable to trading on the LME may be governed by the laws of the UK, rather than the laws of Ontario; and
  - (c) The LME is regulated by the FCA, rather than the OSC.

#### **Filings with the FCA**

- 16 The LME will promptly provide staff of the OSC copies of all material rules of the LME, and material amendments to those rules, that it files with the FCA.
- 17 The LME will promptly provide staff of the OSC copies of all material contract specifications and material amended contract specifications that it files with the FCA.
- 18 The LME will promptly provide staff of the OSC the following information to the extent it is required to file such information with the FCA:

- (a) the annual Board of Directors' report regarding the activities of the Board and its committees;
- (b) the annual financial statements of the LME;
- (c) details of any material legal proceeding instituted against the LME;
- (d) notification that the LME has instituted a petition for a judgment of bankruptcy or insolvency or similar relief, or to wind up or liquidate the LME or has a proceeding for any such petition instituted against it; and
- (e) the appointment of a receiver or the making of any voluntary arrangement with creditors.

**Prompt Notice or Filing**

- 19 The LME will promptly notify staff of the OSC of any of the following:
- (a) any material change to its business or operations or the information provided in the Application, including, but not limited to:
    - (i) changes to the regulatory oversight by the FCA;
    - (ii) the corporate governance structure of the LME;
    - (iii) the access model, including eligibility criteria, for Ontario Participants;
    - (iv) systems and technology; and
    - (v) the clearing and settlement arrangements for the LME;
  - (b) any change in the LME's regulations or the laws, rules and regulations in the UK relevant to futures and options where such change may materially affect its ability to meet the criteria set out in Appendix 1 to this schedule;
  - (c) any condition or change in circumstances whereby the LME is unable or anticipates it will not be able to continue to meet its obligations under any applicable requirements of the FCA or the FSMA regulations;
  - (d) any revocation or suspension of, or amendment to, the LME's registration as an RIE by the FCA or if the basis on which the LME's registration as a RIE was granted has significantly changed;
  - (e) any known investigations of, or disciplinary action against, the LME by the FCA or any other regulatory authority to which it is subject;
  - (f) any matter known to the LME that may affect its financial or operational viability, including, but not limited to, any significant system failure or interruption; and
  - (g) any default, insolvency, or bankruptcy of any Member known to the LME or its representatives that may have a material, adverse impact upon the LME or any Ontario Participant.
- 20 LME will promptly file with staff of the OSC copies of any enforcement reports regarding LME once issued as final by the FCA.

**Quarterly Reporting**

- 21 LME will maintain the following updated information and submit such information in a manner and form acceptable to the OSC on a quarterly basis (within 30 days of the end of each calendar quarter), and at any time promptly upon the request of staff of the OSC:
- (a) a current list of all Ontario Participants, specifically identifying for each Ontario Participant:
    - (i) its status as LME or LME Clear Members , and
    - (ii) the basis upon which it represented to the LME that it could be provided with direct access (i.e. that it is appropriately registered to trade in the LME contracts or benefits from another form of exemption);

- (b) a list of all Ontario Participants against whom disciplinary action has been taken in the last quarter by the LME or, to the best of LME's knowledge, by any non-Canadian regulatory bodies with respect to such Ontario Participants' activities on the LME;
- (c) a list of all referrals to the LME Head of Risk, Regulation and Compliance by the LME surveillance team concerning Ontario Participants;
- (d) a list of all Ontario applicants for status as an Ontario Participant who were denied such status or access to the LME during the quarter;
- (e) a list of all new by-laws, rules, and contract specifications, and changes to by-laws, rules and contract specifications, not already reported;
- (f) a list of all LME contracts available for trading during the quarter, identifying any additions, deletions or changes since the prior quarter;
- (g) for each LME contract,
  - (i) the total trading volume and value originating from Ontario Participants, presented on a per Ontario Participant basis, and
  - (ii) the proportion of worldwide trading volume and value on the LME conducted by Ontario Participants, presented in the aggregate for such Ontario Participants; and
- (h) a list outlining each incident of a significant system outage that occurred at any time during the quarter for any system impacting Ontario Participants' trading activity, including trading, routing or data, specifically identifying the date, duration and reason for the outage, and noting any corrective action taken.

#### **Annual Reporting**

- 22 LME will arrange to have the annual audited financial statements of the LME filed with the OSC promptly after their issuance.

#### **Reporting**

- 23 If an IT Service Auditor's Report (**Report**) is prepared for the LME, the LME will promptly file with the OSC the Report after the Report is issued as final by its independent auditor.

#### **Information Sharing**

- 24 The LME will provide information (including additional periodic reporting) as may be requested from time to time by, and otherwise cooperate with, the OSC or its staff, subject to any applicable privacy or other laws (including solicitor-client privilege) governing the sharing of information and the protection of personal information.

## APPENDIX 1

### CRITERIA FOR EXEMPTION

#### PART 1 REGULATION OF THE EXCHANGE

##### 1.1 Regulation of the Exchange

The exchange is regulated in an appropriate manner in another jurisdiction by a foreign regulator (**Foreign Regulator**).

##### 1.2 Authority of the Foreign Regulator

The Foreign Regulator has the appropriate authority and procedures for oversight of the exchange. This includes regular, periodic oversight reviews of the exchange by the Foreign Regulator.

#### PART 2 GOVERNANCE

##### 2.1 Governance

The governance structure and governance arrangements of the exchange ensure:

- (a) effective oversight of the exchange,
- (b) that business and regulatory decisions are in keeping with its public interest mandate,
- (c) fair, meaningful and diverse representation on the board of directors (Board) and any committees of the Board, including:
  - (i) appropriate representation of independent directors, and
  - (ii) a proper balance among the interests of the different persons or companies using the services and facilities of the exchange,
- (d) the exchange has policies and procedures to appropriately identify and manage conflicts of interest, and
- (e) there are appropriate qualifications, remuneration, limitation of liability and indemnity provisions for directors, officers and employees of the exchange.

##### 2.2 Fitness

The exchange has policies and procedures under which it will take reasonable steps, and has taken such reasonable steps, to ensure that each director and officer is a fit and proper person.

#### PART 3 REGULATION OF PRODUCTS

##### 3.1 Review and Approval of Products

The products traded on the exchange and any changes thereto are reviewed by the Foreign Regulator, and are either approved by the Foreign Regulator or are subject to requirements established by the Foreign Regulator that must be met before implementation of a product or changes to a product.

##### 3.2 Product Specifications

The terms and conditions of trading the products are in conformity with the usual commercial customs and practices for the trading of such products.

##### 3.3 Risks Associated with Trading Products

The exchange maintains adequate provisions to measure, manage and mitigate the risks associated with trading products on the exchange including, but not limited to, margin requirements, intra-day margin calls, daily trading limits, price limits, position limits, and internal controls.

## **PART 4 ACCESS**

### **4.1 Fair Access**

- (a) The exchange has established appropriate written standards for access to its services including requirements to ensure
  - (i) participants are appropriately registered as applicable under Ontario securities laws or Ontario commodity futures laws, or exempted from these requirements,
  - (ii) the competence, integrity and authority of systems users, and
  - (iii) systems users are adequately supervised.
- (b) The access standards and the process for obtaining, limiting and denying access are fair, transparent and applied reasonably.
- (c) The exchange does not unreasonably prohibit, condition or limit access by a person or company to services offered by it.
- (d) The exchange does not
  - (i) permit unreasonable discrimination among participants, or
  - (ii) impose any burden on competition that is not reasonably necessary and appropriate.

## **PART 5 REGULATION OF PARTICIPANTS ON THE EXCHANGE**

### **5.1 Regulation**

The exchange has the authority, resources, capabilities, systems and processes to allow it to perform its regulation functions, whether directly or indirectly through a regulation services provider, including setting requirements governing the conduct of its participants, monitoring their conduct, and appropriately disciplining them for violations of exchange requirements.

## **PART 6 RULEMAKING**

### **6.1 Purpose of Rules**

- (a) The exchange has rules, policies and other similar instruments (Rules) that are designed to appropriately govern the operations and activities of participants.
- (b) The Rules are not contrary to the public interest and are designed to
  - (i) ensure compliance with applicable legislation,
  - (ii) prevent fraudulent and manipulative acts and practices,
  - (iii) promote just and equitable principles of trade,
  - (iv) foster co-operation and co-ordination with persons or companies engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in the products traded on the exchange,
  - (v) provide a framework for disciplinary and enforcement actions, and
  - (vi) ensure a fair and orderly market.

## **PART 7 DUE PROCESS**

### **7.1 Due Process**

For any decision made by the exchange that affects a participant, or an applicant to be a participant, including a decision in relation to access, exemptions, or discipline, the exchange ensures that:

- (a) parties are given an opportunity to be heard or make representations, and
- (b) it keeps a record of, gives reasons for, and provides for appeals or reviews of its decisions.

## **PART 8 CLEARING AND SETTLEMENT**

### **8.1 Clearing Arrangements**

The exchange has appropriate arrangements for the clearing and settlement of transactions through a clearing house.

### **8.2 Regulation of the Clearing House**

The clearing house is subject to acceptable regulation.

### **8.3 Authority of Regulator**

A foreign regulator has the appropriate authority and procedures for oversight of the clearing house. This includes regular, periodic regulatory examinations of the clearing house by the foreign regulator.

### **8.4 Access to the Clearing House**

- (a) The clearing house has established appropriate written standards for access to its services.
- (b) The access standards for clearing members and the process for obtaining, limiting and denying access are fair, transparent and applied reasonably.

### **8.5 Sophistication of Technology of Clearing House**

The exchange has assured itself that the information technology used by the clearing house has been adequately reviewed and tested and provides at least the same level of safeguards as required of the exchange.

### **8.6 Risk Management of Clearing House**

The exchange has assured itself that the clearing house has established appropriate risk management policies and procedures, contingency plans, default procedures and internal controls.

## **PART 9 SYSTEMS AND TECHNOLOGY**

### **9.1 Systems and Technology**

Each of the exchange's critical systems has appropriate internal controls to ensure completeness, accuracy, integrity and security of information, and, in addition, has sufficient capacity and business continuity plans to enable the exchange to properly carry on its business. Critical systems are those that support the following functions:

- (a) order entry,
- (b) order routing,
- (c) execution,
- (d) trade reporting,
- (e) trade comparison,
- (f) data feeds,
- (g) market surveillance,
- (h) trade clearing, and
- (i) financial reporting.

## **9.2 Information Technology Risk Management Procedures**

The exchange has appropriate risk management procedures in place including those that handle trading errors, trading halts and circuit breakers.

## **PART 10 FINANCIAL VIABILITY**

### **10.1 Financial Viability**

The exchange has sufficient financial resources for the proper performance of its functions and to meet its responsibilities.

## **PART 11 TRANSPARENCY**

### **11.1 Transparency**

The exchange has adequate arrangements to record and publish accurate and timely trade and order information. This information is provided to all participants on an equitable basis.

## **PART 12 RECORD KEEPING**

### **12.1 Record Keeping**

The exchange has and maintains adequate systems in place for the keeping of books and records, including, but not limited to, those concerning the operations of the exchange, audit trail information on all trades, and compliance with, and/or violations of exchange requirements.

## **PART 13 OUTSOURCING**

### **13.1 Outsourcing**

Where the exchange has outsourced any of its key services or systems to a service provider, it has appropriate and formal arrangements and processes in place that permit it to meet its obligations and that are in accordance with industry best practices.

## **PART 14 FEES**

### **14.1 Fees**

- (a) All fees imposed by the exchange are reasonable and equitably allocated and do not have the effect of creating an unreasonable condition or limit on access by participants to the services offered by the exchange.
- (b) The process for setting fees is fair and appropriate, and the fee model is transparent.

## **PART 15 INFORMATION SHARING AND OVERSIGHT ARRANGEMENTS**

### **15.1 Information Sharing and Regulatory Cooperation**

The exchange has mechanisms in place to enable it to share information and otherwise co-operate with the OSC, self-regulatory organizations, other exchanges, clearing agencies, investor protection funds, and other appropriate regulatory bodies.

### **15.2 Oversight Arrangements**

Satisfactory information sharing and oversight agreements exist between the OSC and the Foreign Regulator.

## **PART 16 IOSCO PRINCIPLES**

### **16.1 IOSCO Principles**

To the extent it is consistent with the laws of the foreign jurisdiction, the exchange adheres to the standards of the International Organisation of Securities Commissions including those set out in the "Principles for the Regulation and Supervision of Commodity Derivative Markets" (2011).

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