



# Derivatives Exam Syllabus

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# Derivatives Exam Overview

## Exam parameters

<b>Exams</b>	1 paper
<b>Exam format</b>	Proctored (remote or in person)
<b>Exam duration</b>	3 hours
<b>Question format</b>	Multiple choice
<b>Questions per exam</b>	120
<b>Attempts allowed per exam</b>	3

## Question weighting

<b>Element</b>	<b>Indicative Qs</b>
<b>1</b> The client relationship	8
<b>2</b> Regulatory documentation	10
<b>3</b> Types and features of derivatives	22
<b>4</b> Derivative pricing	22
<b>5</b> Derivative trading, clearing and settlement	20
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# Syllabus key

The syllabus is divided into a series of learning outcomes. Each learning outcome expects the candidate to remember, understand, apply or analyze information. These expectations are set out below.



**Remember** requires the candidate to recall information such as facts, rules and principles. Associated terms include define, identify, recognize and state.

For example:

- What is the maximum profit on a long future position?
- What type of option gives the investor the right to buy an underlying asset?
- What identifies the price at which you can buy or sell an asset through an option?



**Understand** requires the candidate to demonstrate comprehension of an issue, fact, rule or principle. Associated terms include describe, explain, interpret, recognize and select.

For example:

- Which of the following derivative positions would be most likely to make a profit if the price of the underlying asset rises?
- Why might a person invest in an interest rate swap?
- When might a client have to post margin with an Investment Dealer?



**Apply** requires the candidate to use information in specific situations created in the question. Associated terms include calculate, demonstrate, implement and use.

For example:

- An investor pays \$10 for a long call on an equity with a strike price of \$50. If the underlying share is trading at \$68.20 on the expiry date of the option, what profit or loss would the investor make?
- Review the information on the three derivative positions in the table below. Calculate the approximate net delta position.

	Start value (millions)	End value (millions)
Future	Long	\$590
Option	Long call	At-the-money
Option	Long put	Deeply out-of-the money

- In which of the following situations would a Portfolio Manager use a short future as part of risk management?



**Analyze** requires the candidate to review information and draw conclusions or make connections. Associated terms include compare, contrast, differentiate and examine.

For example:

- An investor goes long on a listed future on 100 shares in a publicly traded company. The contract price is \$25.80 per share. The investor subsequently goes short on the same contract several months later for \$32.40. They make their trades through an order execution only (OEO) account which charges a \$15 flat fee per transaction. Calculate the impact of the fee on the return for the investor.
- A Registered Representative is reviewing the information that they have collected from their client. The information has indicated that the client is seeking long-term growth with balanced risk. The account to be opened is a cash account, and the client is also concerned about the tax implications. Based on this information alone, which of the following indicates a strategy and explanation that best meets the client's needs?
- A client chooses an OEO account at an Investment Dealer. What impact will this choice have on their experience compared to choosing a full-service Investment Dealer?



## Element 1: The client relationship

**Summary:** Client relationship requirements in the Derivatives exam build on the elements covered in other baseline exams, such as the Canadian Investment Regulatory Exam (CIRE), the Retail Securities Exam and the Institutional Securities Exam. Element 1 tests an ability to analyze the processes around product due diligence, know-your-product (KYP), know-your-client (KYC), suitability and account appropriateness within the context of derivatives. This element requires candidates to display a sound application of these elements in the client relationship.

- 1.1** Understand the product's due diligence obligation in relation to derivatives, including the:
  - Obligations on the Investment Dealer and the Approved Person
  - Need to distinguish different derivatives, including option and similar derivatives, futures, and similar derivatives and swaps
- 1.2** Analyze situations involving know-your-product (KYP) obligation to understand the derivative investments purchased, sold or recommended for a client. Consider the:
  - Investment's structure
  - Investment's features
  - Investment's risks
  - Initial and ongoing costs
  - Impact of those costs
- 1.3** Apply the account appropriateness obligation to specific situations relevant to a derivatives account.
- 1.4** Apply the know-your-client (KYC) rules to situations involving clients seeking derivative trading services. Consider:
  - Retail clients and institutional clients
  - Different types of derivative product
  - Different types of derivative strategy
  - The exceptions in dealing with institutional investors and hedgers
- 1.5** Apply the client suitability determination requirements to situations involving clients seeking derivative trading services. Consider:
  - Retail clients and institutional clients
  - Different types of derivative product
  - Different types of derivative strategy
  - The exceptions in dealing with institutional investors, including assessment of sophistication level
- 1.6** Analyze situations involving the importance of internal escalation or delegation procedures to appropriately registered persons for derivative trading services. Consider:
  - Different types of derivative products
  - Where delegation is permitted and prohibited
- 1.7** Apply the CIRO requirements when communicating with clients and/or the public in relation to derivative products. Consider:
  - Awareness of obligations and best practices
  - Misleading communications
  - Restrictions and guidelines regarding social media and other communications with the public
  - Off-channel communication issues
- 1.8** Understand the requirements for documenting, filing and maintaining client records.





## Element 2: Regulatory documentation

**Summary:** The second element of this examination provides an in-depth understanding of the specific regulatory documentation relating to client interactions, reporting and prohibited practices in the derivatives marketplace.

**2.1** Apply to specific situations the regulatory requirements relating to client interactions in derivative contracts. Consider:

- Policies and procedures for client solicitation and derivatives trading businesses
- Procedures for determining whether a client qualifies as a hedger, and circumstances where a qualified hedger can be classified as an institutional client
- Procedures for client communications and changes to the Investment Dealer's derivatives trading business
- Client reporting for expiring derivatives

**2.2** Understand the regulatory requirements governing reporting in derivative contracts. Consider:

- Investment Dealer reporting requirements for all positions (covered and uncovered)
- Concentration reporting
- Profit and loss statements for active accounts
- Exception reports
- Investment Dealer monthly (net) position reporting requirements
- Investment Dealer concentration capital requirements and provisions
- Investment Dealer capital requirements and provisions on open derivatives positions (position limits)

**2.3** Apply the regulatory requirements governing prohibited derivative trading practices to specific situations. Consider:

- Trading using prohibited underlying interests
- Trading without adequate margin
- Trading beyond margin and credit limits
- Cumulative losses exceeding risk limits
- Delivery month trading restrictions
- Excessive risk or loss to account guarantors
- Insider trading restrictions

**2.4** Apply the regulatory requirements governing client margin and treatment of different derivative product positions to specific situations.

**2.5** Understand the regulatory requirements governing opening, managing and monitoring derivative accounts. Consider:

- Derivatives Account Application Form
- Derivatives Trading Agreement
- Derivatives Risk Disclosure Statement or similar disclosure document approved by CIRO
  - Additional disclosure statement, or similar document for each order execution only (OEO) account offering over-the-counter (OTC) derivatives to retail clients, disclosing the percentage of such accounts that were profitable for each of the four most recent quarters
- Basis to classify a qualified hedger as an institutional client or maintain as retail client
- Managed and Discretionary Account Agreements
- Margin Agreement Form
- Futures reporting disclosures
- Hedge Agreement
- Authority to Transfer Funds Form

**2.6** Understand the regulatory requirements governing client statement for derivatives trading. Consider:

- Monthly account statements
- Trade confirmations
- Statement of purchase and sale on liquidating trades

**2.7** Understand the application of National Instrument (NI) 93-101 Derivative: Business Conduct, and other relevant legislation, including the Quebec Derivatives Act. Consider:

- Dealing with or advising derivatives parties
- Derivatives party accounts, including:
  - Disclosure
  - Treatment of assets
  - Reporting
- Compliance and record keeping, including:
  - Policies and procedures
  - Senior derivatives manager
  - Responsibility to report



## Element 3: Types and features of derivatives

**Summary:** Element 3 of this exam takes an overview of derivative contracts. The ability to understand how different types of derivative contracts work, and an analysis of the risks and benefits of using derivative contracts, is tested in this element.

**3.1** Analyze the types and features of futures, forwards and similar derivative contracts, including:

- Obligations created
- Long vs short
- Underlying interest
  - Financial vs commodity
  - Equity vs non-equity
- Listed vs over the counter
- Standardized vs customized
  - Delivery dates
  - Asset quantity
  - Asset quality
- Cash vs physical
- Margin obligations
- Other relevant terminology

**3.2** Analyze the types and features of options and similar derivative contracts, including:

- Obligations and rights created
- Long vs short
- Underlying interest
  - Financial vs commodity
  - Equity vs non-equity
- Call vs put
- American vs European
- Exotic products
  - Options, including:
    - Binary
    - Bermudan

- Barrier
- Asian
  - Prediction/forecasting contracts
- Listed vs over the counter
- Margin obligations
- Other relevant terminology

**3.3** Analyze the types and features of futures contract options contracts.

- Obligations and rights created

**3.4** Analyze the types and features of contracts for difference (CFDs).

- Obligations created

**3.5** Analyze the types and features of swaps contracts.

- Obligations created
- Relevant terminology
- Specific types of swap:
  - Interest rate swaps
  - Currency swaps
  - Equity swaps
  - Commodity swaps
  - Credit default swaps

**3.6** Analyze characteristics of futures, forwards and similar derivative contracts. Consider:

- Advantages and disadvantages to the parties involved
- Price risk and potential returns (this may include calculations)
- Sources of other risks, including:
  - Counterparty
  - Liquidity
  - Operational

- Impact of the costs associated with acquiring and holding futures, forwards and similar derivatives

**3.7** Analyze characteristics of options and similar derivative contracts. Consider:

- Advantages and disadvantages to the parties involved
- Price risk and potential returns (this may include calculations)
- Sources of other risks, including:
  - Counterparty
  - Liquidity
  - Operational
- Impact of the costs associated with acquiring and holding options

**3.8** Apply the requirements relating to leverage in relation to derivatives contracts. Consider:

- Leverage and contract value
- Calculation of contract leverage
  - Options and similar derivatives
  - Futures and similar derivatives

**3.9** Understand the role of derivatives in structured products. Consider:

- Capital protected products
- Capital at risk products



## Element 4: Derivative pricing

**Summary:** In Element 4, candidates will be assessed on the fundamental building blocks of valuing a future or forward and options. Questions will require candidates to define key concepts relating to the value of a derivative, as well as factors that affect these values. Candidates may be expected to show their understanding through calculation.

**4.1** Understand the impact of the underlying asset price on derivative pricing.

Consider:

- Financial instruments (e.g. shares, bonds, bank credit)
- Financial variables (e.g. indexes)
- Commodities (e.g. oil, metals, agricultural products)
- Events (e.g. weather)
- Relationship to futures contract and futures contract options
- Mark-to-market

**4.2** Apply the fair-value pricing method of a future. This may include calculations.

- Cost of carry
  - Time
  - Storage and insurance
  - Cash flows
  - Financing cost
- Basis
- Cash and carry arbitrage
- Convergence

**4.3** Understand option pricing terminology. Consider:

- Premium
- Strike price
- Intrinsic value
- Time value
  - Time to expiry/exercise
- At-the-money
- In-the-money
- Out-of-the money

**4.4** Understand the concepts of option Greeks and their application. Consider:

- Delta
- Gamma
- Theta
- Vega
- Rho

**4.5** Understand the key differences between option pricing models. Consider:

- Black-Scholes
- Binomial

**4.6** Apply basic pricing theory to calculations of time value and intrinsic value, having been given the price of the underlying asset, the option strike price and the option premium.

**4.7** Understand the impact of corporate actions on option contract terms.

Consider:

- Stock splits
- Stock consolidation
- Stock dividends
- Cash dividends

**4.8** Apply put-call parity theory to the calculation of the fair value. This may include calculations. Consider the fair value of:

- A call option
- A put option
- A future
- An underlying asset
- Synthetic positions

**4.9** Understand price forecasting techniques. Consider:

- Fundamental analysis
- Technical analysis

**4.10** Understand tax implications for investors in derivatives. Consider:

- Professional vs non-professional
  - Non-professional trading frequency
- Allowable use of derivatives in registered accounts



## Element 5: Derivative trading, clearing and settlement

**Summary:** Candidates must be able to analyze the differences between listed and over-the-counter (OTC) derivatives, as well as the rules and procedures of specific exchanges. Questions will assess different types of order and the processes that allow for trading of both listed and OTC derivatives. Element 5 also requires candidates to understand the function of a clearing house and the different types of margin that can be applied in the derivatives market.

**5.1** Analyze differences between listed derivatives and over-the-counter (OTC) derivatives. Consider:

- Market access
- Structure of contracts
- Counterparty risk
- Margin requirements
- Liquidity
- Regulatory protections
- Transparency

**5.2** Apply the features of different types of order to derivatives. Consider:

- Limit order
- Market order
- Immediate and cancel
- Fill or kill
- On-stop orders
- Iceberg orders
- Short sales

**5.3** Analyze the benefits and disadvantages of algorithmic trading. Consider:

- Contribution to market discipline
- Contribution to market efficiency
- Consistency provided
- Speed
- Lack of oversight
- Technological failure
- Over-optimization
- Unintended consequences

**5.4** Understand various aspects of the trade execution and settlement process to futures. Consider:

- Awareness of the marketplaces, including Montreal Exchange, and related regulations
- Placing orders, including processes for handling order errors and changes
- Introducing broker/carrying broker relationship
- The settlement and delivery process
- Special terms transactions, including:
  - Exchange for physical (EFP)
  - Exchange for risk (EFR)
  - Block trades
  - Riskless basis cross
- Considerations for foreign exchange transactions and currency conversions to facilitate transactions

**5.5** Understand various aspects of the trade execution and settlement process to options. Consider:

- Awareness of the various marketplaces
- Placing orders, including processes for handling order errors and changes
- Introducing broker/carrying broker relationship
- The settlement and delivery process
- Exercise and assignment
- Abandonment
- Considerations for foreign exchange transactions and currency conversions to facilitate transactions





- 5.6** Apply trading rules and mechanics of over-the-counter (OTC) derivative contracts. Consider:
- International Swaps and Derivatives Association (ISDA) framework and standardized documentation
  - Liquidation of existing positions
  - Assessments of value
  - Determinations of fair price
  - Assessments of exposure to risk
  - Underlying delivery and cash settlement exposure to risk
- 5.7** Understand the nature of the various trading desks. Consider:
- Agency
  - Proprietary
  - Buy-side
  - Sell-side
  - Retail
  - Institutional
- 5.8** Understand the types of trading account. Consider:
- Client (CL)
  - Inventory (IN)
  - Non-client (NC)
  - Options market maker (OT)
  - Options firm account (OF)
  - Equities specialist (ST)
- 5.9** Understand the requirement for order designations and identifiers, and the implications of the designation. Consider:
- Identifiers, including:
    - Order for an insider or significant shareholder
    - Client identifier/Legal entity identifier
    - Non-client orders for the account of a responsible designated trader at a market-maker dealer

- Designation, including:
  - Principal orders
  - Jitney orders
  - Orders that are part of a program trade
  - Short marking exempt order
  - Normal course issuer bid (NCIB)

**5.10** Apply the requirements on managing client orders to specific situations relevant to derivative services. Consider:

- Accuracy of trade details
- Execute without discretion
- Record trade details
- Confirm orders with clients
- Remain available to clients
- Account statements

**5.11** Understand the need to accurately document discussions with clients and have the client confirm the accuracy of the information.

**5.12** Understand rules and procedures for derivative-clearing corporations, such as Canadian Derivatives Clearing Corporation (CDCC), ICE Clearing System (ICE Clear Canada) and Options Clearing Corporation (US). Consider:

- Membership standards
- Margin
  - Initial/original and variation
  - Maintenance margin call
- Clearing/default/guaranty fund
- Default management
- Client protection

**5.13** Understand Canadian Depository for Securities (CDS) delivery procedures for underlying interests.

**5.14** Understand the characteristics of margin. Consider:

- Differences between futures and similar derivatives margin and securities margin
- Risk-based margin system
- Acceptable forms of margin
- Exchange margin
- In-house margin
- Hedge margin
- Day trading margin
- Margin change

**5.15** Apply margin calculations for different strategies and situations.



## Element 6: Speculating, hedging and other investment strategies

**Summary:** Element 6 requires the candidate to apply specific derivative strategies in a range of situations. Candidates may have to suggest the correct strategy or calculate the profit or loss of a chosen strategy.

- 6.1** Understand the use of derivatives and similar derivative products in specific situations. Consider:
- Risk management/mitigation through hedging
  - Speculative trading
  - Arbitrage
- 6.2** Analyze the use of speculative strategies using futures, forwards and similar derivative contracts. This may include calculations of profit or loss.
- 6.3** Analyze the use of hedging strategies using futures, forwards and similar derivative contracts. This may include calculations of number of contracts to hedge.
- 6.4** Analyze arbitrage strategies using futures, forwards and similar derivative contracts. This may include calculations of potential arbitrage opportunities and profits.
- 6.5** Analyze the use of futures, forwards and similar derivative contracts to other strategies. Consider:
- Spread strategies
    - Basis spread
    - Inter-commodity spread
    - Intra-commodity spread
  - Risks related to spread strategies
  - Volatility strategies
- 6.6** Analyze the use of speculative strategies using options and similar derivative contracts. This may include calculations of profit or loss.
- 6.7** Analyze the use of hedging strategies, including delta hedging, using options and similar derivative contracts. This may include calculations of number of contracts to hedge.
- 6.8** Analyze the use of arbitrage strategies using options and similar derivative contracts. This may include calculations of potential arbitrage opportunities and profits.
- 6.9** Analyze the use of options or similar derivative contracts to other strategies. Consider:
- Income-producing strategies
  - Spread strategies
    - Vertical spreads
  - Options volatility strategies
    - Straddles
    - Strangles





## Element 7: Integrity in the derivative markets

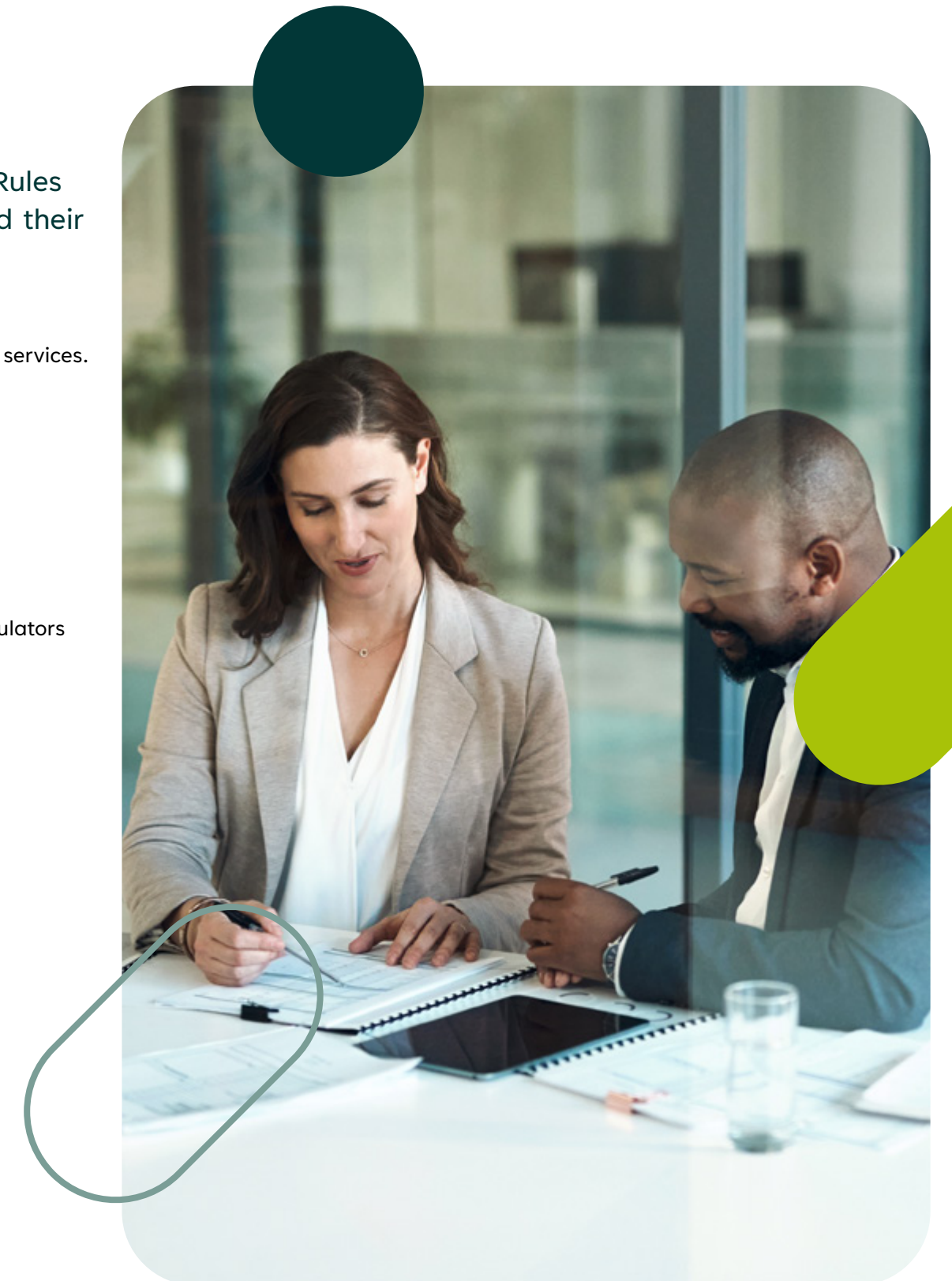
**Summary:** In Element 7, candidates are expected to apply the requirements under the Universal Market Integrity Rules (UMIR) regarding the recognition of abusive trading and the gatekeeping responsibilities of Investment Dealers and their representatives.

**7.1** Apply UMIR to specific situations relevant to derivative trading services.  
Consider:

- Best execution
- Abusive trading
- Specific unacceptable activities
- Manipulative and deceptive practices
- Artificial pricing
- Improper orders and trades
- Cross-asset manipulation
- Front running

**7.2** Apply the regulatory requirements in relation to gatekeeping responsibilities to specific situations relevant to derivative trading services.  
Consider:

- The purpose of the gatekeeping obligations
- The client's typical investment activity and patterns to identify suspicious transactions
- How to identify and escalate suspicious transactions
- Possible insider trading activity and violations
- Applicable regulatory frameworks on whistleblowers
- Applicable reporting obligations to Investment Dealers and regulators





## Element 8: Standards of conduct and conflicts of interest

**Summary:** The ability to act ethically and professionally when servicing clients in derivatives markets is fundamental to any candidate's role. This element requires candidates to apply the standards of conduct expected by CIRO and under National Instrument (NI) 93-101. This section also requires an ability to analyze situations that could cause conflicts of interest, and provide appropriate responses.

**8.1** Analyze situations to appraise standards of conduct in specific situations relevant to derivative trading services. Consider:

- CIRO standards of conduct
  - High standards of ethics and conduct
  - Acting openly and fairly
  - Acting in accordance with just and equitable principles of trade
  - Avoiding actions that would be considered unbecoming or detrimental to public interest
  - Avoiding conduct that may contravene standards of conduct
- NI 93-101 Derivatives: Business Conduct, Part 3, Division 1: General Obligations, including:
  - Fair dealing
  - Conflicts of interest
  - Know your derivatives party
  - Handling complaints
  - Tied selling

**8.2** Analyze the application of regulatory requirements governing the management of conflicts of interest in situations relevant to derivative trading services. Consider:

- The best interests of the client
- Identifying
- Avoiding
- Addressing
- Disclosing

**8.3** Analyze the application of regulatory requirements relating to outside activities in situations relevant to derivative trading services. Consider:

- Prohibition
- Approval
- Addressing
- Disclosure

**8.4** Analyze the application of regulatory requirements relating to personal financial dealings with clients in situations relevant to derivative trading services. Consider prohibition and action relating to:

- Accepting any consideration
- Settlement agreements
- Personal borrowing from clients
- Personal lending to clients
- Control or authority



