

DRAFT Guidance Note

Trading in Securities of U.S. Over-the-Counter Issuers Dealer Member Rules 1300.1(n), (o) and (p)

INTRODUCTION

Dealer Member Rule 1300.1(o) establishes a beneficial owner identification requirement that Dealer Members must comply with before the sale of securities of U.S. over-the-counter (OTC) issuers.

This Guidance Note explains how IIROC will apply and interpret the Dealer Member Rules relating to trading in U.S. OTC securities.

IDENTIFICATION OF THE BENEFICIAL OWNER

The essential requirement of Dealer Member Rule 1300.1(o) is the Dealer Member's obligation to establish the identity of the ultimate, individual beneficial owner or owners of OTC securities before a sale of OTC securities is executed. If the securities are not owned by a natural person, then the Dealer Member is required to determine the identity of every individual who is a beneficial owner of those securities. Therefore, in the case of a corporate account, the Dealer Member must ascertain the identity of every natural person who beneficially owns the corporation wanting to sell OTC securities. If such a corporation is owned in whole or in part by another corporation, then the Dealer Member must establish the identity of every individual who beneficially owns that other corporation. The basic identification requirement is not complied with until the Dealer Member is able to establish beneficial ownership by natural persons for 100% of the ownership of the OTC securities sought to be sold.

There is no exemption from the beneficial owner identification requirement where the account holder is a bank, securities dealer or similar financial institution, whether foreign or domestic. Where financial intermediaries are involved in the sale of OTC securities, Dealer Members must look beyond the agency relationship in order to establish the ultimate beneficial owners. In the case of accounts for foreign institutions subject to bank secrecy legislation, if the Dealer Member can not obtain the required information, then the Dealer Member is prohibited from accepting an order to sell the securities. For example, if a Dealer Member holds securities on behalf of a bank that in turn holds the securities on behalf of the beneficial owner of the securities, the Dealer Member's client is the bank. However, the beneficial owner that must be identified is the client of the bank. If the client of the bank is a corporation or similar entity, then it is the individual who ultimately owns the corporation or

entity that is the beneficial owner. Dealer Members should not assume that the person who has signing authority, such as an officer or director, is the person who owns the corporation or other entity.

For clients with direct market access and DAP accounts, Dealer Members are similarly expected to comply with the identification requirements prior to the sale of any OTC securities.

If the Dealer Member is unable to ascertain the identity of the beneficial owners of OTC securities, then it is prohibited from accepting or executing a sell order for the OTC securities.

REASONABLE BELIEF

Dealer Members are expected to make good faith inquiries and use reasonable and reliable methods that would enable them to form a reasonable belief as to the identity of the beneficial owner(s) of the OTC securities. In practice, Dealer Members may use current procedures for complying with existing identity verification requirements under Dealer Member Rule 1300.1, as reasonable and reliable methods of identification of beneficial owners, except that such methods will be applied in order to establish the ownership of OTC securities to the point where 100% of the ownership by natural persons is known.

Reasonable and reliable methods of identification may also encompass , but are not limited to, direct contact with those identified as the beneficial owner where the Dealer Member's client is not the beneficial owner, and making independent inquiries with third parties.

Where a doubt exists as to the identity of the beneficial owner of the OTC securities, the identification requirements have not been complied with. Dealer Members must be able to form a reasonable belief that they know the true identity of every beneficial owner of the OTC securities.

The Dealer Member's identification methods should be regularly tested and verified in order to ensure that they allow the Dealer Member to form the requisite reasonable belief.

If the beneficial owner's identity is determined at the time of account opening, at the time of purchase, or any other time prior to acceptance of the sell order, Dealer Members should use reasonable and reliable methods to record any changes or updates to the identity of the beneficial owner. Where a Dealer Member has reason to believe, or ought to know, that its existing records are inaccurate or out-of-date, it must determine prior to the sale of OTC securities accurate and up-to-date information regarding the identity of beneficial owners.

ISOLATED TRADE EXEMPTION

Dealer Member Rule 1300.1(p) provides an isolated trade exemption to the identification requirements under sub-section 1300.1(o). The exemption is only available in instances where the Dealer Member does not trade OTC securities for its own account, or the account of any other person, except as permitted under the isolated trade exemption itself. Furthermore, the exemption only applies to trades on behalf of a client that does not trade in securities of OTC issuers, either generally or occasionally, and if the firm records the relevant details of the isolated trade. The relevant details to be recorded include, but are not limited to, name of the issuer, number of securities traded, date of the trade, the price, and the circumstances that the firm believes brought the trade within the exemption.

All Dealer Members will be required to comply with the identification requirements, except in those rare instances where the trade may be made under the isolated trade exemption. IIROC expects the isolated trade exemption to be used sparingly. By definition, Dealer Members repeatedly attempting to avail themselves of the exemption will be disqualified from using the exemption further.

RECORD-KEEPING

The record-keeping requirements under Dealer Member Rule 1300.1(q) apply to the beneficial owner identification requirements for the sale of securities of OTC issuers in the same manner that they do for all other identification requirements under Dealer Member Rule 1300.1. Dealer Members must maintain sufficient records to reconstruct the basis on which they formed a reasonable belief as to the identity of beneficial owners of OTC securities.