

Registration Reform IN CANADA

The Finish Line is Here

Stikeman Elliott's Report on Canada's New Registration Regime
JULY 2009

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Overview of Canada's New Registration Regime

On July 17, 2009, the Canadian Securities Administrators (CSA) published their final proposal for National Instrument 31-103 *Registration Requirements and Exemptions* (31-103), and revocations of, or amendments to, a number of related instruments and policies. This final proposal results from two comment and review processes that started in 2007, with the first proposal published in February 2007 and the second proposal published in February 2008. Both proposals were the subject of substantial comments. 31-103 is scheduled to come into force on September 28, 2009 (the Implementation Date), subject to government and other local approvals in each province and territory. Transition and grandfathering provisions vary for different aspects of the new regime.

31-103 is intended to harmonize, streamline and modernize registration requirements and exemptions across all Canadian provinces and territories (jurisdictions). It regulates the registration of firms and individuals and consolidates requirements for registration, including proficiency, solvency and insurance requirements, as well as ongoing compliance requirements for registrants. These include requirements with respect to financial reporting, know your client, suitability, client disclosure, safekeeping of assets, recordkeeping, account activity reporting, complaint handling and other compliance procedures. The CSA note that, to create flexible regulation, 31-103 combines principles, supported by guidance in its companion policy, with prescriptive elements where considered appropriate.

31-103 represents a major overhaul of the current registration regime and has significant implications for Canadian and non-Canadian dealers, advisers and investment fund managers currently doing business on a registered or exempt basis in any jurisdiction of Canada.

The new rules will also have significant implications for private placements and other capital market activities.

Significant changes resulting from the new registration regime include:

- the removal of most dealer registration exemptions, including for trades with “accredited investors” (except in a few jurisdictions in very limited circumstances), and the move to a “business trigger” for the dealer registration requirement; this change effectively requires that all persons that are in the business of trading in securities in Canada register as dealers;
- the requirement that persons who are in the business of trading in the so-called “exempt market”, including those now registered in Ontario or Newfoundland and Labrador as limited market dealers, be registered as “exempt market dealers”, and subject to capital, insurance and proficiency requirements and other ongoing compliance requirements;
- the introduction of a new investment fund manager registration requirement;
- the introduction of registration exemptions for international dealers and international advisers;
- the introduction of principles-based rules for managing conflicts of interest;
- the regulation of referral arrangements; and
- the introduction of new client complaint handling and dispute resolution procedures.

Not in Perfect Harmony – What Imperfect Harmonization Means for Market Participants

Each of Canada’s thirteen jurisdictions has its own securities legislation and securities regulator and in some cases its own approach to implementation of the new registration regime. All jurisdictions are not taking a fully harmonious approach with the new registration regime, although on the business trigger for dealer registration, the CSA believe that functional harmonization has been reached since anyone who is in the business of trading in securities must register as a dealer. As to the aspects where there are differences, some jurisdictions, in particular the western provinces and the territories, are providing limited exemptions from the requirement that a person in the business of trading in securities in the exempt market register as an exempt market dealer. Ontario alone will have the sub-adviser exemption from the adviser registration requirement. In Quebec, firms and individuals in the mutual fund and scholarship plan sector are subject to a specific regulatory framework that differs from other jurisdictions. While the differences are generally modest and often of form rather than substance, the result is that market participants will have to continue to consider some local requirements in connection with their activities.

“Business Trigger” for Registration

Currently, the dealer registration requirement is triggered by the act of trading in a security. With the implementation of 31-103 and related legislative amendments, the dealer registration requirement will be triggered by being in the “business of trading” in securities as principal or agent. The introduction of the “business trigger” for the dealer registration requirement may eliminate the need for certain persons to register as a dealer if they carry out limited trades and are not otherwise in the “business of trading” in securities.

The requirement to register as an adviser is already based on a “business trigger” and no change in this approach is contemplated under the new registration regime.

Companion Policy 31-103CP *Registration Requirements and Exemptions* (31-103CP) provides guidance on how the CSA will interpret the provisions of 31-103 and describes a number of factors to consider in determining whether a person is in the “business of trading” or advising. Under 31-103CP, the business trigger analysis focuses on the type of activity (trading or advising) and whether it is conducted as a business. The mere fact of holding oneself out as being in the business of trading or advising is sufficient to engage the registration requirement. Other factors which alone may not be determinative, but which in one or more combinations may be indicative of a business purpose, include acting in an intermediary capacity between a seller and a buyer of securities or making a market in securities, carrying on the activity with repetition, regularity or continuity, receiving or expecting to receive compensation for carrying on the activity (whether transaction or value based) and direct or indirect solicitation activities.

31-103CP discusses the application of the business trigger factors for various parties and activities, including securities issuers, venture capital and private equity investing and incidental activities such as M&A advisory activities and other professional activities where the trading or advising activity involved may not be considered to be for a business purpose.

In conjunction with the move to a “business trigger” for the dealer registration requirement, the dealer registration exemptions currently set out in National Instrument 45-106 *Prospectus and Registration Exemptions* (45-106) will be repealed, including the “accredited investor” exemption, subject to limited exceptions in certain jurisdictions. The prospectus exemptions in 45-106, including that for distributions to “accredited investors”, will generally remain unchanged.

Registration Required for Investment Fund Managers

Persons acting as investment fund managers will now be required to register in a new category of investment fund manager. An investment fund manager is a person that directs the business, operations or affairs of an “investment fund”. (For a discussion of the meaning of “investment fund” see the discussion under the topic Impact on Private Equity and Venture Capital Funds). The investment fund manager need not be acting as the portfolio manager of the fund for the

investment fund manager to become subject to the registration requirement. Registrants in this category will be subject to capital, insurance and proficiency requirements for their chief compliance officers and other ongoing compliance obligations.

Managers of all types of investment funds will become subject to registration in this new category, including managers of funds typically characterized as mutual funds, non-redeemable investment funds, labour-sponsored investment funds, scholarship plans, pooled funds or hedge funds. Whether the manager of a fund that is described as a private equity fund or a venture capital fund will be subject to this registration requirement will require careful consideration of the facts specific to the fund. 31-103 does not provide any registration exemption for managers of funds of these types, the question being whether the registration requirement is triggered for them.

If a firm carries on the activities of an investment fund manager it must register as such. The “business trigger” does not apply for this registration requirement. The CSA plan to publish a proposal for comment during the upcoming year describing under what circumstances an investment fund manager that (i) has a head office outside of Canada would be required to register, or (ii) that has a head office in Canada and that is registered in that jurisdiction in Canada would be required to register in another Canadian jurisdiction.

Categories of Registration and Permitted Activities

31-103 introduces new categories of registration, and removes and consolidates several other categories. The categories of registration under 31-103 are the following:

Investment Dealer – permitted to trade in any security with any type of client. An investment dealer is also permitted to act as an underwriter in respect of any security.

Mutual Fund Dealer – permitted to trade only in securities of mutual funds and, except in Quebec, securities of investment funds that are labour sponsored investment corporations or labour sponsored venture capital corporations under provincial legislation.

Scholarship Plan Dealer – permitted to trade only in securities of scholarship plans, educational plans or educational trusts.

Exempt Market Dealer – permitted to trade only in securities distributed under a prospectus exemption, whether or not a prospectus was filed in respect of the distribution, or in securities that, if the trade were a distribution, would be exempt from the prospectus requirement. An exempt market dealer is also permitted to act as an underwriter in a distribution of securities that is made under a prospectus exemption. With the introduction of this new category of registration, the current limited market dealer category in Ontario and Newfoundland and Labrador will be repealed.

Restricted Dealer – permitted to carry on business under terms and conditions imposed by the local regulator. This category is intended for specialized dealers that would not necessarily qualify for an unrestricted dealer registration.

Portfolio Manager – permitted to advise any type of client with regard to any security. Portfolio managers include advisers with or without discretionary authority.

Restricted Portfolio Manager – permitted to advise in specific securities, classes of securities or the securities of a class of issuers, subject to the terms and conditions imposed by the local regulator.

Investment Fund Manager – permitted to direct the business, operations or affairs of an investment fund.

Where the firm carries on business in more than one registrable activity, then unless otherwise exempt, the firm must register in all applicable categories and comply with the most stringent registration and ongoing compliance requirements. For example, certain investment fund managers, as a result of their activities, may become subject to a triple registration requirement (namely, as investment fund manager, adviser and dealer).

International Dealer and International Adviser Exemptions

The key changes introduced by 31-103 for non-Canadian dealers are (1) the elimination of the international dealer category of dealer registration in Ontario and Newfoundland and Labrador and (2) the repeal of the accredited investor exemption and other dealer registration exemptions currently available under 45-106 in all Canadian jurisdictions other than in limited cases in Alberta, British Columbia, Manitoba, and the territories.

Significantly, 31-103 introduces a new “international dealer exemption” in all Canadian jurisdictions. Provided the applicable conditions are met, the exemption permits non-Canadian dealers to trade in “foreign securities” and certain debt instruments with “permitted clients”, a subset of “accredited investors” under 45-106. “Permitted Clients” include institutional investors, persons or companies, other than individuals or investment funds, with net assets exceeding \$25,000,000 and individuals with net financial assets exceeding \$5,000,000. The practical effect of the international dealer exemption is to narrow the list of persons with which a non-Canadian dealer is permitted to trade on an exempt basis outside Ontario and Newfoundland and Labrador and to eliminate the requirement to register as a dealer in Ontario and Newfoundland and Labrador to trade on this limited basis. A non-Canadian dealer would be required to register as an exempt market dealer in order to trade with the full range of accredited investors in all types of securities, in which case it would be subject to the registration conditions and ongoing compliance obligations for that category of registration. (For a discussion of the international dealer exemption and its requirements, see the topic Impact on International Dealers and Non-Canadian Dealers Trading in the Exempt Market.)

The key changes introduced by 31-103 for non-Canadian advisers are the elimination of the international adviser and portfolio manager & investment

counsel (foreign) registration categories in Ontario and Alberta, respectively. 31-103 introduces an “international adviser exemption” in all Canadian jurisdictions which, provided the applicable conditions are met, permits a non-Canadian adviser to advise “permitted clients” in Canada on “foreign securities”. Where the “international adviser exemption” cannot be relied upon, the non-Canadian adviser will be required to register as a “portfolio manager” and will be subject to the registration conditions and ongoing compliance obligations for that category of registration. (For a discussion of the international adviser exemption and its requirements, see the topic Impact on International Advisers.)

Sub-Adviser and Other Adviser Registration Exemptions

31-103 does not extend the sub-adviser exemption to the adviser registration requirement to jurisdictions beyond Ontario at this time. For now, the adviser registration exemption for sub-advisers in OSC Rule 35-502 – *Non Resident Advisers* (35-502) will be retained in Ontario and exemptive relief where necessary will be considered on a case by case basis in other jurisdictions, as is the current situation.

With the elimination in Ontario of the “look-through” analysis on the adviser registration requirement, which has been confirmed by the CSA in 31-103, related adviser registration exemptions that are currently available under 35-502, such as that for non-Canadian advisers in connection with the private placement of the securities of non-Canadian investment funds, are considered unnecessary and not being carried forward in 31-103 or 35-502.

Registration and Ongoing Compliance Requirements

31-103 sets out registration requirements, including proficiency (for individual registrants) and capital and insurance requirements, as well ongoing compliance requirements applicable to registrants. These include, by way of example, rules governing policy and procedure requirements for control systems and supervision, recordkeeping, know your client and suitability obligations, relationship disclosure, complaint handling, conflicts of interest, and referral arrangements.

31-103 provides certain exemptions from these requirements for a registrant that is an investment fund manager or for a registrant that is a member of a self-regulatory organization (SRO) (e.g., an investment dealer or mutual fund dealer) and is subject to SRO rules that deal with the same subject matter.

31-103 extends the application of a number of existing requirements that currently apply to current categories of registrants to other types of registrants. 31-103 also provides a number of new or expanded requirements, including:

- moving to exam-based individual proficiency requirements;
- a requirement that all registrants appoint an ultimate designated person and a chief compliance officer;
- increased capital requirements for most non-SRO registrants;

- moving from pre-set insurance amounts to a formula-based method for determining insurance requirements;
- a requirement for registrants to file financial statements with regulators more frequently and on an unconsolidated basis;
- a requirement for investment fund managers to file with the regulators, together with their financial statements, a description of any net asset value adjustment made during the period;
- a requirement for registrants (other than investment fund managers and SRO members) to provide to a client “relationship disclosure information”, which is to be all information that a reasonable investor would consider important about the client’s relationship with the registrant and is to include various items such as disclosure of the compensation paid to the registered firm in relation to the different types of products that a client may purchase through it, a description of risks that should be considered, a description of applicable client reporting and a description of certain conflicts of interest;
- a requirement for registrants (other than investment fund managers) to document and respond to client complaints and to ensure that an independent dispute resolution or mediation services are made available, at the firm’s expense; and
- requirements for entering into referral arrangements, including prescribed disclosure to clients and the requirement for the referring party and recipient of the referral to enter into a written agreement.

Firms registered in more than one category must comply with the highest capital and insurance requirements and with conduct requirements that apply to the registrable activity being conducted.

Continuous Registration

Registration will no longer have to be renewed annually, and will remain in effect until suspended or terminated by certain triggering events, including non-payment of annual fees.

Transition

Firms and individuals currently registered will be automatically moved by the securities regulators in each jurisdiction to equivalent categories of registration under 31-103. The equivalent categories are set out in Appendices C and D to 31-103.

31-103 sets out various transition periods to allow firms and individuals to comply with the new requirements.

Firms

Generally for firms registered in a jurisdiction before 31-103 comes into force, the transition timelines from the Implementation Date are as follow:

- 3 months for firms to designate and apply for registration for the ultimate designated person (UDP) and chief compliance officer (CCO);

- 12 months for firms to satisfy capital requirements and notify the regulator of a subordination agreement;
- 6 months for firms to satisfy bonding or insurance requirements;
- 6 months for firms to comply with referral arrangement requirements;
- 12 months for firms to deliver relationship disclosure information to clients; and
- 24 months for firms to ensure that an independent dispute resolution or mediation service is available to resolve client complaints.

Capital and insurance in accordance with current requirements must be maintained during the transition.

A firm which fails to meet the prescribed timelines will be prohibited from carrying on business in the relevant jurisdictions until all the requirements of 31-103 are met.

MUTUAL FUND DEALER

- 24 months for firms to comply with the requirement to deliver client statements.

INTERNATIONAL DEALER

- A firm's registration as an international dealer in Ontario and Newfoundland and Labrador will be automatically revoked on the date 31-103 comes into force and, as of such date, the firm can continue to do business in these provinces pursuant to the international dealer exemption under 31-103. The firm will have one month to submit the required Form 31-103F2 *Submission to Jurisdiction and Appointment of Agent for Service* (Form 31-103F2), which is a condition of the exemption.

INTERNATIONAL ADVISER

- 12 months for firms currently registered as an international adviser in Ontario or as a portfolio manager & investment counsel (foreign) in Alberta, to submit Form 31-103F2, which is a condition of the international adviser exemption.

During the 12 month transition period, registrants in the category of international adviser in Ontario, or portfolio manager & investment counsel (foreign) in Alberta will be automatically converted to the category of portfolio manager and permitted to operate under their current conditions of registration. At the end of the transition period, the firm's registration as portfolio manager will be revoked. During the transition period, the firm will need to register as a portfolio manager under 31-103 or determine that it is able to operate under the international adviser exemption under 31-103.

Individuals

For **individuals registered before 31-103 comes into force**, individuals currently registered, and in each case who will continue to be registered, as a dealing representative of a mutual fund dealer, advising representative of a portfolio manager, associate advising representative of a portfolio manager, or

advising representative subject to terms and conditions of registration equivalent to the scope of authority of an associate advising representative under 31-103, will not be required to satisfy formal proficiency requirements. Individuals designated on the National Registration Database as CCOs upon implementation of 31-103 will not be required to satisfy formal proficiency requirements.

An individual currently registered as a dealing representative of either a scholarship plan dealer or a limited market dealer (which is transitioning to exempt market dealer registration) will have 12 months to satisfy formal proficiency requirements. Similarly, a CCO of a limited market dealer who applies for registration within three months of implementation will have 12 months to meet formal proficiency requirements.

Individuals and Firms not Required to be Registered before 31-103 comes into force, but Requiring Registration once in force

Generally, a firm or individual that is **not registered before the date 31-103 comes into force** must meet all requirements of 31-103 at the time of the firm's or individual's application for registration is filed. However, there are two main exemptions to this general rule for individuals or firms who intend to register as exempt market dealers or investment fund managers. These are:

EXEMPT MARKET DEALERS

- Other than in Ontario and Newfoundland, firms **active** in the exempt market in a jurisdiction prior to the date 31-103 comes into force will have 12 months from the Implementation Date to apply for registration in that jurisdiction and comply with the requirements. New entrants, not previously active in the jurisdiction, will have no transitional relief;
- in Ontario and Newfoundland and Labrador, limited market dealer registrants will be moved automatically to the exempt market dealer registration on the Implementation Date, and will be subject to the transition periods set out above.

INVESTMENT FUND MANAGERS

- Investment fund manager firms with their head office in Canada and **active** prior to the Implementation Date will have 12 months from the Implementation Date to apply for registration in the jurisdiction in which their head office is located and 24 months to apply for registration in other applicable Canadian jurisdictions;
- firms with their head office outside Canada that are either **active or inactive** prior to the Implementation Date will have 24 months to apply for registration.

Continuation of Exemptive Relief

Discretionary relief granted by regulators prior to 31-103 coming into force will extend to equivalent requirements under 31-103 on the same terms and conditions.

Operational Transition by the CSA and IIROC

CSA Staff Notice 31-311 – *Proposed National Instrument 31-103 Registration Requirements and Exemptions - Transition into the New Regime (31-311)* discusses a number of operational matters for transitioning into the new regime. Key features include:

- a “freeze period” for the National Registration Database (NRD) from 5:00 pm (ET) on September 25, 2009 to 11:59 pm (ET) on October 12, 2009;
- during the freeze period the following information will need to be filed by paper (and after the freeze period, on NRD by November 10, 2009)
 - reinstatements,
 - termination notices for individuals who resign or are dismissed for cause,
 - notices of changes to civil, criminal and financial information,
- all other notices which should have been submitted during the freeze period, must be submitted on NRD by November 24, 2009; and
- applications made by paper during the freeze period must be resubmitted on NRD, and if approved during the freeze period, they must be resubmitted by November 24, 2009.

Matters Being Considered Further by the CSA

While 31-103 is a very comprehensive overhaul of registration requirements and exemptions in Canada, the CSA have noted a number of matters which they expect to revisit. These matters include:

- the circumstances under which an investment fund manager that does not have a Canadian head office would need to register;
- the circumstances under which an investment fund manager with a head office in one Canadian jurisdiction would need to register in other Canadian jurisdictions;
- amendments to 31-103 are expected in respect of requirements or guidance for cost disclosure and performance reporting. The CSA have stated that the goal is to make 31-103 consistent with the Client Relationship Models (CRMs) of the SROs, once finalized, and to potentially exempt members of the SROs from some of these requirements if they are satisfied with the CRMs;
- the CSA have stated that they are working with the SROs to harmonize complaint-handling requirements and anticipate amending 31-103 accordingly;
- the CSA have stated that they are considering proposing expanded custodial requirements;
- the forms related to registration will be subject to further review and changes may be proposed to the registration process; and
- the CSA have stated that they will continue to assess new examinations for recognition as sufficient for proficiency requirements.

Impact on Limited Market Dealers and Unregistered Dealers Trading in the Exempt Market

Requirement to Register as a Dealer

Under National Instrument 31-103 – *Registration Requirements and Exemptions* (31-103), dealer registration in Canadian provinces and territories (jurisdictions) is required when an individual or firm conducts trading activity as a business or holds itself out as being in the business of trading. This is called the “business trigger” for registration. To determine whether registration is required, a firm or individual must consider whether its activities amount to trading, and then determine whether it is carrying out those activities as a business.

Companion Policy 31-103CP – *Registration Requirements and Exemptions* (31-103CP) outlines a number of factors to be considered in determining whether a “business” is being conducted. These include factors such as whether the individual or firm is engaging in activities similar to a registrant, intermediating trades between sellers and purchasers, conducting the activity repeatedly, receiving compensation or directly or indirectly soliciting clients.

A number of dealer registration exemptions currently available for trading in securities pursuant to National Instrument 45-106 – *Prospectus and Registration Exemptions* (45-106) will be repealed upon implementation of 31-103 including the exemption for trades with “accredited investors”. Currently, in jurisdictions other than Ontario and Newfoundland and Labrador, dealer registration exemptions are generally available for trades that are exempt from prospectus requirements (the exempt market). After 31-103 most of these dealer registration exemptions will be repealed and accordingly unregistered dealers trading in the exempt market who are in the business of trading will be required to register as “exempt market dealers” (EMDs).

In Ontario and Newfoundland and Labrador, currently persons who act as “market intermediaries” in respect of trades in the exempt market are required to register as limited market dealers. Upon implementation of 31-103, limited market dealers will be registered as EMDs and will be subject to capital, insurance and proficiency requirements and other ongoing compliance requirements.

Earlier versions of 31-103 incorporated different regulatory requirements for EMDs, depending on whether or not the EMD handled, held or had access to client assets. This distinction has been eliminated.

Exemptions from Registration

Exemptions from the requirement to register as a dealer will be much more limited upon the implementation of 31-103. However, some of the principal exemptions contemplated by 31-103 include:

Trades through a Registered Dealer

There is an exemption for a trade being conducted solely through a registered dealer. The Canadian Securities Administrators (CSA) note in 31-103CP that this exemption is not available for trades where an intermediary is involved and that it is only available where a person trades their own securities directly with a registered dealer.

Mobility Exemption

31-103 includes a new “mobility exemption” which would in some circumstances allow a registered firm and representative to continue to deal with a small number of clients who move to another jurisdiction without the need to register in that other jurisdiction. The mobility exemption allows a firm to deal with up to 10 “eligible” clients (the client who relocated and his or her spouse and children) or an individual to deal with up to five eligible clients in a jurisdiction without being registered. Certain client notices and regulatory filings are required to rely on this exemption.

Northwestern Jurisdictions

Alberta, British Columbia, Manitoba, the Northwest Territories, Nunavut and the Yukon Territory will introduce orders exempting individuals and firms from the dealer registration requirement when they trade in securities that have been distributed under one of the following prospectus exemptions in 45-106:

- accredited investor;
- family, friends and business associates;
- offering memorandum; or
- minimum \$150,000 purchase of a security in one transaction.

To rely on this order, an individual or firm in one of those provinces or territories must:

- not be registered in any category of registration in any jurisdiction (including any non-Canadian jurisdiction);
- not provide suitability advice about the trade to the purchaser;
- except in British Columbia, not otherwise provide financial services to the purchaser;
- not hold or have access to the purchaser's assets;
- provide risk disclosure in the prescribed form to the purchaser; and
- file an information report with the securities regulatory authority.

Saskatchewan is considering whether it will adopt this exemption.

Exemptions Where Another Regulatory Regime Applies

There are dealer registration exemptions for certain trades conducted by persons subject to other regulatory regimes, such as trades in mortgages, trades conducted pursuant to personal property legislation, trades in variable insurance contracts and trades in evidences of deposits by Schedule III banks and co-operative associations.

Certain Types of Plans

Issuers and administrators in respect of certain employee or reinvestment plans, are exempt from dealer registration requirements in respect of those trades.

Portfolio Managers

A portfolio manager may trade securities of non-prospectus qualified funds (pooled funds) for which it acts as the adviser and the fund manager with discretionary accounts it manages without registering as a dealer. Written notice of reliance on this exemption is required to be given to the applicable regulator.

Other Investment Fund Exemptions

There are other exemptions from the dealer registration requirement for certain types of trades in investment fund securities by an investment fund or its manager such as trades pursuant to certain reinvestment plans, and additional investments where the investor holds securities of the fund with a value or acquisition cost of \$150,000 or more.

International Dealers

This exemption allows non-resident dealers to operate in Canada, with limitations. See the discussion under the topic Impact on International Dealers and Non-Canadian Dealers Trading in the Exempt Market.

Permitted Activities for EMDs

Under 31-103, EMDs will be restricted to:

- i) acting as a dealer by trading a security that is distributed under an exemption from the prospectus requirement, whether or not a prospectus was filed in respect of the distribution;
- ii) acting as a dealer by trading a security that, if the trade were a distribution, would be exempt from the prospectus requirement;
- iii) receiving an order from a client to sell a security that was acquired by the client in a circumstance described in subparagraph (i) or (ii), and acting or soliciting in furtherance of receiving such an order; and
- iv) acting as an underwriter in respect of a distribution of securities that is made under an exemption from the prospectus requirement.

Registration of UDPs and CCOs

31-103 will require EMDs to register an ultimate designated person (UDP) and a chief compliance officer (CCO). The UDP's role is to supervise the activities of the registrant that are directed toward ensuring compliance with applicable securities regulations and promote compliance within the firm. While the actual form of compliance system to be implemented is not prescribed in 31-103, 31-103CP gives guidance on what the CSA view as an effective compliance framework. The designated UDP should be the CEO of the EMD or an officer in charge of the applicable division, but does not necessarily need to be someone who is involved in day-to-day compliance matters. No proficiency requirements are specified for the UDP function.

The CCO is required to establish and maintain compliance policies and procedures, monitor and assess compliance, report non-compliance to the UDP and annually report on compliance matters to the firm's board of directors. Accordingly, the CCO (who must be an officer or partner of the EMD) will be subject to certain proficiency requirements as described below. Firms must designate only one CCO and large firms will need to apply for an exemption to appoint more than one CCO, for example, where there are multiple distinct operating divisions within a firm. Both the UDP and the CCO must be able to access the firm's board of directors at such times as they consider necessary or advisable.

Proficiency and Financial Condition

EMDs will be required to meet the following proficiency and financial condition requirements. Non-compliance may result in the imposition of terms and conditions by the securities regulators, or revocation or suspension of registration:

- **Proficiency** – EMD sales representatives will need to satisfy proficiency requirements, which will generally be exam-based, rather than course-

based. Representatives can qualify, among other ways, by passing the Canadian Securities Course Exam or the Exempt Market Products Exam. While a UDP does not need to satisfy specific proficiency requirements, a CCO of an EMD can qualify, among other ways, by passing the Partners, Directors and Officers Exam and either the Canadian Securities Course Exam or the Exempt Market Products Exam.

- **Capital requirements** – EMDs will have to satisfy capital requirements. This means that their excess working capital (calculated as prescribed, via Form 31-103F1 - *Calculation of Excess Working Capital*, and certified by management) must not be less than zero for two consecutive days, and the minimum capital must be \$50,000.

The working capital position of a registrant is required to be known at all times. Negative excess working capital at any time must be reported to the regulator as soon as possible. Under Form 31-103F1, "excess working capital" is calculated according to the following formula:

- adjusted current assets (those readily convertible into cash), less
 - adjusted current liabilities (current liabilities plus 100% of unsubordinated long-term related party debt), less
 - the required minimum capital which, in the case of EMDs is \$50,000, less
 - an amount on account of market risk (based on owned securities, applying Investment Industry Regulatory Organization of Canada margin rules), less
 - the insurance deductible for the financial institution bond, less
 - the amount of any guarantees by the firm, less
 - "unresolved differences" (both firm and client, and securities shortfalls must include the applicable margin amount).
- **Insurance** – EMDs will need to have specified insurance, namely a financial institution bond (with fidelity, on premises, in transit, forgery or alterations and securities coverage, and either a double aggregate limit or a full reinstatement of coverage provision) in the greater of: (1) \$50,000 per employee, agent and representative or \$200,000, whichever is less; (2) one percent of total clients assets held or accessible by the dealer or \$25,000,000, whichever is less; (3) one percent of the dealer's total assets or \$25,000,000, whichever is less; and (4) the amount determined by its board of directors. Changes, claims or cancellation of such insurance policy will need to be reported in writing to the regulator as soon as practicable.
 - **Financial records** – EMDs will need to have an auditor (for annual purposes and to be on standby to deliver an audit or review report as and when requested by the regulator), and will be required to deliver annual financial statements with the audit report and a completed Form 31-103F1 within 90 days of year end.

All financial statements are currently required to be prepared in accordance with GAAP but on an unconsolidated basis. The CSA have indicated they intend to require registrants to adopt international financial reporting standards for financial years beginning on or after January 1, 2011.

Compliance and Dealing with Clients

31-103 and 31-103CP contain detailed and technical conduct requirements for all registrants, including EMDs. The CSA consider compliance to be a firm-wide responsibility to be carried out in accordance with a documented compliance system which should address, among others, the following elements:

- internal controls;
- supervision (both day-to-day and systemic monitoring);
- a visible commitment to compliance by the board of directors or partners;
- sufficient resources and training;
- detailed policies and procedures; and
- detailed records of activities.

In addition, EMDs will be subject to a number of specific rules for dealing with clients, including the following:

Know your client and suitability obligations – 31-103 outlines the requirements for fulfilling know your client and suitability obligations. Account opening and client documentation (including for know your client and suitability purposes) must be maintained and kept current. Unsuitable trades (in the firm's opinion, acting reasonably) at a client's direction can be executed only if the client is first informed of their unsuitability (in the EMD's opinion). Know your client and suitability exemptions are available for certain specified institutional clients.

Leverage disclosure – Where an EMD is recommending using borrowed money to finance any part of the purchase of a security, written disclosure of the risks of leverage must be provided to the client, with certain exceptions (including for “permitted clients” or where the proposed purchase is on margin and the client's margin account is maintained in accordance with certain margin rules).

Client assets – Client assets that are held by an EMD must be segregated and held in trust for the client (in the case of cash, in a designated trust account with certain types of Canadian financial institutions, and in the case of securities in accordance with certain requirements).

Margin and Prohibition on Lending – EMDs may not lend money, extend credit or provide margin to clients.

Record keeping and account activity reporting – Record-keeping is mandated, and certain records must be kept for at least 7 years. 31-103 does not contain an exhaustive list of records that must be kept, instead requiring maintenance of records that accurately record a registrant's business activities,

financial affairs and client transactions and that demonstrate compliance with securities legislation. Client statements are required to be provided at least once every three months and at the end of each month during which a transaction was effected. Trade confirmations are required, with related party disclosure, if applicable, and other specified disclosure.

Complaint handling – EMDs will also be required to document and, in a manner that a reasonable investor would consider fair and effective, respond to complaints about products and services, and must make an independent dispute resolution or mediation service available at the EMD's expense.

Conflicts of Interest

Material conflicts of interest and potential material conflicts of interest must be identified and responded to, and conflict of interest disclosure is prescribed in certain cases, including with respect to trades and offerings involving securities of related entities or recommendations to buy, sell or hold such securities. Client "relationship disclosure information" will also be required. Referral arrangements are also regulated as are "tied selling" and unnecessary mandatory financial institution settlement arrangements.

For further compliance requirements see the discussion under the topic New Compliance Requirements for Registrants.

Impact on Investment Fund Managers

The final proposal for National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) and the recent amendments to the provinces and territories' Securities Acts impose a new requirement that investment fund managers register as such. This new category of registration is provided for in 31-103 and imposes requirements for capital, insurance, proficiency for the chief compliance officer, as well as ongoing compliance and conduct.

Who is an Investment Fund Manager

The term "investment fund manager" is defined in the securities legislation of the various jurisdictions and refers to a person or company that directs the business, operations or affairs of an investment fund. This role is distinguishable from a person who provides portfolio management services or investment advice to the investment fund. A person providing such services or advice would be acting as an adviser and subject to the adviser registration requirements.

There are no material exemptions from the requirement to register as an investment fund manager and existing managers of mutual funds, for example, who often act as an investment adviser for the mutual fund (and would be registered as an adviser), would need to also register in the investment fund manager category. An investment fund manager that engages in the business of trading in securities of the investment fund it manages may also be required to register as a dealer.

In commentary to National Instrument 81-107 *Independent Review Committee for Investment Funds* (81-107), which includes a definition of "manager" that is the same as the definition of investment fund manager in other parts of the securities laws, the CSA have commented that they are of the view that the term "manager" should be interpreted broadly and is intended to include a group of members on the board of an investment fund or the general partner of an investment

fund organized as a limited partnership, where it acts in the capacity of ‘manager’/ ‘decision maker’. As such, the substance of how investment funds are organized and governed, as well as the question whether the fund is an investment fund, will need to be considered in determining which person or persons may be subject to the investment fund manager registration requirement. In Companion Policy 31-103CP *Registration Requirements and Exemptions* (31-103CP) it is noted that where investment funds are organized as limited partnerships, multiple registrations may not be necessary if each general partner in an affiliated group enters into a management contract with a single registered investment fund manager in the group. See the topic Impact on Private Equity and Venture Capital Funds for a discussion of the meaning of “investment fund”.

Application of Registration Requirement to Non-Canadian Investment Fund Managers

The CSA plan to publish a proposal for comment during the next year to explain under what circumstances an investment fund manager that has a head office outside Canada would need to register and in what circumstances an investment fund manager with a head office in one jurisdiction in Canada would need to register in other jurisdictions.

Registration of Individuals

A firm registered as an investment fund manager is required to have an individual registered as its ultimate designated person (UDP) and an individual registered as its chief compliance officer (CCO). No other individuals at firms that are registered as investment fund managers are required to be registered, although directors and certain officers would be required, as “permitted persons” under National Instrument 33-109 *Registration Information*, to submit Form 33-109F4 in connection with the firm’s registration.

The UDP is required to supervise the activities of the firm that are directed towards ensuring compliance with securities legislation by the firm and each individual acting on its behalf and to promote compliance with securities legislation within the firm.

The CCO is required to establish and maintain policies and procedures for assessing compliance by the firm, and individuals acting on its behalf, with securities legislation; monitor and assess compliance by the firm, and individuals acting on its behalf, with securities legislation; report to the UDP as soon as practicable if the CCO becomes aware of any circumstances indicating that the firm, or any individual acting on behalf of the firm, is in substantial non-compliance with securities legislation; and submit an annual report to the board of directors or partnership for the purpose of assessing compliance by the firm, and individuals acting on its behalf, with securities legislation.

The proficiency requirements for the CCO of an investment fund manager are one of three standards:

FIRST STANDARD:

- has a CFA Charter or professional designation as a lawyer, Chartered Accountant, Certified General Accountant or Certified Management Accountant in a jurisdiction in Canada, a notary in Quebec, or the equivalent in a foreign jurisdiction;
- has both the Canadian Securities Course Exam of CSI Global Education Inc. (CSI) and either the Investment Funds Institute of Canada (IFIC) Officers', Partners' and Directors' Exam or CSI's Partners, Directors and Senior Officers Exam (each the PDO Exam); and
- has either (1) gained 36 months of relevant securities experience while working at a registered dealer, a registered adviser or an investment fund manager or (2) provided professional services in the securities industry for 36 months and worked for an investment fund manager for 12 months.

SECOND STANDARD:

- has IFIC's Canadian Investment Funds Exam, the Canadian Securities Course Exam or the CSI's Investment Funds in Canada Course Exam;
- has the PDO Exam; and
- has gained five years of relevant securities experience while working at a registered dealer, registered adviser or an investment fund manager, including 36 months in a compliance capacity.

THIRD STANDARD:

- has met the proficiency requirements for a CCO of a portfolio manager.

There are no proficiency requirements for the UDP, but the UDP must be the chief executive officer, an officer in charge of a division of the firm, if the activity that requires registration occurs only in the division, or an individual acting in a similar capacity.

Financial Condition Requirements

An investment fund manager is subject to capital and insurance requirements as follows:

- minimum capital of \$100,000;
- requirement that excess working capital be not less than zero;
- bonding or insurance in respect of each prescribed clause and for each clause the highest of the following amounts:
 - one percent of assets under management or \$25,000,000, whichever is less,
 - one percent of the investment fund manager's total assets or \$25,000,000, whichever is less,
 - \$200,000, and
 - the amount determined to be appropriate by a resolution of the directors of the investment fund manager.

Financial and Other Reporting to Regulator

An investment fund manager will be required to deliver to the regulator quarterly and audited annual financial statements, prepared in accordance with generally accepted accounting principles but on an unconsolidated basis, and calculations of excess working capital. The CSA have indicated that they intend to require registrants to adopt international financial reporting standards for financial years beginning on or after January 1, 2011.

An investment fund manager's financial statements delivered to the regulator must include a description of any net asset value adjustment made during the period.

Business Operations and Client Relationship Rules for Investment Fund Managers

An investment fund manager is not subject to the know your client or suitability, client complaint handling or most client account handling requirements for registered firms, but otherwise is subject to the same business operations and client relationship rules as other registered firms. These include: segregation and other requirements pertaining to holding client assets, record keeping requirements, and requirements for its controls and compliance systems. See the discussion under the topic New Compliance Requirements for Registrants.

Conflicts of Interest

An investment fund manager is subject to the conflict of interest provisions of 31-103 that apply generally to registered firms. The obligation to identify conflicts of interest with clients and to resolve them and, in some cases, to disclose them to clients does not apply to an investment fund manager in respect of an investment fund that is subject to 81-107. This rule, which among other things contemplates the appointment of an independent review committee for an investment fund, applies to investment funds that are reporting issuers.

Registrations in Multiple Categories May Be Required and Some Exemptions

As noted, an investment fund manager that is also managing the portfolio for the investment fund or otherwise providing investment advice to the investment fund it is managing will be subject to the adviser registration requirement as well as the investment fund manager registration requirement. Its activities in connection with the selling of securities of the investment fund may also require it to register as a dealer. There is a dealer registration exemption for a person or company in respect of a trade by the person or company if the trade is made solely through an agent that is a registered dealer. In 31-103CP, the CSA note that an investment fund manager does not have to register as a dealer to promote the fund to registered dealers. An investment fund manager is also exempt from the dealer registration requirements for trades in securities of the non-prospectus qualified funds it manages and advises to client accounts it manages. There are further exemptions from the dealer registration requirement for investment fund managers in respect of dividend or distribution reinvestment plans or optional

investment plans of the investment funds or certain additional investments by fund security holders.

If a firm is registered in more than one category it must meet the highest capital requirement and comply with all applicable requirements for registrants in each category. The capital requirements are not cumulative.

Fees Payable in Respect of Registration and the Unregistered Investment Fund Manager Capital Markets Participation Fee in Ontario

In Ontario firms registered as investment fund managers will be required to pay participation fees under OSC Rule 13-502 *Fees* (Ontario Fee Rule). Participation fees must also be paid under the Ontario Fee Rule by any investment fund manager who continues to operate on an unregistered basis in accordance with an exemption from the investment fund manager registration requirement. Fees may also be applicable in other jurisdictions.

Impact on Portfolio Managers and Investment Counsel

The final proposal for National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) and the recent amendments to the provinces and territories' Securities Acts modify the adviser registration categories and change some of the requirements associated with registration as a "full adviser".

Categories of Registration for Firm and Individuals and Transition Matters

Advisers have typically been registered as both "investment counsel" and "portfolio managers", although these are separate categories of adviser registration in most jurisdictions. Under the new regime, advisers are required to be registered in one of two categories, either:

- portfolio manager, being an adviser that is permitted to advise in any securities; or
- restricted portfolio manager, being an adviser that is limited by conditions on its registration to advising in specified securities, classes of securities or the securities of a class of issuers.

As such, there will be one general category of adviser registration, for both residents and non-residents, that of portfolio manager.

Under the transition provisions of the new regime, persons that are registered as an investment counsel, portfolio manager or portfolio manager/investment counsel (or, in Ontario, non-Canadian investment counsel & portfolio manager or extra-provincial investment counsel & portfolio manager) will be automatically registered in the new category of "portfolio manager". Generally, the only persons who will be reregistered as "restricted portfolio managers" are those persons presently registered in Quebec as "restricted practice advisers".

Individuals at firms registered as portfolio managers will be registered as:

- advising representatives; or
- associate advising representatives.

Portfolio managers will also be required to have individuals who are designated and registered as their ultimate designated person (UDP) and their chief compliance officer (CCO), as is generally currently the case.

Directors and certain officers would still be required, as “permitted persons” under National Instrument 33-109 *Registration Information*, to submit Form 33-109F4 in connection with the firm’s registration.

Matters Materially Different for Portfolio Managers under 31-103

The matters that are materially different portfolio managers under the new registration regime include:

- the requirement to provide a client with relationship disclosure information before advising the client;
- the capital and insurance requirements; and
- the requirement to make available an independent dispute resolution or mediation service, at the firm’s expense, to clients to resolve clients’ complaints.

Adviser Registration Exemptions

31-103 retains the existing adviser registration exemption for members of the Investment Industry Regulatory Organization of Canada (IIROC) that manage clients’ investment portfolios through discretionary authority granted by the client and who are approved to perform that function by IIROC. It also retains in concept the “incidental activities” exemption from the adviser registration requirement for registered dealers that advise a client in connection with a trade in security.

31-103 also adds a new adviser registration exemption for persons who act as advisers if the advice does not purport to be tailored to the needs of the person or company receiving the advice. As a result, for example, newsletter writers who provide general investment recommendations will often no longer be required to be registered as advisers. 31-103 requires a person relying on the general advice exemption that has, or has certain specified relationships with a person that has, a financial or other interest in any recommended securities, to disclose the interest when making the recommendation. In addition, international advisers are exempted from the requirement to register as an adviser where their activities are limited as set out in 31-103 and they are providing the advice from outside of Canada. For further information on the international adviser registration exemption see the discussion under the topic Impact on International Advisers.

31-103 does not extend the sub-adviser exemption to the adviser registration requirement to jurisdictions beyond Ontario at this time. For now, the adviser

registration exemption for sub-advisers in OSC Rule 35-502 – *Non Resident Advisers* (35-502) will be retained in Ontario and exemptive relief where necessary will be considered on a case by case basis in other jurisdictions, as is the current situation.

With the elimination in Ontario of the “look-through” analysis on the adviser registration requirement, which has been confirmed by the CSA in the Notice to 31-103, related adviser registration exemptions that are currently available under 35-502, such as that for non-Canadian advisers in connection with the private placement of the securities of non-Canadian investment funds, are considered unnecessary and are not being carried forward in 31-103 or 35-502.

Dealer Registration Exemptions for Advisers with respect to their Non-Prospectus Qualified Funds

31-103 exempts a registered adviser from the dealer registration requirement in respect of a trade in a security of a non-prospectus qualified investment fund (pooled fund) if (1) the adviser acts as the fund’s adviser and investment fund manager, and (2) the trade is to a managed account of a client of the adviser. This exemption is not available however if the managed account or non-prospectus qualified investment fund was created or is used primarily for the purpose of qualifying for the exemption. Notice to the regulator is required for an adviser to rely on this exemption.

Registration of Individuals and Fit and Proper Requirements for Registration

Individuals registered as advising representatives of a portfolio manager are required:

- to have a CFA charter and 12 months of relevant investment management experience in the 36 month period before applying for registration; or
- to have a Canadian Investment Manager designation (being the designation earned through the Canadian investment manager program of CSI Global Education Inc. (CSI)) and 48 months of relevant investment management experience, 12 months of which was in the 36 month period before applying for registration.

Less experience is required for registration as an associate portfolio manager. Any advice given by an associate portfolio manager must be approved by an advising representative of the firm.

A firm registered as an adviser is required to have an individual registered as its ultimate designated person (UDP) and an individual registered as its chief compliance officer (CCO).

The UDP is required to supervise the activities of the firm that are directed towards ensuring compliance with securities legislation by the firm and each individual acting on its behalf and to promote compliance with securities legislation within the firm.

The CCO is required to establish and maintain policies and procedures for assessing compliance by the firm, and individuals acting on its behalf, with securities legislation; monitor and assess compliance by the firm, and individuals acting on its behalf, with securities legislation; report to the UDP as soon as practicable if the CCO becomes aware of any circumstances indicating that the firm, or any individual acting on behalf of the firm, is in substantial non-compliance with securities legislation; and submit an annual report to the board of directors or partnership for the purpose of assessing compliance by the firm, and individuals acting on its behalf, with securities legislation.

The proficiency requirements for the CCO of a portfolio manager are one of three standards:

FIRST STANDARD:

- has a CFA Charter or professional designation as a lawyer, Chartered Accountant, Certified General Accountant or Certified Management Accountant in a jurisdiction in Canada, a notary in Quebec, or the equivalent in a foreign jurisdiction;
- has both the Canadian Securities Exam of CSI and either the Investment Funds Institute of Canada (IFIC) Officers', Partners' and Directors' Exam or CSI's Partners, Directors and Senior Officers Exam (each the PDO Exam); and
- has either (1) gained 36 months of relevant securities experience while working at an investment dealer, a registered adviser or an investment fund manager, or (2) provided professional services in the securities industry for 36 months and worked for a registered dealer, a registered adviser or an investment fund manager for 12 months.

SECOND STANDARD:

- has the Canadian Securities Exam and the PDO Exam and has either:
 - worked for an investment dealer or a registered adviser for 5 years, including for 36 months in a compliance capacity, or
 - worked for 5 years at a Canadian financial institution in a compliance capacity relating to portfolio management and worked at a registered dealer or a registered adviser for 12 months.

THIRD STANDARD:

- has the PDO Exam and has met the proficiency requirements for registration as an advising representative of a portfolio manager.

There are no proficiency requirements for the UDP, but the UDP must be the chief executive officer, an officer in charge of a division of the firm, if the activity that requires the firm to register occurs only within the division, or an individual acting in a similar capacity.

Capital and Insurance Requirements

An adviser is subject to capital and insurance requirements as follows:

- minimum capital of \$25,000;
- requirement that excess working capital be not less than zero;
- for advisers that do not handle, hold or have access to clients' assets, bonding or insurance in respect of each prescribed clause in the amount of \$50,000 for each clause; and
- for advisers that do handle, hold or have access to clients' assets, bonding or insurance in respect of each prescribed clause and in the highest of the following amounts for each clause:
 - one percent of assets under management that the adviser handles, holds or has access to or \$25,000,000, whichever is less,
 - one percent of the adviser's total assets or \$25,000,000, whichever is less,
 - \$200,000, and
 - the amount determined to be appropriate by a resolution of the directors of the adviser.

Financial Reporting to Regulators

An adviser will be required to deliver to the regulator audited annual financial statements, prepared in accordance with generally accepted accounting principles but on an unconsolidated basis, and calculations of excess working capital. The CSA have indicated they intend to require registrants to adopt international financial reporting standards for financial years beginning on or after January 1, 2011.

Business Operations and Client Relationship Rules for Portfolio Managers

Advisers are subject to the conduct rules under 31-103, which include:

- know your client requirements;
- suitability requirements;
- the requirement to provide relationship disclosure information before the portfolio manager first advises the client. This information is all information that a reasonable investor would consider important about the client's relationship with the portfolio manager and is to include, for example, a discussion that identifies which products or services are offered by the firm, a discussion of the types of risk a client should consider when making an investment decision, a description of the conflicts of interest that the portfolio manager is required to disclose under securities legislation, and disclosure of all costs to a client for the operation of an account;
- segregation requirements for clients' assets;

- records requirements; and
- compliance system requirements.

The terms on which a portfolio manager may participate in a referral arrangement are prescribed in 31-103.

Conflicts of Interest

31-103 consolidates a number of conflicts of interest requirements that previously appeared in various places in securities legislation. It requires that a portfolio manager make reasonable efforts to identify material conflicts of interest or potential material conflicts of interest between the firm and its clients, to respond to such conflicts of interest and, where the client, acting reasonably, would expect to be informed of such a conflict of interest, to disclose the nature and extent of the conflict of interest to the client. The CSA note in 31-103CP that this would include disclosure about related or connected issuers when the portfolio manager is recommending securities of those issuers.

31-103 prohibits a portfolio manager from implementing certain types of transactions for investment portfolios managed by it. Among the types of transactions prohibited for a portfolio manager is the purchase or sale of a security between investment portfolios managed by the portfolio manager or other “responsible persons”.

A portfolio manager is required to ensure fairness in the allocation of investment opportunities among its clients.

Handling of Client Complaints and Disputes

Under 31-103 a portfolio manager is required to document and respond to each complaint made to it about its products or services, in a manner that a reasonable investor would consider fair and effective, and is required to ensure that independent dispute resolution or mediation services are made available, at the firm’s expense, to resolve client complaints.

Prohibition on Providing Margin or Lending to Clients

Like all registrants other than IIROC members, a portfolio manager is prohibited from lending money, extending credit or providing margin to a client.

Impact on International Dealers and Non-Canadian Dealers Trading in the Exempt Market

On July 17, 2009, the Canadian Securities Administrators (the CSA) published their final proposal for National Instrument 31-103 - *Registration Requirements and Exemptions* (31-103). Subject to government and other local approval requirements, 31-103 will come into force on September 28, 2009 (the Implementation Date).

31-103 is intended to harmonize, streamline and modernize registration requirements and exemptions across all Canadian provinces and territories (jurisdictions) and represents a major overhaul of the current registration regime. The new registration regime has significant implications for Canadian and non-Canadian dealers, advisers and investment fund managers currently doing business on a registered or exempt basis in any jurisdiction of Canada, including non-Canadian dealers registered in Ontario and Newfoundland and Labrador in the category of international dealer and persons relying on the "accredited investor" exemption and other exemptions from the dealer registration requirement in other Canadian jurisdictions. The new rules will also have significant implications for private placements and other capital market activities in Canada.

Key Changes to the Current Dealer Registration and Exemption Regimes

Material changes introduced by 31-103 for international dealer registrants and persons relying on the current dealer registration exemptions include:

- the elimination of the international dealer registration category in Ontario and Newfoundland and Labrador;
- the repeal of the dealer registration exemptions contained in National Instrument 45-106 - *Prospectus and Registration*

Exemptions (45-106), including the exemption for trades with accredited investors;

- the introduction of a new international dealer exemption that narrows the list of clients with whom a non-Canadian dealer may trade on an exempt basis;
- for persons relying on the dealer registration exemptions under the current version of 45-106 and who would be relying in future on the international dealer exemption, the introduction of a new restriction that trading activities under the international dealer exemption relate to "foreign securities" (which excludes inter-listed securities of Canadian issuers) and certain Canadian debt securities only;
- the introduction of a "business trigger" requiring registration of all persons who are in the business of trading in securities unless an exemption is available; and
- the introduction of an exempt market dealer (EMD) registration category that will permit Canadian and non-Canadian dealers to trade (1) in securities being distributed under a prospectus exemption or (2) with persons or companies to whom a security may be distributed under a prospectus exemption (for example, trading with an accredited investor).

Introduction of "Business Trigger" for Dealer Registration

Currently, the dealer registration requirement is generally triggered by the act of trading in a security. With the implementation of 31-103 and related legislative amendments in most Canadian jurisdictions, the dealer registration requirement will be triggered by being "in the business of" trading in securities as principal or agent. The introduction of the business trigger for the dealer registration requirement may eliminate the need for certain persons to register as a dealer if they carry out limited trades and are not otherwise in the business of trading in securities. For a discussion of the types of factors that the CSA view as indicative of a business purpose and that may trigger the dealer registration requirement, see the discussion under the heading Business Trigger for Registration under the topic Overview of Canada's New Registration Regime.

Blanket Registration Exemptions for Certain Trades in Selected Canadian Jurisdictions

Alberta, British Columbia, Manitoba and the three Canadian territories (the Northwest Territories, Nunavut and the Yukon Territory) will introduce standard blanket orders exempting individuals and firms from the dealer registration requirement when they trade in securities distributed under the accredited investor and other specified exemptions from the prospectus requirement under NI 45-106 (the Blanket Registration Exemptions). The Blanket Registration Exemptions will be unavailable to non-Canadian dealers that are registered in their home jurisdictions or in any Canadian jurisdiction. To rely on the Blanket Registration Exemptions, a non-resident person must: (1) not be registered in any jurisdiction; (2) not provide suitability advice leading to the trade; (3) not otherwise provide financial services to the purchaser; (4) not hold or have access

to the purchaser's assets; (5) provide a risk disclosure in prescribed form to the purchaser; and (6) file an information report with the local regulator.

Current Dealer Registration and Exemption Regime

In Ontario and Newfoundland and Labrador, registration as an international dealer has permitted a non-Canadian dealer to trade with local "designated institutions" in non-Canadian equity securities and certain Canadian debt securities. The practical effect of the international dealer registration regime in these jurisdictions has been to permit a non-Canadian dealer to trade in permitted securities with any person or entity, other than an individual, that qualifies as an accredited investor. In all other Canadian jurisdictions, securities laws currently permit a non-Canadian dealer to trade in both Canadian and non-Canadian securities with an accredited investor on a basis that is exempt from the dealer registration requirement.

International Dealer Exemption – Restrictions and Conditions

Under 31-103, a non-Canadian dealer that is an "international dealer" may rely on the international dealer exemption to trade with "permitted clients" (a subset of accredited investors under 45-106) when trading in foreign securities and certain Canadian debt securities.

In order to qualify as an international dealer, the non-Canadian dealer must be registered under the securities legislation of the foreign jurisdiction in which its head office or principal place of business is located in a category of registration that permits the dealer to carry on the activities which the non-Canadian dealer is proposing to carry on in the local Canadian jurisdiction. The non-Canadian dealer must also be engaged in the business of a dealer in that foreign jurisdiction.

In order to rely on the exemption, the international dealer must have previously:

- submitted to the relevant securities regulatory authorities an executed Form 31-103F2 *Submission to Jurisdiction and Appointment of Agent for Service* (Form 31-103F2); and
- notified the permitted client (1) that it is not registered in Canada, (2) of its jurisdiction of residence, (3) of the name and address of the agent for service of process appointed by the international dealer in the local jurisdiction, and (4) that there may be difficulty enforcing legal rights against the international dealer because it is resident outside Canada and all or substantially all of its assets are situated outside of Canada.

A person relying on the international dealer exemption will be required to pay capital market participation fees and submit a prescribed form to the Ontario Securities Commission on an annual basis. Other fee requirements may apply in other Canadian jurisdictions. In those other jurisdictions, the non-Canadian dealer must notify the local regulator 12 months after it first submits a Form 31-103F2 and each year thereafter if it continues to rely on the exemption.

International Dealer Exemption – Narrower List of Permitted Clients

The practical effect of the international dealer registration exemption is to narrow somewhat the list of clients with whom a non-Canadian dealer is permitted to trade on an exempt basis and to require registration as an exempt market dealer as a condition to trading with the full range of accredited investors without restriction as to the type of security. For example, non-Canadian dealers currently registered as international dealers in Ontario and Newfoundland and Labrador will no longer be permitted to trade with the following categories of clients under the international dealer exemption:

- a corporate entity with net assets of C\$5,000,000 (the applicable threshold under the exemption is increased to C\$25,000,000); or
- an investment fund that is not advised by a person registered as a portfolio manager or managed by an investment fund manager registered in a jurisdiction in Canada.

Non-Canadian dealers relying on the international dealer exemption, however, will be permitted to trade with individuals with net financial assets before taxes in excess of C\$5,000,000. Registered international dealers are not currently permitted to trade with individuals. The CSA have also expanded the regulated pension fund category to include a wholly-owned subsidiary of a registered pension fund in recognition of the fact that large Canadian pension plans now often invest through master trust structures.

In the Canadian jurisdictions that currently permit non-Canadian dealers to trade with any category of accredited investor in any type of security on an unregistered basis, 31-103 will require such dealers to register or to rely on the more restricted international dealer exemption, as a consequence of which, the unregistered non-Canadian dealer will only be permitted to trade with the narrower list of permitted clients and then only in foreign securities and certain Canadian debt securities.

Alternatively, a non-Canadian dealer will be required to register as an exempt market dealer to gain access to the full list of accredited investors with whom it is currently permitted to trade without restriction as to the type of security.

International Dealer Exemptions – Subject to Foreign and Debt Securities Restriction

A non-Canadian dealer may currently trade on an exempt basis in both Canadian and non-Canadian securities with accredited investors resident in most provinces and territories, other than Ontario and Newfoundland and Labrador where registered international dealers are already subject to a restriction as to the type of securities they can trade.

Under the international dealer exemption, non-Canadian dealers will be restricted to trading in "foreign securities" and in certain Canadian debt securities only. The term "foreign security" is defined as a security of an issuer formed under the laws of a foreign jurisdiction or a security issued by a foreign government.

Inter-listed Securities

The CSA have confirmed in the Notice to 31-103 that the definition of foreign security is intended to exclude securities of Canadian issuers inter-listed on non-Canadian markets. This restriction would appear to require non-Canadian dealers to register as dealers in Canada in order to trade the securities of inter-listed Canadian issuers with Canadian clients even if the trade is effected on a non-Canadian market, unless a dealer registration exemption other than the international dealer exemption is available.

Exempt Market Dealer Registration Requirement

Under 31-103, a non-Canadian dealer will be required to register as an exempt market dealer (EMD) to trade in Canadian and non-Canadian securities with the full list of accredited investors and without restriction as to the type of security. A non-Canadian dealer that wishes to register as an EMD will be required to:

- make informational filings for each of its directors and senior executive officers;
- register each of its individual dealing representatives that will trade in Canada, who will be subject to Canadian proficiency requirements; and
- register an ultimate designated person (the senior person responsible for supervising and promoting compliance by the firm and individuals acting on its behalf) and a chief compliance officer (the person responsible for the day-to-day monitoring of the firm's adherence to its compliance policies and procedures).

The U.S. Series 7 exam together with the New Entrants Course Exam of CSI Global Education Inc. (CSI) is considered the equivalent of CSI's Canadian Securities Course Exam, which is required for registration as a dealing representative of an EMD. Discretionary exemptions from proficiency requirements may be available in certain cases.

In addition to registration requirements, EMDs will be subject to requirements applicable to the business operations of non-SRO registered dealers (including mandated compliance systems, books and records requirements, capital, bonding and insurance requirements, annual (audited) financial statement reporting requirements, capital adequacy calculation and reporting requirements, and other notice filing requirements). EMDs will also be subject to client information and reporting requirements, requirements governing client relationships (including know your client and product suitability requirements, mandated conflict of interest procedures and disclosure requirements), complaint handling procedures, and specific safekeeping and custody rules for client assets. For a discussion of requirements for exempt market dealers refer to the topic Impact on Limited Market Dealers and Unregistered Dealers Trading in the Exempt Market.

Non-Resident Status

31-103 does not require registered firms to be incorporated or maintain a place of business in Canada, although firms applying in a category of dealer registration (for example, investment dealer or mutual fund dealer), which is subject to membership with a recognized Canadian self regulatory organization (SRO) may be subject to residency requirements imposed by the SRO. All non-resident applicants for registration will be required to provide disclosure to clients as to their non-resident status and designate an agent for service of process in the local jurisdiction.

Margin and Prohibition on Lending to Clients

31-103 prohibits the provision of loans, credit or margin to clients by any registrant that is not a member of the Investment Industry Regulatory Organization of Canada (IIROC), the SRO for fully registered investment dealers.

Underwriting

Non-Canadian dealers registered in the category of exempt market dealer may act as an underwriter in respect of a distribution of securities that is made under an exemption from the prospectus requirements. The international dealer exemption is also an exemption from the requirement to be registered to be an underwriter, subject to the same conditions.

Custody Requirements

Non-Canadian dealers registered as EMDs will be subject to specific custody requirements.

Commodity Futures

The regulation of exchange-traded and other derivatives varies considerably across all Canadian jurisdictions. See the discussion under the topics Quebec's Derivatives Act and Trading or Advising in Commodity Futures.

Continuation of Existing Discretionary Relief

A non-Canadian dealer relying on a discretionary exemption, waiver or approval granted by a local regulator prior to the Implementation Date is exempt from any substantially similar provision of 31-103.

Transition Requirements for Registered International Dealers – Exemption Filing Deadline October 27, 2009

The registration of international dealers in Ontario and Newfoundland and Labrador will be revoked on the Implementation Date.

To rely on the international dealer exemption in these jurisdictions, non-Canadian dealers previously registered in this category must submit a completed Form 31-103F2 in the jurisdiction of registration within one month following the Implementation Date (that is, on or before October 27, 2009).

Transition Requirements for Registered Limited Market Dealers

The registration of non-Canadian dealers currently registered as limited market dealers in Ontario (and the registrations of their representatives) will be transitioned to EMD registration in that jurisdiction on the Implementation Date. See the discussion under the topic Limited Market Dealers and Unregistered Dealers Trading in the Exempt Market for more information on this category of registration.

Transition for Dealers Active in Exempt Market

All non-Canadian dealers who have previously been active in the exempt market in a Canadian jurisdiction prior to the Implementation Date will have 12 months to apply for registration in that jurisdiction and comply with applicable requirements.

New entrants, not previously active in the jurisdiction, will have no transitional relief and will have to comply with the conditions of the international dealer exemption or apply for registration as an EMD.

Impact on International Advisers

On July 17, 2009, the Canadian Securities Administrators (CSA) published their final proposal for National Instrument 31-103 - *Registration Requirements and Exemptions* (31-103). Subject to government and other local approval requirements, 31-103 will come into force on September 28, 2009 (the Implementation Date).

31-103 is intended to harmonize, streamline and modernize registration requirements and exemptions across all Canadian provinces and territories (jurisdictions) and represents a major overhaul of the current registration regime. The new registration regime has significant implications for Canadian and non-Canadian dealers, advisers and investment fund managers currently doing business on a registered or exempt basis in any jurisdiction of Canada. The new rules will also have significant implications for private fund offerings and other capital market activities in Canada.

Key Changes to Current Adviser Registration and Exemption Regimes

Material changes introduced by 31-103 and related legislative amendments to the current adviser registration and exemption regimes for non-Canadian advisers include:

- the elimination of the international adviser registration category in Ontario and the portfolio manager & investment counsel (foreign) registration category in Alberta;
- the elimination of the adviser registration exemption in Quebec for advisory activities conducted solely with a specified sub-class of "accredited investors";
- the introduction of a single general category of adviser registration, for both resident and non-resident advisers, namely that of portfolio manager;
- the introduction of a new international adviser exemption that permits a non-Canadian adviser registered or operating under an

exemption from registration under the securities legislation of its home jurisdiction to advise "permitted clients" in Canada on "foreign securities", subject to certain conditions;

- the elimination of the "look through" analysis of certain CSA members with respect to the adviser registration requirement for non-resident advisers to foreign investment funds;
- the introduction of a harmonized exemption for general advice not purporting to be tailored to the needs of the recipient; and
- the addition of an exemption from the dealer registration requirement for registered advisers and exempt international advisers when distributing securities of their own non-prospectus qualified funds to a managed account of a client of the adviser.

Current Adviser Registration and Exemption Regime

With the implementation of 31-103 and related legislative amendments in most Canadian jurisdictions, the adviser and dealer registration requirements will be triggered by being in the business of advising or trading in securities as principal or agent. While the business trigger for trading activities is a change to the existing rules in most Canadian jurisdictions, the current trigger for the adviser registration requirement under the local legislation is generally being in the business of advising others with respect to investing in securities.

Non-Canadian advisers with a limited range of clients and advisory activity most often have registered as advisers in categories specifically restricted to non-resident advisers (for example, the international adviser category in Ontario and the portfolio manager & investment counsel (foreign) category in Alberta). In other Canadian jurisdictions, such non-Canadian advisers often have been registered as portfolio managers with terms and conditions restricting their activities similar to the restrictions imposed on registered international advisers in Ontario.

Under the new registration regime, advisers are required to be registered in one of two categories, namely:

- portfolio manager, being an adviser that is permitted to advise in any securities; or
- restricted portfolio manager, being an adviser that is permitted to advise in respect of any security in accordance with the terms of its registration.

Individuals at firms registered as portfolio managers will be registered as:

- advising representatives; or
- associate advising representatives.

Portfolio managers will also be required to designate and register individuals as their ultimate designated person (UDP) and their chief compliance officer (CCO).

31-103 and related legislative amendments introduce a number of changes to the registration and ongoing compliance regime applicable to portfolio managers. Non-Canadian firms that are registered as a portfolio manager in one or more Canadian jurisdictions will be subject to requirements applicable to such category of registration generally. See the discussion under the topic Impact on Portfolio Managers and Investment Counsel.

International Adviser Exemption – Restrictions and Conditions

Under 31-103, a non-Canadian adviser may rely on the international adviser exemption to advise "permitted clients" (described below) provided the non-Canadian adviser does not advise in Canada on securities of Canadian issuers, unless providing that advice is incidental to its providing advice on a foreign security.

In order to rely on the international adviser exemption, the non-Canadian adviser must be registered, or operate under an exemption from registration, under the securities legislation of the foreign jurisdiction in which its head office or principal place of business is located in a category of registration that permits the adviser to carry on the activities in that jurisdiction that registration as an adviser would permit it to carry on in the local Canadian jurisdiction. The non-Canadian adviser must also be engaged in the business of an adviser in that foreign jurisdiction. Furthermore, during its most recently completed financial year, not more than 10% of the aggregate consolidated gross revenues of the adviser, its affiliates and affiliated partnerships may have been derived from portfolio management activities in Canada. Note that under the current requirements in Ontario for registration as an international adviser, this figure is 25%.

In order to rely on the exemption, the non-Canadian adviser must have previously:

- submitted to the relevant securities regulatory authorities an executed Form 31-103F2 *Submission to Jurisdiction and Appointment of Agent for Service* (Form 31-103F2); and
- notified the permitted client (1) that it is not registered in Canada, (2) of its jurisdiction of residence, (3) of the name and address of the agent for service of process appointed by the non-Canadian adviser in the local jurisdiction, and (4) that there may be difficulty enforcing legal rights against the non-Canadian adviser because it is resident outside Canada and all or substantially all of its assets are situated outside of Canada.

A person relying on the international adviser exemption will be required to pay fees applicable to an unregistered exempt international firm under OSC Rule 13-502 *Fees* and submit a prescribed form to the Ontario Securities Commission on an annual basis. Other fee requirements may apply in other Canadian jurisdictions. In those other jurisdictions, the non-Canadian adviser must notify the local regulator 12 months after it first submits a Form 31-103F2 and each year thereafter if it continues to rely on the exemption.

International Adviser Exemption – Permitted Clients

The list of permitted clients includes:

- most Canadian institutional investors;
- a person or company, other than an individual or an investment fund, with net assets of at least C\$25,000,000 as shown on its most recent financial statements;
- an investment fund managed by a person registered as an investment fund manager or advised by a person authorized to act as an adviser Canada; and
- an individual with net financial assets before taxes in excess of C\$5,000,000;

but excludes dealers and advisers registered in Canada (the Canadian Adviser/Dealer Exclusion).

The CSA have also expanded the regulated pension fund category to include a wholly-owned subsidiary of a registered pension fund in recognition of the fact that large Canadian pension plans now often invest through master trust structures.

International Adviser Exemption – Foreign Securities Restriction

Under the international adviser exemption, a non-Canadian adviser may not advise on securities of Canadian issuers, unless providing that advice is incidental to its providing advice on a "foreign security". The term foreign security is defined as a security of an issuer formed under the laws of a foreign jurisdiction and a security issued by a foreign government.

Quebec Adviser Registration Exemption

The international adviser exemption effectively would replace the exemption under section 194.2 of the *Regulation Respecting Securities* (Quebec), on the basis of which many non-Canadian advisers have entered into portfolio management arrangements with Quebec-resident institutional investors. Non-Canadian advisers who propose to rely on the international adviser exemption should revisit these arrangements and consult with their Canadian counsel to ensure that they comply with both the procedural and substantive conditions of the exemption, including the foreign securities restriction and the Canadian Adviser/Dealer Exclusion.

Elimination of "Look Through" Analysis for Advisers to Funds

Certain Canadian regulators (notably the Ontario Securities Commission) have historically taken the view that advice to an investment fund "flows through" to the investors in the fund. The effect of this interpretation has been to require that non-Canadian advisers providing investment advice to an investment fund located outside Canada be registered, or exempt from the registration

requirement, in the relevant Canadian jurisdiction in connection with the sale of securities of the fund in that jurisdiction.

In the Notice to 31-103, the CSA have confirmed that this interpretation will be discontinued. As a result, non-Canadian advisers to investment funds established outside Canada which sell securities in a Canadian jurisdiction will no longer have to be registered as an adviser or rely on an adviser registration exemption in that jurisdiction.

Adviser Registration Exemption for General Advice

31-301 contains an exemption from the adviser registration requirement for advice that does not purport to be tailored to the needs of the person or company receiving the advice. As a result, for example, newsletter writers who provide general investment recommendations often will no longer be required to be registered as an adviser. 31-103 requires a person relying on the general advice exemption that has, or has certain specified relationships with a person that has, a financial or other interest in any recommended securities, to disclose the interest when making the recommendation.

Sub-Adviser Exemption

The sub-adviser exemption under the preceding proposals for 31-103 has not been incorporated in the final instrument. The exemption will remain available in Ontario pursuant to section 7.3 of OSC Rule 35-502 *Non-Resident Advisers* and the CSA have stated that discretionary relief on a similar basis will be granted in other jurisdictions.

Trades to Managed Accounts of Securities of Non-Prospectus Qualified Funds

31-103 exempts an adviser relying on the international adviser exemption from the dealer registration requirement in respect of a trade in a security of a non-prospectus qualified fund if (1) the adviser acts as the fund's adviser and investment fund manager, and (2) the trade is to a managed account of a client of the adviser. The exemption is not available however if the managed account or non-prospectus qualified fund was created or is used primarily for the purposes of qualifying for the exemption. Notice to the regulator is required for an adviser to rely on this exemption.

Commodity Futures

The regulation of exchange-traded and other derivatives varies considerably across all Canadian jurisdictions. See the discussion under the topics Quebec's Derivatives Act and Trading or Advising in Commodity Futures.

Continuation of Existing Discretionary Relief

A non-Canadian adviser relying on a discretionary exemption, waiver or approval granted by a local regulator prior to the Implementation Date is exempt from any substantially similar provision of 31-103.

Transition to New Regime

Under the transition provisions of the new registration regime, persons that are fully registered as an investment counsel, portfolio manager or portfolio manager/investment counsel (or, in Ontario, non-Canadian investment counsel & portfolio manager) will be registered automatically in the new category of portfolio manager. Generally, the only persons who will be reregistered as restricted portfolio managers are those persons presently registered in Quebec as “restricted practice advisers”.

The registration of non-Canadian advisers registered as international advisers in Ontario and the registration of non-Canadian advisers registered as portfolio managers & investment counsel (foreign) in Alberta will be revoked within 12 months following the Implementation Date. During that transition period, non-Canadian advisers registered in Ontario and Alberta may continue to operate under their current conditions of registration (including those set out in OSC Rule 35-502 *Non-Resident Advisers* for Ontario registrants) and would have to consider whether they can rely on the international adviser exemption or will be required to register as portfolio manager. In the former case, the non-Canadian adviser must deliver an executed Form 31-502F2 to the local regulator in the relevant Canadian jurisdictions or register by the end of the transition period.

In other Canadian jurisdictions where there is no category of international adviser, non-Canadian advisers may apply to be registered as portfolio managers with similar terms and conditions restricting their activities. The CSA recommend that such firms consider relying on the international adviser exemption and surrender their registrations or apply for portfolio manager registration in those other jurisdictions.

Impact on Investment Dealers and Mutual Fund Dealers

Investment dealers and mutual fund dealers are generally required to be members of, and so subject to the regulations of, the Investment Industry Regulatory Organization of Canada (IIROC) or the Mutual Fund Dealers Association of Canada (MFDA), which are self regulatory organizations (SROs).

Members of SROs are exempt from a number of the requirements of National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) (but only in respect of their registration as an investment dealer or mutual fund dealer) including:

- capital and insurance requirements;
- financial reporting requirements;
- certain know your client requirements (for IIROC members only);
- certain suitability requirements;
- restrictions on lending to clients or providing margin (for IIROC members only); and
- certain disclosure requirements.

They are not exempt from other requirements, including:

- requirements relating to complaint handling and referral arrangements;
- the conflicts of interest provisions because 31-103 includes outcome-based requirements that apply to registrants in all categories, whether or not they are SRO members; and
- the requirements relating to statements of account and portfolio statements.

In Quebec, firms and individuals in the mutual fund and scholarship plan sectors are subject to the following regulatory regime, the requirements of which include:

- mutual fund dealers registered only in Quebec are not required to be members of the MFDA;
- mutual fund dealers and scholarship plan dealers registered only in Quebec are under the direct supervision of the Autorité des marchés financiers;
- individual representatives of mutual fund dealers and scholarship plan dealers registered in Quebec are required to be members of the Chambre de la sécurité financière;
- mutual fund dealers and scholarship plan dealers registered in Quebec and their individual representatives registered in Quebec must maintain professional liability insurance;
- mutual fund dealers and scholarship plan dealers registered in Quebec must contribute to the Fonds d'indemnisation des services financiers, which provides financial compensation to investors who are victims of fraudulent tactics or embezzlement committed by these firms or individuals; and
- individuals who are representatives of an investment dealer cannot be employed by a financial institution and carry on business at the same time as a representative in a Quebec branch of a financial institution unless they specialize in mutual funds or scholarship plans.

In Quebec mutual fund dealers which comply with applicable Quebec regulations are exempt from certain requirements in 31-103.

SRO Rule Amendments

The Canadian Securities Administrators (CSA) are working with both SROs to try to harmonize 31-103 and SRO rules. It is intended that the SRO rules will be amended as of the implementation of 31-103.

IIROC Registration Reform Rule Amendments

On July 17, 2009 IIROC published (in IIROC Notice 09-0213 – Rules Notice – Notice of Approval by IIROC Board – *IIROC Dealer Member Rule Amendments to Implement the CSA's Registration Reform Project*) amendments to its Dealer Member Rules that are related to the implementation of 31-103. These amendments were approved by the IIROC Board on June 25, 2009 and are subject to final approval by applicable CSA members.

These amendments seek to modernize registration related requirements applicable to its Dealer Members, moving, to the extent reasonable, to a more principles-based approach. IIROC has also sought to harmonize these rules to 31-103. The amendments include:

- a simplification of approval categories, reducing the number from 46 to 9;
- merging supervisory categories and the implementation of a principles-based approach to supervision; and

- limiting partner, director and officer registration to those individuals fulfilling executive management functions.

On April 24, 2009, IIROC published for second comment proposed amendments to its Dealer Member Rules to establish substantive requirements developed under the Client Relationship Model (CRM) Project (IIROC Notice 09-0120 – Rules Notice – Request for Comments – Dealer Member Rules – *Client Relationship Model*). The CSA have stated that they will be working with IIROC and the MFDA to harmonize proposed Client Relationship Models and 31-103.

MFDA Registration Reform Rule Amendments

It is expected that the MFDA will be publishing amendments to its rules that are related to the implementation of 31-103. It is also expected that the MFDA will issue guidance to its members on the requirements that apply during the interim period between the implementation of 31-103 and the adoption of consequential MFDA rule amendments.

The MFDA published for second comment proposed amendments to its rules to implement CRM proposals on April 27, 2009 (MFDA Bulletin #0370-P)

Impact on Issuers Generally

For issuers generally, the final proposal for National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) and the related amendments to the provinces and territories' Securities Acts and other instruments and policies should have a modest impact.

Dealer Registration Requirement

The removal of the requirement that a person trading in securities be registered as a dealer, or have the benefit of a dealer registration exemption and the imposition of a "business trigger", should simplify matters for issuers that occasionally trade in securities (for investment purposes, as part of a reorganization or to raise additional capital) in that they would not need to identify a dealer registration exemption for every trade they make. An issuer that is in the "business of trading" in securities, however, would generally be subject to the dealer registration requirements under the new regime. Whether or not an issuer's activities would be considered to constitute the business of trading in securities is something that an issuer should canvass with its counsel.

The Canadian Securities Administrators (CSA) have provided some guidance on how they interpret the business trigger in the context of issuers in Companion Policy 31-103CP *Registration Requirements and Exemptions* (31-103CP) where it is noted that:

- in general, securities issuers with an active non-securities business do not have to register as a dealer if they:
 - do not hold themselves out as being in the business of trading in securities;
 - trade in securities infrequently;
 - are not, or do not expect to be, compensated for trading in securities;
 - do not act as intermediaries; and
 - do not produce, or intend to produce, a profit from trading in securities.

- securities issuers may have to register as dealers if they:
 - frequently trade in securities;
 - employ or otherwise contract individuals to perform activities on their behalf that are similar to those performed by a registrant (other than underwriting in the normal course of a distribution or trading for their own account);
 - solicit investors actively; or
 - act as an intermediary by investing client money in securities.

Dealer Registration Exemptions

31-103 includes:

- dealer registration exemptions in respect of trades if (1) made solely through an agent that is a registered dealer, or (2) made to a registered dealer that is purchasing as principal. The CSA note in 31-103CP that this exemption is not available for trades where an intermediary is involved and that it is only available where a person trades their own securities directly with a registered dealer; and
- dealer registration exemptions for an investment fund or an issuer generally in respect of dividend or distribution reinvestment plans or optional investment plans or, for an investment fund, certain additional investments by fund security holders.

Prospectus Exemptions

As part of the registration reform project, changes are also being made to National Instrument 45-106 *Prospectus and Registration Exemptions* (45-106) and OSC Rule 45-501 *Ontario Prospectus Registration Exemptions* (45-501), as well as related rules and provisions of securities legislation cross country. The changes to these rules relate largely to the removal of the current dealer registration exemptions, which will no longer apply. There is no change to the trigger for the prospectus filing and delivery requirement. It remains the “distribution” of a security. An issuer distributing securities will need to identify a prospectus exemption for the distribution or file and deliver a prospectus. The prospectus exemptions are for the most part unchanged so, for example, an issuer will still have a prospectus exemption for trades with an “accredited investor”. As there are some changes to these rules, and there are still some differences in approach among the jurisdictions, issuers will want to canvass with their advisers the prospectus exemptions that may be available under the amended rules and legislation for future distributions.

See also the discussion under the topics Impact on Investment Funds and Impact on Private Equity and Venture Capital Funds for more information about the impact of 31-103 on these types of issuers.

Registration Reform IN CANADA

The Finish Line is Here

Impact on Investment Funds

The final proposal for National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) and the related amendments to the provinces and territories' Securities Acts and other instruments and policies do not impose any kind of registration or qualification requirements on investment funds per se. The impact on such funds generally will be through the new and enhanced requirements for registered firms, particularly the registration requirements for investment fund managers and the dealer registration requirement that applies to persons in the "business of trading" in securities. The requirement to register as an investment fund manager is not based on the type of investment fund that is managed. It applies equally to investment fund managers of funds that are reporting issuers and those that are not. See the discussion under the topic Impact on Investment Fund Managers.

Dealer Registration Requirement

As an issuer of securities, often in continuous distribution, an investment fund may be in the business of trading in securities and thus subject to the requirement to register as a dealer. 31-103 includes an exemption from the requirement to register as a dealer for a person or company in respect of a trade by the person or company if the trade is made solely through an agent that is a registered dealer. The Canadian Securities Administrators (CSA) note in Companion Policy 31-103CP *Registration Requirements and Exemptions* that this exemption is not available for trades where an intermediary is involved and that it is only available where a person trades their own securities directly with a registered dealer. There are also dealer registration exemptions for an investment fund (as well as the investment fund manager) in respect of dividend or distribution reinvestment plans or optional investment plans of the investment fund or for certain additional investments by fund security holders.

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Other Matters

From the investment fund's perspective, there are a few other matters to note:

- where net asset value adjustments occur in respect of a fund, as part of the investment fund manager's financial reporting to the regulator, the investment fund manager will be required to include a report of the net asset value adjustments, including:
 - the cause of the adjustments,
 - the dollar amount of the adjustments, and
 - the effect of the adjustments on net asset value per unit or share and any corrections made to purchase and sale transactions affecting either the investment fund or securities holders of the investment fund,
- while investment fund managers are generally subject to the conflict of interest provisions of 31-103, the obligation to identify existing material conflicts of interest with clients and to resolve them and, in some cases, to disclose them to clients does not apply to an investment fund manager in respect of an investment fund that is subject to National Instrument 81-107 *Independent Review Committees for Investment Funds*. This rule applies to investment funds that are reporting issuers; and
- various prohibitions are consolidated in 31-103, and 31-103 includes a prohibition on registered advisers knowingly causing inter-fund trades to be made between investment portfolios managed by it, including those of investment funds for which the adviser acts as portfolio manager.

Impact on Private Equity and Venture Capital Funds

There are no provisions of the final proposal for National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) and the related amendments to the provinces and territories' Securities Acts and other instruments and policies that are specific to private equity funds or venture capital funds, so the application of the registration requirements under 31-103 and the related amendments will need to be considered under the basic principles of the regime. These basic principles are generally that a person in the "business of trading" in securities is required to be registered as a dealer; a person in the business of advising others as to the investing in or the buying or selling of securities is required to be registered as an adviser and a person who acts as an investment fund manager (that is, who directs the business, operations or affairs of an investment fund) is required to be registered as an investment fund manager.

Meaning of "Investment Fund"

Key for the investment fund manager registration requirement is the meaning of "investment fund", since it is only managers of investment funds that must register. The term "investment fund" is defined in the securities legislation of the various provinces and territories (jurisdictions) and refers to:

- a mutual fund, being an issuer whose primary purpose is to invest money provided by its security holders and whose securities are redeemable on demand, or within a specified period after demand, at an amount computed by reference to the value of the fund's net assets, or
- a non-redeemable investment fund, being an issuer that is not a mutual fund and whose primary purpose is to invest money provided by its security holders and that does not invest for the purpose of seeking to exercise control of an issuer or of being actively involved in the management of any issuer in which it invests.

In each case, the facts will be key in assessing the impact of the new registration regime in 31-103 for any fund, including one that characterizes itself as a private equity or venture capital fund. Some guidance has been provided by the Canadian Securities Administrators (CSA) in Companion Policy 31-103CP *Registration Requirements and Exemptions* (31-103CP) on how this test for investment fund status would be applied in particular factual situations. The CSA have indicated that they anticipate providing supplemental guidance at a later date.

In 31-103CP, the CSA note that:

- venture capital and private equity investing are distinguished from other forms of investing by the role played by venture capital and private equity management companies (collectively, VCs). This type of investing includes a range of activities that may require registration;
- VCs typically raise money under one of the prospectus exemptions in NI 45-106, including for trades to “accredited investors”. The investors typically agree that their money will remain invested for a period of time. The VC uses this money to invest in securities of companies that are not publicly traded. The VC usually becomes actively involved in the management of the company, often over several years;
- examples of active management in the company include the VC having:
 - representation on the board of directors;
 - direct involvement in the appointment of managers; or
 - a say in material management decisions;
- the VC looks to realize on the investment either through a public offering of the company’s securities, or a sale of the business. At this point, the investors’ money can be returned to them, along with any profit.
- investors rely on the VC’s expertise in selecting and managing the companies it invests in. In return, the VC receives a management fee or “carried interest” in the profits generated from these investments. They do not receive compensation for raising capital or trading in securities;
- applying the business trigger factors to the VC activities as described above, there would be no requirement for the VC to register as:
 - a portfolio manager, if the advice provided in connection with the purchase and sale of companies is incidental to the VC’s active management of these companies; or
 - a dealer, if both the raising of money from investors and the investing of that money in companies are occasional and uncompensated activities;
- if the VC is actively involved in the management of the companies it invests in, the investment portfolio would generally not be considered an investment fund. As a result, the VC would not need to register as an investment fund manager; and

- the business trigger factors and investment fund manager analysis may apply differently if the VC engages in activities other than those described above.

For a discussion of the registration requirements for dealers, advisers and investment fund managers in the context of investment funds, see the discussion under the topics Impact on Investment Fund Managers and Impact on Investment Funds.

Impact on Non-Canadian Investment Funds Privately Placing Securities in Canada

Traditionally, the most significant issues for non-Canadian funds offering securities in Canada on a private placement basis have been: (1) whether the person selling the securities had the benefit of a dealer registration exemption and (2) whether, in Ontario, the “look through” analysis that the Ontario Securities Commission (OSC) applied on the adviser registration issue required a person providing investment advice to the investment fund outside of Ontario to register as an adviser in Ontario, or an adviser registration exemption was available. There has also been the matter of the capital markets participation fee payable in Ontario by unregistered investment fund managers.

The final proposal for National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) and the related amendments to the securities legislation do not make a distinction between non-Canadian funds and Canadian funds per se in the application of the new registration regime. Accordingly, non-Canadian funds proposing to privately place securities in Canada, or who have previously privately placed funds in Canada, will want to canvass their situation with their counsel and the application of the new registration regime to such funds’ activities will need to be considered under the basic principles of the regime.

These basic principles are generally that a person in the “business of trading” in securities is required to be registered as a dealer; a person in the business of advising others as to the investing in or the buying or selling of securities is required to be registered as an adviser and a person who acts as an investment fund manager (that is, who directs the business, operations or affairs of an investment fund) is required to be registered as an investment fund manager.

In addition, the following issues will continue to be relevant in connection with prospective private placements in Canada:

- capital markets participation fees; and
- prospectus exemptions.

Dealer Registration Requirements

A few matters to note on the dealer registration issue are:

- with the removal of the accredited investor exemption from the dealer registration requirement in all provinces and territories, there is no bright line exemption from the dealer registration requirement except in very limited circumstances in Alberta, British Columbia, Manitoba, New Brunswick and the territories. (See the discussion under the topic Impact on Limited Market Dealers and Unregistered Dealers Trading in the Exempt Market.) Under the new regime the dealer registration requirement is triggered when a person is in the “business of trading” in securities;
- there is a dealer registration exemption for trades by a person or company where the trade is made solely through an agent that is a registered dealer. The Canadian Securities Administrators (CSA) note in Companion Policy 31-103CP *Registration Requirements and Exemptions* that this exemption is not available for trades where an intermediary is involved and that it is only available where a person trades their own securities directly with a registered dealer.

Adviser Registration Requirements

The CSA have clarified in the Notice to 31-103 that the look through analysis on the adviser registration question will no longer be applied anywhere in Canada. As a result, an investment adviser that is providing investment advice to an investment fund outside Canada where the investment advice is received by the fund outside Canada generally will not be required to register as an adviser under securities legislation in Ontario simply because the securities of the investment fund are sold to Ontario residents.

Investment Fund Manager Registration Requirements

The CSA plans to publish a proposal for comment during the next year to explain under what circumstances an investment fund manager that has a head office outside Canada would need to register, and in what circumstances an investment fund manager with a head office in one jurisdiction in Canada would need to register in other jurisdictions.

Capital Market Participation Fees

In Ontario firms registered as investment fund managers will be required to pay participation fees under OSC Rule 13-502 *Fees* (Ontario Fee Rule). Participation fees must also be paid under the Ontario Fee Rule by any investment fund manager who continues to operate on an unregistered basis in accordance with an exemption from the investment fund manager registration requirement. Fees may also be applicable in other jurisdictions.

Prospectus Exemptions

As part of the registration reform project, changes are also being made to National Instrument 45-106 *Prospectus and Registration Exemptions* (45-106) and OSC Rule 45-501 *Ontario Prospectus Registration Exemptions* (45-501), as well as related rules and provisions of the securities legislation cross country. The changes to these rules are largely the removal of the dealer registration exemptions which will no longer apply. There is no change to the trigger for the prospectus filing and delivery requirement. It remains the “distribution” of a security. A non-Canadian fund as an issuer distributing securities will need to identify a prospectus exemption for the distribution or file and deliver a prospectus. The prospectus exemptions are for the most part unchanged so, for example, a non-Canadian fund as an issuer will still have a prospectus exemption for trades with an “accredited investor”. As there are some changes to these rules, and there are still some differences in approach among the jurisdictions, non-Canadian funds will want to canvass with their advisers the prospectus exemptions that may be available under the amended rules and legislation for future distributions.

Registration Reform IN CANADA

The Finish Line is Here

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New Compliance Requirements for Registrants

National Instrument 31-103 – *Registration Requirements and Exemptions* (31-103) sets out registration requirements, including proficiency (for individual registrants) and capital and insurance requirements, as well ongoing compliance requirements applicable to registrants. These include rules governing reporting, account opening and documentation, leverage disclosure, recordkeeping, know your client and suitability obligations, complaint handling, conflicts of interest, client disclosure and the regulation of referral arrangements. The approach taken is a combination of principles-based requirements and prescriptive rules.

31-103 provides certain exemptions from certain of these requirements for a registrant that is an investment fund manager, for a registrant that is a member of a self-regulatory organization (SRO) (e.g. an investment dealer or mutual fund dealer) and is subject to SRO rules that deal with the same subject matter, and for a registrant that is dealing with “permitted clients”.

31-103 extends the application of a number of existing requirements that apply to current categories of registrants to other types of registrants. 31-103 also provides a number of new or expanded requirements, including:

- moving to exam-based instead of course-based individual proficiency requirements;
- a requirement that all registrants appoint an ultimate designated person and a chief compliance officer;
- increased capital requirements for most non-SRO registrants;
- moving from pre-set insurance amounts to a formula-based method for determining insurance requirements;

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- a requirement for registrants to file financial statements with regulators more frequently and on an unconsolidated basis; (The Canadian Securities Administrators (CSA) have separately indicated the intention to require registrants to comply with international financial reporting standards in 2011.);
- a requirement for investment fund managers to file with the regulators, together with their financial statements, a description of any net asset value adjustment made during the period;
- new requirements with respect to the preparation and delivery of client statements;
- a requirement for registrants (other than investment fund managers and SRO members) to provide to a client “relationship disclosure information”, which is to be all information that a reasonable investor would consider important about the client’s relationship with the registrant and is to include various items such as disclosure of the compensation paid to the registered firm in relation to the different types of products that a client may purchase through it, a description of risks that should be considered a description of applicable client reporting and a description of the conflicts of interest that the registered firm is required to disclose under securities legislation;
- a requirement for registrants to document and, in a manner that a reasonable investor would consider fair and effective, respond to complaints with respect to products and services, and to make an independent dispute resolution or mediation service available at the registrant’s expense;
- requirements for entering into referral arrangements, including prescribed disclosure to clients and the requirement for the referring party and recipient of the referral to enter into a written agreement;
- prohibitions on “tied selling” and unnecessary mandatory financial institution settlement arrangements;
- requirements with respect to identifying and responding to material conflicts of interest and potential material conflicts of interest as well as requirements with respect to disclosure for certain specified conflicts of interest; and
- requirements for 30 days’ advance notice to regulators if a registrant is going to acquire directly or indirectly, beneficial ownership or control of a security of a registrant or acquire all or a substantial part of the assets of a registrant. Similar notification requirements apply to a registered firm that believes 10% or more of a class of its voting or equity securities may be acquired. Regulators may object to the acquisition. An exemption is available for acquisition that results in a holding of less than 10% of a class of listed securities.

Firms registered in more than one category are required to comply with the highest capital requirements and with conduct requirements that apply to the registrable activity being conducted.

Companion Policy 31-103CP *Registration Requirements and Exemptions* provides guidance on the general principles set out in 31-103 with respect to

matters such as internal controls and systems, compliance systems, maintenance of books and records, know your client and suitability obligations and identifying and addressing material conflicts of interest.

Continuous Registration

Registration will no longer have to be renewed annually, and will remain in effect until suspended or terminated by certain triggering events, including non-payment of annual fees and failure to comply with fit and proper requirements and conduct rules under 31-103.

Registering in Multiple Jurisdictions

The requirements and procedures for applying for registration in more than one Canadian province or territory (jurisdiction) are currently set out in National Instrument 31-101 *National Registration System* and National Policy 31-201 *National Registration System* (collectively, NRS). NRS will be repealed and replaced with a “passport system” for registrants, effective as of the date National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) comes into force. 31-103 is scheduled to come into force on September 28, 2009 (the Implementation Date), subject to government and other local approvals in each jurisdiction. The adoption of the passport system for registration will be facilitated by 31-103 as registration categories and requirements will become more uniform across Canada.

All members of the Canadian Securities Administrators (CSA), other than the Ontario Securities Commission (OSC), (the passport regulators) have implemented Multilateral Instrument 11-102 *Passport System* (11-102). The passport system gives market participants, in the main areas of securities legislation, access to the capital markets in multiple jurisdictions while generally only needing to deal with one principal regulator. Although the OSC has not adopted 11-102, it can be a principal regulator under the passport system. Effective as of the Implementation Date, the passport regulators are implementing amendments to 11-102, and together with the OSC, are adopting National Policy 11-204 *Process for Registration in Multiple Jurisdictions* (11-204), which will extend the passport system to registration (other than for restricted dealer firms). Firms and individuals will generally be able to register in more than one jurisdiction by dealing only with their principal regulator. Firms and individuals that register in their principal jurisdiction through the Investment Industry Regulatory Organization of Canada (IIROC) will continue to do so.

Identifying Principal Regulator

The principal regulator is the regulator in the applicable “principal jurisdiction”.

A firm’s principal jurisdiction is the jurisdiction of its head office within Canada. If the head office is outside Canada (a foreign firm), the principal jurisdiction is: (1) if the firm is not already registered in a jurisdiction or has not completed its first financial year since being registered, the jurisdiction in which the firm expects most of its clients to be resident at the end of its current financial year, or (2) if the firm is already registered in a jurisdiction and has completed its first financial year, the jurisdiction in which most of the firm’s clients were resident at the end of its most recently completed financial year.

If prior to the Implementation Date a foreign firm is registered in more than one jurisdiction, it must, no later than October 28, 2009, submit to its principal regulator Form 33-109F5 *Change of Registration Information* identifying its principal jurisdiction.

An individual’s principal jurisdiction is where the individual has his or her working office (which is the office of the sponsoring firm where an individual does most of his or her business), unless the individual’s working office is outside Canada. If the working office of an individual is outside Canada (a foreign individual), his or her principal jurisdiction is the principal jurisdiction of the individual’s sponsoring firm.

If a regulator is of the view that the principal regulator identified by the firm or individual is inappropriate, the regulator will give the firm or individual written notice of the new principal regulator and the reasons for the change.

We note the principal regulator may differ for applications for exemptive relief from registration requirements.

Registration Process

Passport Registration

If a person (a firm or individual) is seeking registration or is registered in its principal jurisdiction (including Ontario) and seeks registration in another jurisdiction (excluding Ontario), this is referred to as a “passport registration”. Under a passport registration, a firm is only required to submit Form 33-109F6 *Firm Registration (F6)* and any supporting documentation to its principal regulator. An individual seeking registration under a passport registration is required to submit Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals (F4)* or if applicable Form 33-109F2 *Change or Surrender of Individual Categories (F2)* on the electronic National Registration Database (NRD). Only the principal regulator reviews these submissions.

If the registration is approved in the principal jurisdiction, the registration sought in the non-principal passport jurisdiction is automatically granted provided, if required for that category of registration, the person is a member or approved person of a self regulatory organization (SRO). For a mutual fund dealer whose principal jurisdiction is Quebec, the firm must be a member of the Mutual Fund

Dealers Association of Canada (MFDA) before it can become registered in another jurisdiction. For a representative of a mutual fund dealer whose principal jurisdiction is Quebec, the individual must be an approved person of the MFDA before he or she can become registered in another jurisdiction. For a representative of a mutual fund dealer or scholarship plan dealer whose principal jurisdiction is outside Quebec, that individual must be a member of the *Chambre de la sécurité financière* before he or she can become registered in Quebec.

Passport registration is not available to a firm seeking registration as a restricted dealer. In this case, the firm must complete the F6 and submit it, together with any supporting documentation, in each jurisdiction where it seeks registration.

Interface Registration

If a person seeks registration or is registered in its principal jurisdiction, the principal regulator is a passport regulator (i.e. a regulator in a jurisdiction other than Ontario), and the person seeks registration in Ontario, this is referred to as an “interface registration”. Under an interface registration, a firm is to submit an F6 to its principal regulator and the OSC. Any required supporting materials need only be submitted to the firm’s principal regulator. An individual seeking registration under an interface registration is required to submit an F4 or if applicable an F2, as required, using NRD. The applicant will generally deal only with the principal regulator.

The principal regulator will review the application to register in Ontario and will submit to the OSC an interface document containing its proposed determination. The OSC will advise the principal regulator whether it opts into, or opts out of, the principal regulator’s proposed determination. The OSC is to give the principal regulator written reasons for any decision to opt out and the principal regulator is to facilitate resolving issues between the applicant and the OSC.

Interface registration is not available to a firm seeking registration as a restricted dealer in Ontario. In this case, the firm must complete the F6 and submit it, together with any supporting documentation, in each jurisdiction where it seeks registration.

Passport and Interface Registration

If a person whose principal regulator is a passport regulator seeks registration in a non-principal passport jurisdiction and in Ontario, the person must follow the process for (i) a passport registration, to register in the non-principal passport jurisdiction, and (ii) an interface registration, to register in Ontario.

Effect of Certain Actions of Principal Regulator

Terms and conditions of registration applied by the principal regulator will also apply in other passport jurisdictions. This becomes effective October 28, 2009 for persons registered on September 28, 2009. Certain terms and conditions applied by non-principal jurisdictions prior to October 28, 2009 will be revoked effective October 28, 2009.

Any suspension, termination or surrender of registration in a principal jurisdiction will also apply in other passport jurisdictions.

Non-Harmonized Requirements

Generally, under the passport system for registration, a person is required to meet one set of harmonized laws, namely the requirements under 31-103. However, certain jurisdictions have maintained local requirements which must also be met. Of note are the local requirements in Quebec and British Columbia.

In Quebec, firms and individuals in the mutual fund and scholarship plan sectors are subject to a specific regulatory framework:

- mutual fund firms registered in Quebec are not required to be members of the Mutual Fund Dealers Association of Canada (MFDA) and are under the direct supervision of the Autorité des marchés financiers, as are scholarship plan firms;
- individuals in the mutual fund and scholarship plan sectors are required to be members of the Chambre de la sécurité financière;
- firms and individuals must maintain professional liability insurance; and
- firms must contribute to the Fonds d'indemnisation des services financiers which provides financial compensation to investors who are victims of fraudulent tactics or embezzlement committed by these firms or individuals.

In addition, in Quebec, an individual who is a representative of an investment dealer cannot concurrently be employed by a financial institution and carry on business as a representative in a Quebec branch of a financial institution unless he or she is a representative specialized in mutual funds or scholarship plans.

In British Columbia, investment dealers that trade in the U.S. over-the-counter markets must comply with local requirements to manage the risks of trading these securities, retain records and report quarterly to the British Columbia Securities Commission.

Quebec's Derivatives Act

On July 17, 2009, the Canadian Securities Administrators (the CSA) published their final proposal for National Instrument 31-103 - *Registration Requirements and Exemptions* (31-103). Subject to governmental and other local approval requirements, 31-103 will come into force on September 28, 2009 (the Implementation Date).

The adoption of 31-103 in Quebec can be expected to accelerate the further implementation of the Quebec *Derivatives Act* (QDA) which came into in force in Quebec on February 1, 2009 and governs trading and advisory activities relating to all forms of derivatives.

Highlights of QDA

Overview

The QDA is comprehensive stand alone derivatives legislation which regulates both over-the-counter (OTC) and exchange-traded derivatives, subject to certain carve outs for OTC derivatives activities involving “accredited counterparties” and in other cases to be specified by regulation. A series of client updates published in connection with the adoption of the QDA can be found at Stikeman Elliott's securities blog, www.canadiansecuritieslaw.com, as a [January 21, 2009 posting](#) and a [January 30, 2009 posting](#).

Key Requirements

The QDA imposes a requirement to register as a derivatives dealer or adviser for any person that engages in those activities in Quebec. The QDA also sets out a recognition requirement for “regulated entities” (including exchanges, alternative trading systems not registered as derivatives dealers or other published markets, clearing houses, information processors and self-regulatory organizations) which carry on derivatives activities in Quebec. The QDA further requires that any person other than a “recognized regulated entity” that seeks to “create or market” a derivative be qualified by the *Autorité des marchés*

financiers (AMF), Quebec's financial services regulator (the derivatives qualification requirement) and that the derivative be approved by the AMF (the derivatives approval requirement). The QDA also contains rules for the purposes of determining whether so-called "hybrid products" are to be regulated as derivatives under the QDA or as securities under Quebec securities legislation.

Derivatives Regulation and Interaction with 31-103

The QDA is formulated as principles-based legislation and its key provisions cross-reference regulations which (for the most part) have yet to be published. The current *Derivatives Regulation* covers a limited range of matters, including the minimum asset requirement for self-certified "accredited counterparties" (discussed below), the rules for self-certification of operating rules of "recognized regulated entities", and the prescribed information document to be delivered to by derivatives dealers.

The AMF is expected to publish a more comprehensive Derivatives Regulation following the adoption in Quebec of 31-103. This regulation is expected to incorporate by reference a number of provisions of 31-103 governing individual and firm registration with respect to derivatives dealers and advisers registered under the QDA. The regulation would also likely cross-reference detailed provisions of 31-103 governing the business operations and client relationships of registered firms.

OTC Derivatives – Section 7 of the QDA sets out an important blanket exemption for OTC derivatives "involving accredited counterparties only or in any other cases specified by regulation" from the application of certain specified provisions, including the derivatives dealer and adviser registration requirements, the derivatives qualification and approval requirements, and certain limited procedural and enforcement-related provisions, except in the case of market manipulation and fraud (the OTC Derivatives Exemption). The list of "accredited counterparties" includes most of the leading Quebec institutional investors, as well as accredited persons meeting certain subjective (knowledge and experience) and objective (minimum financial assets) and qualified "hedgers".

Exchange-Traded Derivatives – Significantly, the QDA does not contain any exemption for exchange-traded derivatives activities that is equivalent to the OTC Derivatives Exemption. With the coming into force of the QDA on February 1, 2009, this marked a significant departure from the existing "accredited investor" exemptions under Quebec securities legislation on the basis of which many Canadian, U.S. and other foreign dealers had historically engaged in exchange-traded derivatives activities outside of Quebec for Quebec-resident institutional investors.

It remains unclear whether the application of the international dealer and international adviser exemptions under 31-103 to qualified non-Canadian dealers and advisers will be extended to the QDA. See the discussion under topics

Impact on International Dealers and Non-Canadians Trading in the Exempt Market and Impact on International Advisers.

What seems more likely is that the AMF will develop a specially tailored exemption regime that is generally analogous to those exemptions but which incorporates appropriate exemptions from the derivatives dealer/adviser registration requirements, and the derivatives qualification and approval requirements.

The AMF Blanket Decision – In the interim, the AMF has responded to the above concerns in part by issuing a blanket decision (the AMF Blanket Decision) that sets out an exemption from the derivatives dealer and adviser registration requirements and the derivatives qualification rules under the QDA for specified derivatives activities carried out solely with accredited investors as defined under the soon to be revised National Instrument 45-106 *Prospectus and Registration Exemptions* (45-106).

The AMF Blanket Decision will continue to apply for an unspecified temporary period and is subject to the following conditions:

- the derivatives activities must be carried out solely with accredited investors as defined under NI 45-106 and in accordance with the conditions set forth in that instrument (including the filing of a report under Part 6); and
- the activities must relate only to the following categories of derivatives (the Specified Categories) which were regulated under the *Securities Act* (Quebec) prior to the coming into force of the QDA:
 - an option or a negotiable futures contract pertaining to securities, or a Treasury bond futures contract;
 - an option on a commodity futures contract or financial instrument futures contract;
 - commodities futures contracts, financial futures contracts, currencies futures contracts and stock indices futures contracts.

The notices published by the AMF in conjunction with the coming-into-force of the QDA (the QDA Implementation Documents) include ancillary statements that would appear to imply that the relief under the AMF Blanket Decision is restricted to OTC derivatives. There is in fact no such restriction in the decision which we understand is intended to cover both OTC and exchange-traded derivatives of a type covered by the Specified Categories. All other derivatives are subject to the QDA.

Other QDA Transitional Relief – In addition to the AMF Blanket Decision, the QDA Implementation Documents contain other important transitional relief, namely:

- The postponement of the coming into force of provisions dealing with derivatives dealer and adviser registration categories and procedures to permit the incorporation of registration-related requirements under 31-103 and related instruments;

- The postponement of the coming into force of the derivatives approval requirement (outlined above). The stated intention of this measure is to “*permit the [Canadian Securities Administrators] to complete harmonization initiatives with respect to derivatives offered to the public*”; and
- A six-month window (to August 1, 2009) to enable financial sector participants to phase in the implementation of derivatives-related compliance measures to address new requirements under the QDA. This window has enabled, in particular, participants in the OTC derivatives industry seeking to rely on the OTC Derivatives Exemption to qualify current OTC counterparties as “accredited counterparties” for new transactions (and, depending on the terms, potentially for re-couponing), obtain appropriate counterparty representations and make the required amendments to ISDA and other documentation.

Industry participants that engage in derivatives trading or advisory activities in Quebec not covered by the OTC Derivatives Exemption, the AMF Blanket Decision and the other transitional relief described above will have to apply to the AMF for specific exemptive relief.

Registration Reform IN CANADA

The Finish Line is Here



Trading or Advising in Commodity Futures

In Manitoba and Ontario, trading in and advising with respect to investing in commodity futures contracts and options thereon, which are standardized exchange-traded instruments, are regulated under the Commodity Futures Acts of those jurisdictions. These statutes include dealer and adviser registration requirements, which generally are not affected by the new registration regime in the final proposal for National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) and the related amendments to the provinces and territories' Securities Acts and other instruments and policies.

In Quebec, a new Derivatives Act that governs these types of instruments, as well as other types of derivatives, was recently enacted. See the discussion under the topic Quebec's Derivatives Act.

In Alberta, British Columbia, New Brunswick and Saskatchewan, trading and advising in "exchange contracts" which, like commodity futures contracts and options in Manitoba and Ontario, are standardized exchange-traded futures contracts, are or soon will be regulated under the Securities Acts in those provinces. The registration reform regime in 31-103 and related amendments will have some application to the dealer and adviser registration aspects of the regulation of exchange contracts under these statutes. In British Columbia, for example, the new category of restricted dealer will replace the category of exchange contracts dealer. Exchange contracts are expressly excluded for these four jurisdictions from the international dealer and the international adviser registration exemptions, with the result that dealers or advisers relying on those exemptions for their securities related activities in any of these jurisdictions could not rely on them for dealing or advising activity in respect of exchange contracts.

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