



INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Key Aspects of National Instrument 31-103 Registration Requirements and Exemptions and Corresponding IIROC Amendments

On September 28, 2009, National Instrument 31-103 *Registration Requirements and Exemptions* and various related instruments (including the changes to the Ontario Securities Act (Schedule 26 to Bill 162)) will come into force.

Although most of the Instrument applies uniformly to all Canadian jurisdictions, there are some key areas where provinces differ. As such, for certain provisions, industry participants will be subject to different regulation depending upon the province in which they operate.

The CSA has also published a final version of National Instrument 45-106 *Prospectus and Registration Exemptions*, which will also come into force on September 28, 2009. The registration exemptions provided for in that instrument will be revoked six months from the implementation date, so that the only registration exemptions remaining will be in National Instrument 31-103, except for those under blanket orders in the western provinces and the territories.

Requirement to Register

The objective of National Instrument 31-103 is to ensure that only qualified firms and individuals provide advising and trading services in the Canadian capital markets.

Under the Instrument, the test for determining whether a firm or individual is required to be registered as a dealer or advisor is based on the concept of the “business trigger”, which is determined by ascertaining whether the firm or individual is “in the business of”:

- Trading in securities as a principal or agent; or
- Advising others about acquiring or disposing of securities.

Firms must register if they are in the business of trading in, or advising on, securities, or if they act as an underwriter or manage an investment fund.

Individuals must register if they trade, underwrite or advise on behalf of a registered dealer or advisor, or act as the UDP or CCO of a registered firm. Individuals who act on behalf of a registered investment fund manager do not have to register.

Firm Registration Categories

The registration categories have been reduced. For dealers, the registration categories are: investment dealer, mutual fund dealer, scholarship plan dealer, exempt market dealer and restricted dealer. Firm advisor categories are portfolio manager (which includes investment counsel) and restricted portfolio manager. Investment fund managers have a category simply called investment fund manager.

Those firms that are currently registered as dealers and portfolio managers will generally continue to be registered in the same category.

The following categories of registration have been eliminated: international dealer, limited market dealer, foreign dealer, international advisor, securities advisor and investment counsel.

Exempt Market Dealers (EMDs):

This is a new registration category that replaces the Limited Market Dealer in Ontario and Newfoundland. It will be applicable in Saskatchewan, Ontario, Quebec, Nova Scotia, Newfoundland, New Brunswick and PEI.

Exempt market dealers may only trade in securities pursuant to applicable prospectus exemptions, including prospectus-qualified securities where the trade is made in reliance on a prospectus exemption and securities of any investment fund (prospectus-qualified or not) provided that a prospectus exemption is available in respect of that trade. EMDs have proficiency requirements and are required to pass the Canadian Securities course, the Exempt Market Products exam or meet the conditions of an advising representative of a portfolio manager. The CCO of an EMD must also have passed the PDO exam. The Exempt Market Products exam has been developed as an alternative to the Canadian Securities exam for representatives of EMDs.

EMDs may only act as underwriters in respect of prospectus-exempt securities. This means that they will not be able to act as underwriters in respect of prospectus-qualified securities, even where they are only trading in those securities pursuant to applicable exemptions.

All EMDs will be subject to the same capital, insurance and audited financial reporting obligations regardless of whether they handle, hold or have access to client assets or not.

The EMD registration requirement will not apply in Alberta, British Columbia, Manitoba and the three territories of Canada. Those jurisdictions will exempt firms (and their representatives) where they are not otherwise registered in any province or territory if they are in the business of trading securities in those jurisdictions under specified exemptions (including accredited investor, family, friends and business associates, offering memorandum and minimum purchase), provided they comply with certain conditions.

These conditions include a prohibition on providing suitability advice about the trade and providing other "financial services" to the client (except in British Columbia). They can also not hold or have access to purchasers' assets, and they must provide prescribed risk disclosure to the client and file notices with the regulators. The regulators of these jurisdictions will issue a blanket order shortly providing for this exemption.

Restricted Dealer

This firm category is intended to accommodate limited dealing activities and do not fall under any other firm categories. The regulator will attach specific terms and conditions on the firm's registration, restricting that dealer's proposed activity.

Individual Registration Categories

The number of registration categories was reduced substantially by harmonizing existing categories for dealing and advising representatives.

Three new individual registration categories were added:

- Ultimate Designated Person – UDP – firms must designate a UDP - must be the CEO or equivalent - no proficiency requirements apply
- Chief Compliance Officer – CCO – firms must designate a CCO - proficiency requirements apply
- Associate Advising Representative - apprentice category for those working toward full advisor registration, and also those who do not intend to become full advising representatives. Associate Advising Representatives must be supervised by an advising representative.

Permitted Individuals – are not registered but are subject to review by the regulator as part of regulatory oversight. Permitted individuals are those that comprise the mind and management of the firm, such as senior executives and directors. Individuals that have officer titles but do not influence the overall direction of the firm are no longer deemed to be permitted individuals.

IIROC has reduced their categories for individuals from 46 to 9, each with particular proficiency requirements.

- Investment Representative
- Registered Representative
- Trader
- Supervisor
- Executive
- Director
- Ultimate Designated Person
- Chief Financial Officer
- Chief Compliance Officer

Specifics as to the types of products (eg: securities or mutual funds), clients (retail or non retail) and services (eg: trading, order taking only; advisory or portfolio management) that each category provides or services will be information items under each category of registration, however the registrant will remain subject to proficiency requirements in respect of the products and services provided and the clients served. These details will be reported in initial applications, but subsequent changes will require only notification that the Approved Person has completed the necessary proficiencies and will be undertaking the applicable business activity.

The amendments remove the Branch Manager category and requirements, merging all supervisory categories into one: Supervisor. Current Branch Managers will become approved in that category, as will other specific supervisory categories including product-specific supervisors such as options and futures contracts principals. The proficiency requirements to supervise specific types of activity will remain.

In place of the prescribed positions and functions, Dealer Members will be required to maintain detailed historical records of their supervisory structures and those designated persons responsible for fulfilling specific supervisory functions.

The amendments continue to require that specific persons be designated to perform specific functions, such as overall supervision of options or futures trading, portfolio supervision and retail account supervision. However, under the proposed rules those fulfilling those functions will no longer have separate categories and approval requirements based on those specific functions; they will be approved in the broad category of Supervisor.

The amendments are not intended to eliminate the branch manager structure as a viable way of supervising business activity. Dealer Members will still be able to designate branch managers

and assign them the same responsibilities currently contained in the Rules. However, they will be approved as Supervisors.

Permanent Registration

Registration with the CSA is “permanent”. This means that advisors can move between firms without having to re-apply for registration, subject to annual payment of fees, compliance with on-going fit and proper and conduct requirements, and the ability of the Director of the applicable securities regulator to revoke or suspend registration or impose conditions on registration at any time, subject to the registrant’s opportunity to be heard. IIROC has made the necessary changes to their rules to accommodate this.

This means individuals can have their registration automatically transferred from one registered firm to another within 90 days of leaving a sponsoring firm without having to re-apply for registration, if they do not change their registration category and the new firm is registered in the same category and province or territory as the former sponsoring firm. The automatic transfer does not apply if the individual was dismissed, or was asked by the firm to resign following an allegation of criminal activity or a breach of securities legislation or SRO rules.

Exemptions from Registration

New Dealer Exemptions:

- Portfolio Managers – a portfolio manager may trade units of its in-house non prospectus qualified funds with its managed accounts without registering as a dealer
- International Dealers – This exemption (previously in Ont and Nfld) allows non resident dealers to operate in Canada with limitations. (see below)

Non-Canadian Industry Participants:

An entity that is not incorporated under the laws of Canada may be registered in any category of registration, except where restricted by SRO rules. Subject to the conditions of the exemption, non-Canadian dealers and advisors operating in Canada can rely on the “international dealer” or “international advisor” exemption.

The most significant of these conditions are restrictions on trading with or advising only “permitted clients” and only on “foreign securities”. The list of “permitted clients” which are a set of super-accredited investors. International advisors cannot advise Canadian registrants.

The definition of “foreign security” relates to the jurisdiction in which the issuer is incorporated or established. The result is that international dealers and international advisors may only trade in, or advise on, securities of issuers not incorporated in Canada. However, international advisors may advise on Canadian issuers if such advice is incidental to their advice on non-Canadian securities.

Entities that do not have an office in Canada and that act as investment fund managers of investment funds that are distributed in Canada, even where these funds are established in Canada, do not have to be registered in Canada as investment fund managers.

New Advisor Exemptions

- Dealers that provide non-discretionary advice – allows dealers to provide advice necessary to support trading activities not in support of a managed account.

- Generic advice – allows firms to provide generic advice not tailored to the needs and circumstances of the recipient. Usually it is delivered through investment newsletters and articles in general circulation etc.
- International advisors – allows non resident advisors to operate in Canada with limitations. (see above)

Requirements / Responsibilities of Registrants

The registration requirements contained in National Instrument 31-103 for dealers and advisors goes some distance in leveling the playing field as between IIROC members and other registrants. IIROC members are exempted from additional provisions of National Instrument 31-103 where the IIROC rules regulate the particular area. Section 9.3 of the Instrument sets out the specific exemptions in favour of IIROC Rules. IIROC has also published proposed amendments to its rules relating to the implementation of National Instrument 31-103.

The National Instrument includes the following requirements applicable to IIROC registrants:

- Designation and registration of an “ultimate designated person” and “chief compliance officer”
- New guidelines for account opening and know-your-client information
- New record-keeping, and account activity reporting
- New guidance as to referral arrangements
- New principle based requirements relating to goals of compliance regimes
- New conflict of interest guidelines
- New general complaint handling requirements
- New general requirements to prepare and deliver to clients specified relationship disclosure information – will be replaced once IIROC CRM is in place

In respect of referral arrangements, the Instrument now specifies that where names and contact information of potential clients are provided and the registrant pays for that information, it will be considered to be a referral arrangement. It is now clear that referral arrangement requirements apply to arrangements between affiliates.

The conflict of interest requirements state that a registered firm must take reasonable steps to identify existing material conflicts of interest and material conflicts that the firm reasonably expects to arise between the firm and the client. The Instrument considers a conflict of interest to be any circumstance where the interests of different parties, such as the client and registrant, are inconsistent or divergent.

When registrants are dealing with “permitted clients” such clients are able to waive the specific requirements relating to suitability of trades or advice.

The distinction between “activity” records and “relationship” records has been eliminated from the record-keeping requirements and the CSA’s expectations for record-keeping are described in greater detail in the Companion Policy. The Instrument does not provide for a transition period for the record-keeping requirements.

The Instrument contains outcome based requirements for complaint handling. The CSA is working with SROs to harmonize the complaint handling regime. When the IIROC complaint handling regime is finalized, an exemption from the provisions in the National Instrument will be added.

Although the Instrument contains a “mobility” registration exemption for registrants that deal with or advise out of province clients, they are limited to 5 clients per advisor or 10 per firm, making this exemption of very limited use.

Specific Exemptions

Where a firm has obtained an exemption from a rule or legislative provision before the implementation of the Instrument, it may continue to rely on that exemption, in where the requirements in the Instrument 31-103 are substantially similar to the earlier requirements.

Registration Passport – National Instrument 11-204

Multilateral Instrument 11-102 *Passport System* and National Policy 11-204 *Process for Registration in Multiple Jurisdictions* will come into effect with NI 31-103. The result is that most notices and filings with the regulators can be conducted with the registrant's principal regulator, which will be the regulator in the province where the firm has its head office, or where the individual has their "working" office.

Although Ontario is not adopting the Passport System, it can be a principal regulator under that system, so that firms and individuals in Ontario can access the capital markets in other jurisdictions by dealing only with the OSC. Market participants with non Ontario principal regulators may be required to deal with Ontario in addition to their principal regulator.

Firms and individuals that register in their principal jurisdiction through IIROC will continue to do so.

Registration in passport jurisdictions

Under MI 11-102, if a firm or individual seeks registration or is registered in the firm's or individual's principal jurisdiction (including Ontario) and seeks registration in another jurisdiction (excluding Ontario), the firm or individual makes a submission to register in the other jurisdiction. Only the principal regulator reviews the firm's or individual's submission and the firm or individual's sponsoring firm deals only with the firm's or individual's principal regulator. The principal regulator reviews the firm's or individual's submission to register in the other jurisdiction only to ensure that it is complete. The other regulator does not conduct a review of the firm or individual.

Registration in Ontario as non-lead jurisdiction

If a firm or individual seeks registration or is registered in the firm's or individual's principal jurisdiction, the principal regulator is a passport regulator, and the firm or individual seeks registration in Ontario, the firm or individual must submit an application to register in Ontario to the principal regulator and the OSC. The principal regulator will review the firm's or individual's application to register in Ontario and the OSC will decide whether to opt in or opt out of the principal regulator's determination. The firm or the individual's sponsoring firm will generally deal only with the firm's or the individual's principal regulator.

Foreign Firms

If the head office of a firm is outside Canada, the principal regulator for the foreign firm is the regulator in the jurisdiction of Canada the firm identified as its principal jurisdiction in its most recently filed Form 33-109F5 or Form 33-109F6. If the foreign firm is not registered in a jurisdiction of Canada or has not completed its first financial year since being registered, the principal jurisdiction is the jurisdiction of Canada in which the firm expects most of its clients to be resident at the end of its current financial year. In all other circumstances, it is the jurisdiction in which most of the firm's clients were resident at the end of its most recently completed financial year.

Fees

A firm or an individual must submit any required fees for the firm or the individual under applicable securities legislation in the principal jurisdiction and the non-principal passport jurisdiction when making the relevant submission.

Transition and Key Dates

There are a number of transition periods for the application of various provisions of the Instrument, running from 3- 24 months following implementation. Most existing registrants will be automatically converted over on the National Registration Database to the corresponding category of registration under National Instrument 31-103. The conversion will take place during an NRD freeze-period from September 25 to October 12, 2009. Firms will have read-only access to NRD during the freeze period, and authorized firm representatives will be unable to create new submissions via NRD. During the freeze period firms will only be required to file, using the new paper forms, material information (eg. reinstatements, terminations for cause, etc.).

Key transition dates include:

- **Monday, September 28, 2009** – Implementation of National Instrument 31-103 – except as specifically mentioned in the Transition section (Part 16) of National Instrument 31-103, registrants must comply with all of the new requirements of National Instrument 31-103 as of that date. Unregistered firms established after this date will apply for registration under the new regime.

- **Wednesday, October 28, 2009** (one month following implementation) – international dealers, so registered prior to September 28, 2009, must file a completed Form 31-103F2 by October 28 2009, if they intend to carry on business in Canada under the international dealer registration exemption. Their registration as international dealers will be revoked as of September 28, 2009.

- **Monday, December 28, 2009** (three months following implementation) – All existing registrants (as of September 28, 2009) must designate a UDP and a CCO for the firm, and apply for registration of these individuals.

- **Monday, March 28, 2010** (six months following implementation) – All existing registrants (as of September 28, 2009) must:
 - satisfy new bonding and insurance requirements
 - ensure referral arrangements that were in place before September 28, 2009 comply with new requirements.

Note that any new referral arrangement entered into after September 28, 2009 must comply with the new requirements.

- **Tuesday, September 28, 2010** (12 months following implementation):

- Firms acting as investment fund managers as of September 28, 2009 must apply for registration in that category and meet all applicable fit and proper requirements.

- Firms active in the exempt market (that is, that existed as operating entities) as of September 28, 2009 must apply for registration as exempt market dealers and meet all applicable fit and proper requirements.

- International advisors registered in that category in Ontario as of September 28, 2009 must file a completed Form 31-103F2 if they intend to carry on business in Canada under the international advisor exemption. Their registration will be revoked as of September 28, 2010.

- All registered firms as of September 28, 2009 must begin to deliver relationship disclosure to clients.
- All registered firms as of September 28, 2009 must satisfy new capital requirements.
- Representatives of scholarship plan dealers and exempt market dealers must satisfy new proficiency requirements.
- CCOs of exempt market dealers must meet new proficiency requirements.
- **Wednesday, September 28, 2011** (24 months following implementation):
 - All registered firms must ensure that independent dispute resolution or mediation services are made available to clients to resolve complaints.
 - Mutual fund dealers must comply with new requirements for delivery of client statements.

Sections of NI 31-103 that do not apply to IIROC members

9.3 Exemptions from certain requirements for SRO members

(1) An investment dealer that is a member of IIROC is exempt from the following requirements to the extent the provisions apply to the activities of an investment dealer:

- (a) section 12.1 [*capital requirements*];
- (b) section 12.2 [*notifying the regulator of a subordination agreement*];
- (c) section 12.3 [*insurance – dealer*];
- (d) section 12.6 [*global bonding or insurance*];
- (e) section 12.7 [*notifying the regulator of a change, claim or cancellation*];
- (f) section 12.10 [*annual financial statements*];
- (g) section 12.11 [*interim financial information*];
- (h) section 12.12 [*delivering financial information – dealer*];
- (i) subsection 13.2(3) [*know your client*];
- (j) section 13.3 [*suitability*];
- (k) section 13.12 [*restriction on lending to clients*];
- (l) section 13.13 [*disclosure when recommending the use of borrowed money*];
- (m) subsection 14.2(2) [*relationship disclosure information*];
- (n) section 14.6 [*holding client assets in trust*];
- (o) section 14.8 [*securities subject to a safekeeping agreement*];
- (p) section 14.9 [*securities not subject to a safekeeping agreement*];
- (q) section 14.12 [*content and delivery of trade confirmation*].

(2) Despite subsection (1), if a registered firm is a member of IIROC and is registered as an investment fund manager, the firm is not exempt from the following requirements:

- (a) section 12.1 [*capital requirements*];
- (b) section 12.2 [*notifying the regulator of a subordination agreement*];
- (c) section 12.7 [*notifying the regulator of a change, claim or cancellation*];
- (d) section 12.10 [*annual financial statements*];
- (e) section 12.11 [*interim financial information*].