



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

## **National Instrument 31-103 *Registration Reform***

### **CSA Request for Comment**

### **IIAC Summary of Issues**

On February 20, the CSA published NI 31-103 *Registration Reform*, (the Rule) for comment. The Rule is a broad proposal encompassing many elements of registration. The CSA's stated intention is that the Rule harmonize, streamline and modernize the registration regime across Canada, and create a flexible and administratively efficient regime with a reduced regulatory burden.

#### **Summary of Proposal for Registration Reform**

This summary does not purport to cover all elements of the Rule. It highlights the provisions that the IIAC believes will be most important to its Members, and issues on which we will be soliciting feedback and making comment. Members are encouraged to read the actual Rule, or the Request for Comments which provides a very comprehensive summary of the Rule.

#### **Business trigger for registration**

The proposed model represents significant changes to the registration regime. Rather than imposing a registration requirement based on a trade trigger, the Rule requires that all persons "in the business" of dealing in securities, advising on securities or managing investment funds, to be registered. ("business trigger")

The effect of this is that unregistered intermediaries between issuers and purchasers in a transaction involving the sale of securities under prospectus exemptions must be registered.

#### **In the business:**

The term "in the business" is interpreted in the Companion Policy and also in the summary of proposed amendments to include a number of elements that will be considered when determining if it should apply. These elements include:

- (a) undertaking the activity, directly or indirectly, with repetition, regularity, or continuity;**
- (b) being, or expecting to be, remunerated or otherwise compensated for undertaking the activity;**
- (c) soliciting, directly or indirectly, others in connection with the activity;**
- (d) acting as an intermediary, or otherwise inducing reliance by others on the person or company, in connection with the activity;**
- (e) producing, intending to produce, or being capable of producing, profit [monetary value]; and**
- (f) holding oneself out, directly or indirectly, as being in the business of the activity.**

**In addition, a person or company may be considered to be in the business of an activity even if:**

- (a) the activity is not the sole or primary business or occupation of the person or company; or,**
- (b) the person or company does not maintain a physical presence [note: phrase is used in OSC 35-101] in connection with the activity.**

**The Commission may, if it considers that it would be in the public interest to do so, make an order designating a person or company, or class of persons or companies, as being or not being in the business.**

Questions to consider:

- Is this an appropriate definition?
- Does it capture the necessary elements without including activities that should not be subject to registration?

### **Reduction in exemptions from registration**

As a result of moving to the business trigger, the number of registration exemptions will be significantly reduced. Exemptions will be limited primarily to situations where securities regulatory concerns are addressed in some other way such as through the application of another regulatory regime. Some examples of exemptions from the adviser registration requirement under the proposed regime include:

- IDA members acting as portfolio managers in accordance with IDA by-laws;

- advice given by regulated financial institutions where receiving advice is not the primary reason for the client’s relationship with the financial institution;
- advice in relation to the investing of specific securities, not tailored to the needs of specific clients; and
- international advisers and sub-advisers, subject to conditions<sup>5</sup>.

The proposed exemption regime is a substantial change for those jurisdictions that do not currently register dealers who only deal in prospectus exempt securities. No registration exemption is proposed for dealing with accredited investors or dealing in “safe” securities and there is no exemption for dealing with accredited investors. These situations would be dealt with under a new registration category of “exempt dealer”.

**Questions to consider:**

- Will this impact the industry’s ability to raise capital, particularly for junior issuers?
- Are there any unintended consequences of registering these previously unregistered intermediaries?
- Will this impose a significant cost on a large industry segment and if so, is it justified?

**Categories of Registration and Permitted Activities**

The Rule has harmonized the firm and individual categories across all of the CSA jurisdictions. The number of categories has been significantly reduced, simplifying the application process for registration in multiple jurisdictions.

**Firm Categories**

There are a few new firm categories, brought about by the business trigger.

The “exempt market dealers” are dealers restricted to dealing in prospectus exempt securities and with persons to whom prospectus exempt distributions can be made. It is similar to the existing limited market dealer category in Ontario and Newfoundland, except that it will be subject to fit and proper conduct requirements, capital and insurance requirements which appear to be roughly equivalent to IDA registration provisions. There does not appear to be any grandfathering provisions for limited market dealers, so they would likely be provided with a transition period to comply.

British Columbia is considering not adopting this category as it is concerned that requiring registration of persons who are in the business of dealing in the exempt market will have a negative impact on the province’s venture capital raising market. It is also not convinced that there is a market problem in this area in BC that would be addressed

by this registration requirement.

The CSA is also introducing a “restricted dealer” category which is an ad-hoc category to be tailored to unique circumstances that will arise under the new regime.

A “restricted portfolio manager” is a new category for those advising others with respect to specified securities, types or classes for securities or specified industries.

**Questions to consider:**

- Are the new categories useful and are the requirements associated with them appropriate?
- Is the exempt market dealer category useful and necessary?

**Fund Manager Registration**

The Rule also requires that all fund managers must be registered and currently registered portfolio managers that also manage funds be subject to additional requirements. The registration requirement will apply to all investment funds other than private investment clubs. This is a firm registration category with the individual registrations required for those in supervisory roles.

The CSA is requiring this registration due to risks associated with:

- the calculation of net asset value;
- preparation of financial statements and reports;
- transfer agency or record keeping services; and
- conflicts of interest between the fund manager and investors.

**Questions to consider:**

- Can the concerns above be dealt with in another manner other than registration?
- Are the additional resource requirements relating to registration and process requirements justified from a cost/benefit perspective?

**Individual Categories – UDP and CCO**

The Rule creates two new individual categories for the Ultimate Designated Person (UDP) and the Chief Compliance Officer (CCO).

The UDP and CCO can be the same person or different people. The objective is to allow firms the flexibility to adopt compliance and supervision systems appropriate to the size and scope of their operations. The UDP and CCO requirements are similar to

requirements under IDA by-laws, OSC adviser requirements and Quebec securities legislation.

**Questions to consider:**

- If the Rule is designed to emphasize firm-wide compliance, and the compliance reviews of registrants by the CSA jurisdictions are effective in emphasizing that responsibility and creating cultures that get that result, is it necessary to register persons in these roles?
- Will the result be an enhanced firm wide culture of compliance or does it set up a situation where effectively all of the responsibility falls on the designated UDP or CCO, thus achieving the opposite effect?
- Is the proposed registration requirement necessary?
- Will the proposed structure impose additional costs that are unjustified from a risk standpoint?

**Associate Advising Representative**

The Rule proposes to expand this apprenticeship category into all jurisdictions. It covers individuals that are seeking full advisor registration but do not meet the education or experience requirements, and those who work for a portfolio manager and are in charge of client relationships, but do not perform portfolio management for clients.

**Questions to consider:**

- Do such individuals perform functions for which registration is necessary?
- Is the fact that they are supervised by the portfolio manager sufficient?

**Reduction in number of non-registered individuals**

The Rule proposes to narrow the definition of non-registered individuals in MI 33-109, so it only applies to senior executives and directors. This will significantly reduce the number of filings by non registered individuals as such filings will not be required by individuals who have officer titles but do not form part of the mind and management of the firm. The CSA seeks input as to whether senior executives and directors should be registered to assist the regulators in dealing directly with this group of individuals, rather than through the firm.

**Question to consider:**

- Is it appropriate to use registration purely as an enforcement tool to assist regulators or is there another means to achieve this objective?

**Permitted advising activities for dealers and advisors**

The Rule provides an exemption from the adviser registration requirement for a registered dealer who provides non discretionary advice which is necessary to support its dealing activities. The exemption for IDA members who give discretionary advice to fully managed accounts is retained.

The Rule also provides an exemption from the dealer registration requirement for those dealing in units of its in-house pooled funds with bona fide fully managed accounts managed by the adviser as part of its portfolio management for those accounts.

#### **Question to consider:**

- The CSA has asked if it would be appropriate to extend the exemption to situations where advisors are dealing in securities of their own pooled funds with third parties.

### **Fit and Proper Requirements**

#### **Proficiency**

The Rule has harmonized proficiency requirements **for individuals registered with firms that are not SRO members**. The requirements have also been changed from course based to exam based to recognize that many individuals have completed other courses that prepare them for industry exams so that the courses are an unnecessary burden. The proficiency requirements for SRO members will be set out in an SRO by-law.

The currency of exams has been modified so that it must be completed within 36 months of the date of applying for registration. If the exam was completed more than 36 months prior to the application, it will be considered current if the individual was registered or had relevant experience for 12 months during the 36 months preceding registration.

#### **Solvency Requirements**

The Rule contains harmonized minimum capital requirements for non-SRO registered firms, including exempt market dealers and investment fund managers. The capital requirements have been modernized to reflect a more risk-based approach, consistent with the approach taken by the SROs. The key changes include:

- an increase in minimum capital requirements for most non-SRO registered firms
- an increase in the frequency of filings for most non SRO registered firms
- an enhanced capital calculation to better reflect the business model of the firm

- firms must prepare capital calculations on a unconsolidated basis

**Question to consider:**

- Does this level the playing field for SRO/non SRO firms in an appropriate manner?
- Are the fit and proper and conduct requirements appropriate for exempt market dealers? If not, what standards should be imposed?

**Conduct Rules**

**Account opening and know-your-client**

The existing requirements applicable to opening an account for a client and assessing suitability for a client have been consolidated. The Rule also contains an express requirement that a registrant must take reasonable steps to ensure that a proposed purchase or sale is suitable for the client with reference to the client's circumstances.

**Question to consider:**

- The CSA posed a question as to whether some of the requirements of the client opening requirements no apply to accredited investors. Is excluding this or any other group appropriate?

**Relationship Disclosure**

This will governs non SRO relationship disclosure and is intended to be similar to the Client Relationship Model currently being developed by the SROs. It does not apply to an investment fund manager or a registered firm dealing with an accredited investor.

The Rule requires registrants to provide a client with a relationship disclosure document before the registrant first advises the client, regarding a security or purchases or sells a security for the client, and when there is a material change to the information in the document before they advise or purchase or sell a security for the client.

See **Appendix 1** for required contents of the disclosure document applicable to non SRO members

**Question to consider:**

- The CSA seeks input on what issues and concerns firms have with the proposed relationship disclosure requirements and whether it is appropriate for some or all types of accredited investors. They also seek input on what information would be useful to have in the relationship document.

**Client assets**

The Rule harmonizes the safekeeping and segregation of funds requirements currently in some securities legislation in certain jurisdictions. It also introduces a prohibition on non SRO registered firms providing margin to clients, as their capital and insurance requirements do not take into account the risks of providing margin.

### **Record keeping**

The prescriptive lists in the current legislation have been replaced with a general obligation to maintain an effective record keeping system. This recognizes that records relevant for one firm may not be for another.

### **Question to consider:**

- Is the principles based approach effective or is prescription needed in this area?

### **Account activity reporting / Streamlined statements of account and portfolio**

The Rule harmonizes and recognizes the discretionary relief commonly granted. It also sets out a new disclosure option for clients trading in mutual funds and other plans.

The rule also permits firms to aggregate information and reduce the frequency of delivery of statements of account if the information is available to the client upon request and with no charge

### **Compliance**

The Rule has moved to a more principle based regime by setting out a general compliance obligation in the Rule. Registered firms must establish and enforce a system of controls and supervision to ensure a firm's compliance with all applicable requirements of securities legislation.

In addition to the registration of the UDP / CCO, the Rule removed the prescribed relating to branch offices and branch managers. Firms must consider their branch supervision requirements as part of the principle based requirements to have an adequate supervision system. SRO members will continue to be subject to SRO requirements.

### **Question to consider:**

- Is the move to principle based requirements an effective means to allow firms to tailor their business as appropriate without compromising investor protection?

### **Complaint Handling**

The Rule contains a new requirement that registered firms implement policies and procedures to address client complaints. A firm's policies and procedures must provide for the recording and investigation of complaints and for the resolution of disputes concerning the firm's products or services.

The Rule also contains a complaint reporting requirement that will provide securities regulatory authorities with important information for assessing market conduct practices, compliance by firms as well as their risk profile for supervision purposes. A dispute will be considered to be a complaint where it is not settled in the ordinary course of business, and the client remains dissatisfied and is referred to the firm's compliance staff.

Non-SRO firms must also participate in a dispute resolution service which is similar to the requirements of the SROs.

**Question to consider:**

- Does the requirement provide firms with adequate discretion and flexibility to manage complaints?
- Are the reporting requirements triggered at an appropriate level?

**Non-resident registrants**

The conditions of registration that apply to resident registrants also apply to non-resident registrants. However, there are additional requirements in the Rule applicable to non-residents. These requirements incorporate portions of OSC Rule 35-502 *Non-Resident Advisers* and terms and conditions currently imposed by some CSA jurisdictions on the registration of non-resident registrants.

**Conflicts**

**Consolidation**

The Rule consolidates, harmonizes and modernizes conflicts provisions and sets out an over-arching principle that registered firms must identify and deal with all conflicts. There are prescriptive requirements for certain conflicts that must be dealt with in a particular manner (i.e. avoidance or disclosure). This is a new approach for all CSA jurisdictions.

**Question to consider:**

- The Rule requires a registered firm to identify and deal with all conflicts. The CSA questions whether a materiality concept is appropriate within the requirement or should that be dealt with through the Companion Policy and at the firm level within the firm's policies.

## **Advisor fees no longer restricted**

The Rule proposes to remove the prohibition on advisers charging transaction based fees. This will make it consistent with most foreign jurisdictions, and will mean that advisers will be free to decide how they want to charge their clients.

There will be expanded disclosure of conflict of interest requirements in the Rule and the relationship disclosure requirements to balance the removal of this requirement. Clients must receive disclosure about the basis upon which advisers are charging fees.

## **Referral arrangements**

The Rule attempts to address a number of issues and minimize risks relating to referral arrangements. The risks include:

- conflict of interest
- client awareness
- client confusion
- referrer performing activities requiring registration
- supervision and oversight

The Rule requires registrants to:

- manage and disclose conflicts of interest
- disclose information about referral arrangements that a reasonable investor would consider important in order to evaluate the referral arrangement
- establish *clear* lines of responsibility for compliance with securities legislation.

Questions to consider:

- Is the CSA description of the risks of referral arrangements complete and accurate? If not, what is missing?
- Do the requirements address the risks in an appropriate manner?

## **Suspension and Revocation of Registration**

### **Permanent registration**

The Rule implements the concept of permanent registration in all CSA jurisdictions. Once granted, registration will remain effective until it is suspended or revoked as a result of a triggering event. Triggering events include an intervention by the regulator or securities regulatory authority, failure to pay annual fees, an individual ceasing to have a

sponsoring firm, and the regulator's or securities regulatory authority's acceptance of a request to surrender registration.

### **Automatic reinstatement**

The Rule also contains the concept of automatic reinstatement of individual registration in all CSA jurisdictions. This means that although an individual who leaves his or her sponsoring firm will be automatically suspended, if the individual finds a new sponsoring firm within 90 days, the suspension will be lifted automatically so that he or she can begin working at once without waiting for regulatory approval

The regulator will, however have discretionary power to revoke or suspend a registration or impose terms and conditions on registration at any time it makes a determination that a registrant no longer meets the fit and proper requirements or that their continued registration is objectionable. The revocation, suspension or imposition of terms and conditions on registration will be subject to the registrant's right to an opportunity to be heard and right of appeal to the securities regulatory authority.

### **Terminations**

A related amendment to NI 33-109 *Registration Information* introduces a revised Form which includes a list of questions designed to elicit more information from a former sponsoring firm that will be relevant to the regulator's assessment of an individual's continued fitness for registration. The revisions will assist the regulator in deciding whether a registration should be suspended because the individual is no longer fit and proper or because the registration has become objectionable.

### **Information Sharing**

The Rule contains a requirement that a registered firm disclose information about a former registered individual to another registrant that is considering hiring the individual if the information is relevant to an assessment of whether the individual is suitable for registration. The CSA believes this requirement is important because sponsoring firms have an obligation to conduct due diligence before hiring individuals who will be conducting activities requiring registration.

### **Question to consider:**

- Does this requirement, particularly question 10 pose any problems or raise concerns about disclosing information that may negatively affect a registrant's chances of obtaining future employment? Question 10 reads: *Is there any other matter relating to the individual's termination or conduct leading up to it that the firm is aware of, and believes is relevant to his or her suitability for registration?*

### **Mobility exemption**

The CSA has revised and included the mobility exemptions in the Rule for registrants in MI 11-101 *Principal Regulator System* (MI 11-101). Today, MI 11-101 does not apply in Ontario. The revised exemption would apply in all CSA jurisdictions. It narrows the definition of "eligible client" to an existing client who has moved from one jurisdiction to another and that client's spouse and children. The registrant relying on the exemption would also be able to continue dealing with a personal holding company and a family trust of the client.

The caps on assets under management in the local jurisdiction have also been removed, however the caps of 5 clients per individual and 10 clients per firm remain in place.

### **Questions to consider:**

- Is the mobility exemption as drafted, with the caps on clients useful?
- Would the mobility exemption be useful if there were no caps?
- Is there a compromise position where a cap could be implemented and the exemption would still be useful?

### **Transition**

The CSA is considering what are appropriate transition times for each of the changed requirements and ask for feedback on this issue.

Specifically, concerning the proposed restrictions on referral arrangements, a 120 day transition period is proposed for with existing referral arrangements.

### **Incorporated salespersons**

The CSA have not reached a decision on the request by industry to permit salespersons for registered firms to operate through incorporated entities. They intend to address this issue in 2007. The IIAC has been heavily involved in meetings with regulators and industry to have the IDA proposal approved by the commissions.

### **Annual fee payment date**

Comments have been made by some industry participants that a December 31 fee payment date is problematic and that a May 31 fee payment date would be better. Please comment on whether a May 31 or December 31 annual fee payment date is better for your firm.

## Appendix 1

### Content of Relationship Disclosure Document

5.12 (1) A relationship disclosure document must include the following:

- (a) a description of the nature or type of account including, if the registered firm is an adviser, the account's discretionary nature;
- (b) if the registered firm is an adviser,
  - (i) a description of how the firm will ensure that investments made are suitable for the client based on the information provided by the client, and
  - (ii) a statement that there is no guarantee, implied or otherwise, that the investments made will be successful;
- (c) if the registered firm is a dealer, a description of the nature and scope of the firm's obligation to assess whether a purchase or sale of a security is suitable for a client prior to executing the transaction or at any other time;
- (d) a discussion that identifies which products or services offered by the registered firm will meet the client's investment objectives and how they will do so;
- (e) if the registered firm is an adviser, a discussion of investment risk factors and types of risks that should be considered by the client when deciding to invest using an adviser;
- (f) a discussion of investment risk factors and types of risks that should be considered by the client when making an investment decision;
- (g) a description of the conflicts of interest that the registered firm is required to disclose under securities legislation;
- (h) disclosure of all service fees and charges in respect of the operation of the client's accounts;
- (i) a description of the costs the client will pay in making and holding investments and the compensation paid to the registered firm in relation to the different types of products that the client may purchase through the registered firm;
- (j) if the registered firm is an adviser and a sub-adviser is associated with a fully-managed account product or service, information

about the role of the sub-adviser and the sub-adviser's relationship to the client;

- (k) a description of the content and frequency of reporting for each account or portfolio;
  - (l) information about how the client can contact the firm.
- (2) A client's relationship disclosure document must contain the information a registered firm is required to collect about the client under section 5.3 [*know-your-client*].