



## New Registration Rules Alter Canadian Securities Landscape Significantly

by Patrick J. Cummins

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Patrick J. Cummins focuses on securities law and acts for clients in connection with mutual fund offerings and public company offerings. He provides ongoing advice to public and private companies and mutual fund companies and also services public issuers with respect to regulatory compliance, financing issues, shareholder communications and other regulated matters.

Patrick may be reached directly at 416.593.3928 or [pcummins@blaney.com](mailto:pcummins@blaney.com)

The most sweeping revamp in a generation of the registration requirements that securities regulators all across Canada impose on investment intermediaries, advisers and managers is scheduled to take effect September 28, 2009.

The new rules are intended to provide greater protections for Canadian investors by stiffening the competency, integrity, solvency and compliance requirements that dealers, advisers and investment fund managers must meet.

They also streamline and harmonize registration across the country, an important step in simplifying life for market participants around the world who have to deal with only one securities regime in most places but still face 13 in Canada.

The new rules are set out in National Instrument 31-103 *Registration Requirements* and a related companion policy (collectively, the “Rule”) published by the Canadian Securities Administrators (CSA) on July 17, 2009. They constitute the final stage of the CSA Registration Reform Project that has been ongoing for a number of years.

The overhaul of the registration of firms and individuals that they represent will have significant implications for Canadian and foreign dealers, advisers and investment fund managers carrying on business in Canada.

Here’s a summary of the significant changes resulting from the new Rule:

### General Overview

The Rule introduces a new registration regime that provides one-stop shopping for all Canadian registration issues. The significant changes being introduced include the following:

- (i) The streamlining of the number of categories of registration for individuals and firms;
- (ii) The introduction of a “business trigger” for the dealer registration requirement;
- (iii) The requirement that individuals or firms who are in the business of trading in the “exempt market” (where the publication of a costly prospectus accompanying a new securities issue is not required), including those now registered in Ontario or Newfoundland and Labrador as limited market dealers, must be registered as “exempt market dealers” and be subject to the required competency, integrity, solvency and compliance requirements;
- (iv) The introduction of a new category of registration for all investment fund managers (which will capture all investment funds);

- (v) The elimination of the international dealer and international adviser registration categories which will be replaced by the introduction of registration exemptions for international dealers and international advisers.

#### **Categories of registration**

Categories of registration serve two main purposes, namely:

- (i) To specify the types of registrable activity a firm or individual is permitted to conduct, and
- (ii) To provide specific requirements for each category.

The Rule introduces a few new categories of registration but, overall, the number of individual and firm categories has been reduced significantly. Under the new regime, the categories of registration are as follows:

Dealers:

- **Investment Dealer** - permitted to trade in any security with any type of investor.
- **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.
- **Scholarship Plan Dealer** - permitted to trade only in securities of scholarship plans, educational plans or educational trusts.
- **Exempt Market Dealer (new)** - permitted to trade only in securities eligible for distribution under a prospectus exemption. This new category of registration replaces the limited market dealer category in Ontario and Newfoundland and Labrador.
- **Restricted Dealer (new)** - permitted to carry on business under terms and conditions imposed by the local jurisdiction. This category is intended to accommodate specialized dealers carrying out limited dealing activities that would not necessarily qualify for an unrestricted dealer registration.

Advisers:

- **Portfolio Manager** - permitted to advise any type of investor with regard to any security and includes advisers with or without discretionary authority.
- **Restricted Portfolio Manager (new)** - permitted to advise in specified securities, types or classes of securities or the securities of a class of issuers, subject to the terms and conditions imposed by the local jurisdiction.

Other Category:

- **Investment Fund Manager (new)** - permitted to direct the business, operations or affairs of an investment fund.

#### **Business Trigger Threshold for Dealers and Advisors**

Under the existing regime, the dealer registration requirement has historically been triggered by the act of trading in a security. The dealer registration requirement will now be triggered by being in the “business of trading” in securities as principal or agent. This new “business trigger” will likely eliminate the requirement for certain individuals and firms to register as a dealer if they carry out limited trades and are not otherwise “in the business of trading” in securities.

To determine whether a firm or individual is in the “business of trading” in securities, one must consider whether the activities amount to trading and then determine if one is carrying out those activities as a business. The CSA considers factors such as whether an individual or firm is holding itself

out as being in the business of trading in securities and engaging in activities similar to a registrant, intermediating trades between sellers and purchasers, conducting the activity repeatedly or with regularity or continuity, receiving compensation or soliciting clients. The companion policy to the Rule discusses the application of the business trigger factors for various parties and activities.

The existing registration requirement for an adviser is already based on a “business trigger” model so no change in this approach is needed under the new Rule.

With the movement to a “business trigger” model for both dealer and adviser registration, the dealer registration exemptions currently set out in National Instrument 45-106 - *Prospectus and Registration Requirements* (NI 45-106) will no longer be necessary. As a result they are being repealed, subject to limited exceptions in a few Canadian jurisdictions. The prospectus exemptions in NI 45-106 will for the most part remain unchanged.

#### **Introduction of Exempt Market Dealer Category**

As noted above, when the new Rule takes effect, the dealer registration exemptions currently available in NI 45-106 will be repealed and accordingly unregistered dealers in the business of trading in the exempt market will be required to register as an exempt market dealer (EMD).

In Ontario and Newfoundland and Labrador, there has been a category of a limited market dealer, a person or firm who acts as a “market intermediary” in respect of trades in the exempt market. With the introduction of the new Rule, the category of limited market dealer will be removed and replaced by the exempt market dealer category. The permitted activities of an EMD are specified in NI 45-106 and the key permitted activities will be restricted to:

- (i) trades of prospectus - exempt securities to specified clients, including “accredited investors”;
- (ii) trades in securities to clients who buy a minimum of \$150,000 of a security in one transaction; and
- (iii) where permitted, trades in securities distributed under an offering memorandum.

EMDs will be required to meet certain standards of competency, integrity and financial solvency.

The Rule expands these requirements to exempt market dealers and investment fund managers, and changes the requirements for all registrants to reflect a more “risk-based approach”.

#### **Introduction of New Registration for Investment Fund Managers**

This new category of registration is being implemented to respond to a number of issues identified by the CSA with respect to investment funds including:

- incorrect/untimely calculation of net asset values;
- incorrect/untimely preparation of financial statements;
- incorrect/untimely provision of transfer agency or record-keeping services; and
- potential conflicts of interest between an investment fund manager and its clients.

The registration of investment fund managers will allow regulators to regulate the decision-makers – the fund managers – directly instead of imposing restrictions directly on the investment funds.

The new Rule requires that investment fund managers have sufficient competency, integrity and solvency (including prescribed capital) to carry out their functions adequately. Competency or proficiency requirements are aimed at ensuring that only qualified persons deal in securities. Integrity requirements refer to the business conduct requirements and are meant to ensure registered people are held

accountable to clients and regulators for securities-related activities. Financial solvency requirements are intended to ensure registered people are financially viable.

The term “investment fund manager” is already defined in Canadian securities legislation as a “person or company that directs a business, operation or affairs of an investment fund”.

With the introduction of this new category, managers involved in various types of investment funds will need to be registered, including managers of mutual funds, non-redeemable investment funds, labour sponsored investment funds, scholarship plans, pooled funds or hedge funds.

This new category of registration is distinguishable from other registrable activities, such as individuals or firms that provide portfolio management services or investment advice to the investment fund thereby acting as an adviser and subject to adviser registration requirements.

Certain investment fund managers may already be carrying on business in one or more registrable activity, however, and they would be subject to extra registration requirements. For example, an investment fund manager could ultimately have the triple registration requirement that would go with being an investment fund manager, portfolio manager and dealer. In that case, the most stringent requirements of any of those categories of registration would have to be met.

One interesting development that is not actually reflected in the new Rule (but is in the Official Notice) is the clarification statement that the CSA take the view that investment advice/portfolio management provided to an investment fund will not be considered to “flow through” to the investors in the fund (i.e. the investment fund, not the fund’s investors, is the client). The CSA indicate that the adviser to a fund that is constituted in a province must be a registered portfolio manager in that province regardless of where the fund’s investors are located. The regulators are agreed that if the fund is established outside a province where a fund’s units are sold and the adviser is also located outside the province, the advice to the fund is not given in the province and therefore the adviser does not have to register in that province.

#### **Introduction of Registration Exemptions for International Dealers and International Advisers**

The new Rule introduces the following significant changes for international dealers and international advisers:

- (i) Registrations of all international dealers expire on September 28, 2009;
- (ii) Registrations of all international advisers expire one year later, September 28, 2010;
- (iii) dealer registration exemptions, including the accredited investor exemption currently available under NI 45-106 in all Canadian jurisdictions other than in limited cases in Alberta, British Columbia, Manitoba, North West Territories, Yukon and Nunavut, are repealed;
- (iv) new international dealer exemptions are introduced. The exemptions require that notice of certain matters be sent to clients and the firms must file by October 28, 2009 with each province a Form 31-103F2 - Submission to Jurisdiction and thereafter an annual notice of reliance on the exemption. In Ontario, annual fees will continue to be payable under Rule 13-502 for unregistered exempt international dealer firms; and
- (v) new international adviser exemptions are introduced. The exemptions require certain specified conditions to be met, including a Submission to Jurisdiction Form 31-103F2 filing in each Province (along with, thereafter, annual notices of reliance) and certain disclosures are made to clients, although compliance with those requirements for registered International Advisers is deferred one year. In Ontario, filing fees will still be required to be paid under Rule 13-502 annually by exempt international advisers.

The practical effect of all the above noted changes is that the list of Canadian investors with whom an international dealer is permitted to trade on an exempt basis has been narrowed in certain cases and broadened in others.

For example, an international dealer may rely on the new international dealer exemption to trade with “permitted clients,” which is a new definition under the new Rule and is a subset of accredited investors under NI 45-106 when trading foreign securities and certain Canadian debt securities. If international dealers wish to trade with accredited investors outside the permitted client subset, they will be required to obtain registration as exempt market dealers in order to trade with such full range of accredited investors.

In another example of the narrowing of existing rules, international dealers currently registered in Ontario and Newfoundland and Labrador will no longer be permitted to trade with a corporate entity with assets in excess of \$5,000,000. The new threshold is \$25,000,000.

Also, an international dealer in Ontario and Newfoundland and Labrador will no longer be able to trade with 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.

For an example of how permitted trades have been broadened with the introduction of the new Rule, international dealers will now be allowed to trade with individuals with net financial assets before taxes in excess of \$5,000,000. Under the existing regime no trades to individuals were allowed.

### **Conclusion**

This article highlights some of the main features of the new Rule. It is in no way a complete overview or summary of the Rule. There are a number of specific features of the Rule which will be applicable to various market participants. There are also various transition periods which will delay or defer the implementation of certain requirements of the Rule to allow certain market participants time to comply with the new Rule. Blaney McMurtry LLP has experience assisting firms and individuals in complying with their obligations under the new Rule. If you have any questions about the new Rule, please contact Patrick Cummins. ■