

SECURITIES LAW UPDATE

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New National Registration Regime- The Impact on Exempt Market Dealers

National Instrument 31-103 Registration Requirements and Exemptions (“NI 31-103”) came into force on September 28, 2009 (the “Implementation Date”). NI 31-103 represents a consolidation of the previous provincial registration requirements. It also has the effect of removing certain of the previously available registration exemptions for persons receiving finders’ fees (“Finders”) in connection with the distributions exempt market securities.

In general terms, firms that are in the business of trading securities that are or could be issued under prospectus exemptions (such as securities issued to “accredited investors”) to residents of a Canadian province or territory must be registered under NI 31-103 as exempt market dealers (“EMDs”), unless their activities are confined to one of the Western provinces where a registration exemption will be available. Firms and individuals trading in exempt market securities in any of Alberta, British Columbia, Manitoba, the Northwest Territories, Nunavut and the Yukon Territory, and possibly Saskatchewan, may be exempted from the EMD registration requirement as the result of local orders that will be issued in those jurisdictions. Firms and individuals trading in exempt market securities in any other province or territory will be required to register under NI 31-103.

Following is a discussion of the key requirements for EMD’s under NI 31-103.

(a) Requirement to Register as an EMD

Under NI 31-103 any person in the business of trading in securities or holding themselves out as being in the business of trading in securities is required to register, unless an exemption applies.

The companion policy to NI 31-103 states that the regulatory authorities will look at the type of activ-

ity and whether it is carried out for a business purpose to determine if an individual or firm is in the business of trading. They have explicitly identified the following factors as being relevant:

- engaging in activities similar to a registrant
- intermediating trades or acting as market maker
- directly or indirectly carrying on the activity with repetition, regularity or continuity
- being, or expecting to be, remunerated or compensated
- directly or indirectly soliciting

Individuals

Individuals may only act on behalf of a firm registered under NI 31-103. The categories of registration for individuals are set out in Part 2 of NI 31-103. The relevant categories for individuals acting on behalf of an EMD are:

- **Dealing Representative:** a Dealing Representative may act as a dealer or an underwriter in respect of a security that the individual’s sponsoring firm is permitted to trade or underwrite ;
- **Ultimate Designated Person:** an Ultimate Designated Person must perform the functions set out in Section 5.1 (Responsibilities of the Ultimate Designated Person); and
- **Chief Compliance Officer:** a Chief Compliance Officer must perform the functions set out in Section 5.2 (Responsibilities of the Chief Compliance Officer).

Firms

The categories of registration for firms are set out in Part 7 of NI 31-103. The EMD category restricts an individual or firm to acting as a dealer in the “exempt market”. Specifically a firm registered as an EMD is permitted to engage in the following

activities set out under Subsection 7.1(2)(d) of NI 31-103:

- act 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;
- act as a dealer by trading a security that, if the trade were a distribution, would be exempt from the prospectus requirement;
- receive an order from a client to sell a security that was acquired by the client in a circumstance described in the subparagraphs above, and may act or solicit in furtherance of receiving such an order; and
- act as an underwriter in respect of a distribution of securities that is made under an exemption from the prospectus requirement.

Exemptions

Currently most of the dealer registration exemptions are located in National Instrument 45-106-Prospectus and Registration Exemptions (“NI 45-106”). For Finders, the most commonly used registration exemptions in NI 45-106 are the following:

- Section 2.3- Accredited Investor
- Section 2.5 – Family, Friends and Business Associates
- Section 2.9 - Offering Memorandum
- Section 2.10 - Minimum Investment (\$150,000)

Effective March 28, 2010, the registration exemptions contained in NI 45-106 will no longer be available. All dealer registration exemptions will be set out in Part 8 of NI 31-103, or in local rules or blanket orders.

Local Rules and Blanket Orders (Western Provinces Only)

The securities regulators in Alberta, British Columbia, Manitoba, the Northwest Territories, Nunavut and the Yukon Territory (collectively, the “Northwestern Jurisdictions”) intend to issue local

orders exempting individuals and firms from the dealer registration requirements when they trade in securities in certain circumstances. These orders will be issued when the exemptions in NI 45-106 expire on March 27, 2010. They will exempt from registration persons or companies who trade in securities distributed under the exemptions currently in NI 45-106 (as listed above).

The Northwestern Jurisdictions’ local orders will contain a number of conditions that restrict the availability of the exemption. If an individual or firm does not meet any of the following conditions, it must register as EMD under NI 31-103. An individual or firm must:

- not be registered under provincial or territorial securities legislation¹;
- not be registered under the securities legislation of a foreign 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 to the purchaser in the prescribed form (the “Risk Acknowledgement”; and
- file an information report (the “Information Report”) with the securities regulatory authority.

As noted above, at or before the time at which the purchaser enters into an agreement to purchase the security, the Finder must obtain from the purchaser a signed Risk Acknowledgement.

In addition, the Finder will be required to file an Information Report with the securities regulatory authority. The Information Report is a brief report which includes details on the Finder and its business. Provided the Finder has a current Informa-

¹ We note that, as a result of this prohibition, a participant registered as a Limited Market Dealer under the previous regime (and an EMD under the current regime) would not be able to rely on the local orders.

tion Report on file with the securities regulatory authority, it need not file a new Information Report each time it engages in a trade. If the Finder does not have a current Information Report on file, it must file one on or before the 10th day after the prospectus exempt distribution.

(b) Transition Provisions

Market Participants in Ontario and Newfoundland and Labrador

Under the existing registration regime, a firm that acts as a dealer in the exempt market in Ontario or in Newfoundland or Labrador must be registered as a “Limited Market Dealer”. This category of registration does not exist in NI 31-103 and on the Implementation Date all Limited Market Dealers automatically became registered as EMDs under NI 31-103. EMDs (formerly Limited Market Dealers) in Ontario, Newfoundland and Labrador will then have six months to comply with new insurance requirements and one year to comply new capital and proficiency requirements.

For firms that intend to start acting as a dealer in the exempt market after the Implementation Date, the firm must register as an EMD before carrying on business (i.e. no transition period is available).

Market Participants in all Other Jurisdictions

Under the existing regime, a firm that acts as a dealer in the exempt market in jurisdictions other than Ontario and Newfoundland and Labrador

may rely on the various registration exemptions found in NI 45-106. NI 31-103 provides a one year transition period for EMDs active in the exempt market prior to the Implementation Date to apply for registration unless an exemption is available. Accordingly, under NI 31-103 a firm acting as a dealer in the exempt market prior to the Implementation Date must either comply with the conditions of the Northwestern Jurisdictions local orders (as described above) when the registration exemptions in NI 45-106 expire on March 28, 2010 or apply for registration as an EMD on or before September 28, 2010.

Firms that start acting as a dealer in the exempt market in jurisdictions other than Ontario and Newfoundland and Labrador after the Implementation Date should consider whether they will have to register as an EMD when the NI 45-106 exemptions expire on March 27, 2010. As of March 28, 2010, if such a firm cannot rely on the on the Northwestern Jurisdictions’ local orders, it must cease operations until it becomes registered as an EMD.

(c) Proficiency, Financial and Operational Requirements

Under NI 31-103, EMDs are subject to proficiency, financial, operation and client relationship requirements. The table below summarizes the key requirements. All section references are to NI 31-103.

Proficiency Requirements	Reference
<p><i>Exempt Market Dealer- Dealing Representative</i> An individual must:</p> <ol style="list-style-type: none"> 1. pass the Canadian Securities Course Exam; 2. pass the Exempt Market Products Exam; or 3. satisfy the proficiency requirements of an advising representative of a portfolio manager 	Section 3.9
<p><i>Exempt Market Dealer – Chief Compliance Officer</i> An individual must:</p> <ol style="list-style-type: none"> 1. pass the PDO Exam (the Officers’, Partners’ and Directors’ Exam or the Partners, Directors and Senior Officers’ Course Exam); or 2. satisfy the proficiency requirements of a Chief Compliance Officer of a Portfolio Manager 	Section 3.10

Financial Requirements	Reference
<p><i>Working Capital</i> The minimum capital is \$50,000 for a registered dealer</p>	Sections 12.1-12.2
<p><i>Insurance</i> A registered dealer must maintain bonding or insurance that:</p> <ol style="list-style-type: none"> 1. Contains the required bonding and insurance clauses set out in Appendix A of NI 31-103 and in the highest amounts for each clause: <ol style="list-style-type: none"> (a) \$50,000 per employee, agent and dealing representative or \$200,000, whichever is less (b) One percent of the total client assets that the dealer holds or has access to, as calculated using the dealer's most recent financial records or \$25,000,000, whichever is less (c) One percent of the dealer's total assets, as calculated using the dealer's most recent financial records, whichever is less (d) The amount determined to be appropriate by a resolution of the dealer's board of directors or individuals acting in a similar capacity for the firm 2. Provides for a double aggregate limit or a full reinstatement of coverage 	Sections 12.3-12.7
<p><i>Audits</i> A registered firm must direct its auditor in writing to conduct any audit or review required by the regulator during its registration and must submit a copy of the direction to the regulator</p>	Sections 12.8-12.9
<p><i>Financial Reporting</i> A registered dealer must deliver the following no later than the 90th day after the end of the financial year:</p> <ol style="list-style-type: none"> 1. its annual audited financial statements for the year 2. a completed Form 31-103F1- Calculation of Excess Working Capital 	Sections 12.10-12.14
Compliance Requirements	Reference
<p><i>Compliance Systems</i> Registered firms must establish, maintain and apply policies and procedures that establish a system of control and supervision</p>	Section 11.1
<p><i>Designating an Ultimate Designated Person</i> Registered firms must designate an Ultimate Designated Person, who must fulfill specific responsibilities (set out in Section 5.1)</p>	Sections 11.2 and 5.1
<p><i>Designating a Chief Compliance Officer</i> Registered firms must designate a Chief Compliance Officer who must fulfill specific responsibilities (set out in Section 5.2). Proficiency requirements apply.</p>	Sections 11.3 and 5.2
<p><i>Books and Records</i> Registered firms must maintain records</p>	Sections 11.5-11.6
<p><i>Certain Business Transactions</i> Registered firms must not engage in tied settling of securities transactions or tied selling. Registrants must give notice if they acquire a registered firm's securities or assets. Registered firms must also give notice if its securities are acquired</p>	Sections 11.7-11.10

Client Relationship Requirements	Reference
<i>Know Your Client Suitability</i> Registrants must comply with certain known your client suitability obligations	Sections 13.1-13.3
<i>Conflicts of Interest</i> Registered firms must have certain policies and procedures to handle conflicts of interest	Sections 13.4-13.6
<i>Referral Arrangements</i> Registrants may participate in a referral arrangement under certain conditions	Sections 13.7-13.11
<i>Loans and Margin</i> Registrants are restricted from lending to clients. Registrants must provide certain disclosure to clients when recommending the use of borrowed money.	Section 13.12-13.13
<i>Complaints</i> Registered firms must have a system for handling complaints	Sections 13.14-13.16
<i>Disclosure to Clients</i> Registered firms must make certain disclosure to clients	Sections 14.2-14.5
<i>Client Assets</i> A registered firm may only hold client assets as prescribed	Sections 14.6-14.9
<i>Client Accounts</i> A registered firm must provide certain disclosure when selling or assigning client accounts	Sections 14.10-14.11
<i>Account Activity Report</i> A registered dealer must provide certain trade confirmations and client statements	Sections 14.12-14.14

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