Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

Notice of and Request for Comment on Proposed Amendments to National instrument 31-103 *Registration Requirements and Exemptions*, National Instrument 33-109 *Registration Information* and to Related Policies and Forms

Introduction

The Canadian Securities Administrators (the CSA or we) are seeking comments on proposals to amend the current regulatory framework for dealers, advisers and investment fund managers contained in National Instrument 31-103 *Registration Requirements and Exemptions* (NI 31-103 or the Rule) and in Companion Policy 31-103 CP *Registration Requirements and Exemptions* (the Companion Policy). We refer to the Rule and Companion Policy as the "Instrument".

The Instrument, together with amendments to National Instrument 31-102 *National Registration Database* (NI 31-102) and to National Instrument 33-109 *Registration Information* (NI 33-109), came into force on September 28, 2009 and introduced a new national registration regime that is harmonized, streamlined and modernized.

We indicated in the Notice dated July 17, 2009 (the 2009 Notice) that we would propose amendments to the Instrument if investor protection, market efficiency or other regulatory concerns arose. We are now proposing amendments following our monitoring of the implementation of the Instrument and our continuing dialogue with stakeholders about questions and concerns that have arisen with practical experience of working with the Instrument.

We are also seeking comments on proposals to amend NI 33-109, as well as related policies and forms (collectively, the NRD Amendments). We are not proposing amendments to NI 31-102.

The proposed amendments are indicated in the appendices to this Notice and the more significant among them are summarized below. We are soliciting comments on all of the proposed amendments, as well as some additional proposals that are discussed in this Notice.

We think the effect of the amendments we are proposing, which range from technical adjustments to more substantive matters, would be to enhance investor protection and improve the day-to-day operation of the Instrument for both industry and regulators.

The comment period will end on **September 30, 2010.**

Contents of this Notice

This Notice consists of the following sections

1. Impact on investors
2. Summary and purpose of the proposed amendments to the Instrument
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This Notice contains the following appendices:

- Appendix A - Amendments to *National Instrument 31-103 Registration Requirements and Exemptions*

- Appendix B *- National Instrument 31-103 Registration Requirement and Exemptions*, blacklined to show changes to NI 31-103

- Appendix C - *Companion Policy 31-103 Registration Requirements and Exemptions*, blacklined to show changes to the current Companion Policy 31-103CP

- Appendix D - Amendments to *National Instrument 33-109 Registration Information*

- Appendix E - *National Instrument 33-109 Registration Information*, blacklined to show changes to NI 33-109

- Appendix F - *Companion Policy 33-109CP Registration Information*, blacklined to show changes to the current Companion Policy 33-109CP, and

- Appendix G - CSA Staff Notice 31-315 *Omnibus / blanket orders exempting registrants from certain provisions of NI 31-103 Registration Requirements and Exemptions*

1. Impact on investors

We expect that the following proposed amendments will be of particular interest to investors:

- the proposed guidance in the Companion Policy on the firm's complaint handling policies and procedures and the proposed changes to the dispute resolution service requirements (summarized under "Complaints"), and

- our request for comments on the question as to what securities should be included in account statements sent to clients (see the discussion under "Account activity reporting").

2. Summary and purpose of the proposed amendments to the Instrument

The amendments we propose include proposals to

- make various minor drafting changes to the Rule and clarifications to the guidance in the Companion Policy in order to give better effect to our original intent and to codify staff administrative practice that is in keeping with the original intent of NI 31-103 and NI 33-109

- give effect to omnibus / blanket relief orders described in CSA Staff Notice 31-315 *Omnibus / blanket orders exempting registrants from certain provisions of NI 31-103 Registration Requirements and Exemptions* (attached as Appendix G to this Notice); most of these relief orders address issues relating to the transition from the old registration regime to the new regime introduced with the Instrument

- incorporate into the Companion Policy some of the guidance which we published on December 18, 2009 and February 5, 2010 as *Frequently Asked Questions* (FAQ); these FAQs are available on the websites of most of the CSA members

- add an obligation for registered representatives to understand the structure, features and risks of each security they recommend

- propose guidance in the Companion Policy which would guide registrants in meeting the requirement to document complaints and to fairly and effectively respond to them

- amend the requirement to the obligation of the registered firm to ensure independent resolution or mediation services in cases where the complaint relates to a trading or advising activity, a breach of client confidentiality, theft, fraud, misappropriation or forgery, misrepresentation, an undisclosed or prohibited conflict of interest or personal financial dealings with a client

- add obligations for investment fund managers to deliver trade confirmations and account statements to investors who deal directly with them, rather than through a dealer

- address the impact of the coming introduction of International Financial Reporting Standards (IFRS) on the valuation of securities for purposes of NI 31-103

- remove certain non harmonized provisions with respect to the mutual fund dealer category

- grant additional exemptions to members of self regulatory organizations (SROs) where the SRO rules adequately cover the same regulatory risks, and

- extend certain exemptions to circumstances that are consistent with the original policy intent of the rule

We summarize in this section and in section 3 of this Notice the more significant proposed amendments and additional matters for which we would like to receive comments. We follow, in this section, the same order as the provisions in the Instrument.

Title of the Rule

We intend to change the title of NI 31-103 to *Registration Requirements, Exemptions and Ongoing Registrant Obligations* in order to better reflect its breadth and scope, which extends beyond initial registration.

Amendments relating to International Financial Reporting Standards (IFRS)

We are proposing to update the terminology used in NI 31-103 and the Companion Policy by replacing the term *market value* with the term *fair value* in view of the upcoming changeover to IFRS. As a result of this change, where a person or company is required in NI 31-103 to determine the fair value of a security, the fair value must be determined in accordance with IFRS.

This change is proposed in

- section 8.22 [*Small security holder selling and purchase arrangements*] of NI 31-103

- section 14.14 [*Account statements*] of NI 31-103

- Form 31-103 F1 *Calculation of excess working capital*, and

- section 1.2 of the Companion Policy, in the guidance relating to the determination of assets under paragraph (o) of the definition of permitted clients

See *Account activity reporting – Fair value in account statements* in this Notice for a detailed discussion of the proposed changes to section 14.14 of NI 31-103 and of the guidance we propose to add in the Companion Policy.

See also section 3 of this Notice, *Summary and purpose of the proposed NRD Amendments*, for a description of the change to fair value in

- Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals*

- Form 33-109F7 *Reinstatement of Registered Individuals and Permitted Individuals*

Proficiency requirements

(a) Section 3.3 - Time limits on examination requirements

Elimination of the 12 month period within the 36 month time limit

We do not propose to change the 36 month time limit for the currency of the examinations but we do propose clarifications to this regime. We have received comments on the level of complexity of section 3.3 of NI 31-103, for which we propose a new formulation. We have also considered a recommendation that the individual be registered *at any time* during the 36 months before the date the individual applied for registration, rather than for any 12 months during the 36 month period. We agree and propose to amend section 3.3(2)(a) of NI 31-103 accordingly.

Suspensions during the 36 month period

We also propose to add a new subsection (3) to section 3.3 of NI 31-103 which would clarify that for purposes of calculating the 36 month time limit, an individual would not be considered to have been registered during any period in which the individual's registration was suspended. Our intent remains that the individual was actively registered at any time during the 36 month period.

We propose to add guidance in the Companion Policy to the effect that the regulator may consider the length of time between any suspension and reinstatement of registration during the 36 month period.

CFA Charter and Canadian Investment Manager (CIM) designation

We also received comments indicating that it is not practical to expect an individual who currently holds the CFA Charter or the CIM designation to complete these programs again after the expiry of the 36 month period. We agree and propose to amend section 3.3 of NI 31-103 in order to repeal references to these programs. The time limits would therefore not apply to the CFA Charter or the CIM designation.

(b) Proficiency – initial and on going

We propose to add in section 3.4 of NI 31-103 a requirement that the registered representative understand the structure, features and risks of each security the individual recommends to the client. This proposed change reflects the CSA's view that in depth knowledge of all securities a registrant recommends is a fundamental component of the proficiency requirement.

(c) Codification of February 26, 2010 omnibus / blanket relief orders relating to the proficiency transition provisions in sections 16.9(2) and 16.10(1)

We propose to codify the omnibus / blanket relief order issued by each member of the CSA on February 26, 2010 in order to entrench the proficiencies which are the object of the transition provisions in sections 16.9(2) and 16.10(1) of NI 31-103.

These changes would apply to chief compliance officers of mutual fund dealers and exempt market dealers, and to their dealing representatives, and would continue the transition/grandfathering provisions for certain chief compliance officers and certain dealing or advising representatives where their firm adds registration in another jurisdiction.

See Appendix G to this Notice for details of the relief order.

(d) Proposed exemption from the Canadian Securities Course (CSC) Exam for chief compliance officers of portfolio managers and investment fund managers

Under this proposal, individuals having the CFA Charter would not be required to pass the CSC Exam in order to meet the proficiency requirements of the chief compliance officer of a portfolio manager or an investment fund manager. We consider that substantially all matters covered by the CSC are also covered in the CFA Charter. We therefore propose to amend sections 3.13 and 3.14 of NI 31-103 accordingly.

Restrictions on registered individuals

We propose to include in section 4.1 of NI 31-103 a new sub-paragraph (2)(b), which would prohibit an advising, associate advising and dealing representative from being registered with another registered firm.

Our view is that the conflicts of interest in such cases are generally too serious to permit an individual to be sponsored by different firms, and our intent is not to allow for such multiple registrations except in exceptional circumstances. This was the case in some jurisdictions before NI 31-103 was adopted.

We are proposing guidance in the Companion Policy on how we would deal with exemption applications from section 4.1(2)(b) on a case by case basis, noting that affiliation of the firms may be a relevant factor in our evaluation.

Categories of registration for firms - mutual fund dealers

(a) *Labour-sponsored investment fund corporations and labour-sponsored capital corporations in Québec*

We propose to repeal the exception for Québec mutual fund dealers in section 7.1(2)(b)(ii), in order to harmonize with the other CSA jurisdictions in this area.

(b) *Scholarship plans, educational plans and educational trusts in British Columbia*

We propose to repeal section 7.1(3) of NI 31-103 since we are now confident that no members of the Mutual Fund Dealers Association of Canada (MFDA) in British Columbia employ salespersons who trade scholarship or educational plans without the dealer also being registered as a scholarship plan dealer, and that no mutual fund dealers who are not MFDA members employ any salespersons who also trade scholarship or educational plans. This change would be made to harmonize with the other CSA jurisdictions in this area.

Registration exemptions

We are proposing amendments to the following registration exemptions:

(a) *Section 8.6 [Adviser – non-prospectus qualified investment fund]*

We propose to eliminate the restriction of this exemption to non-prospectus qualified investment funds, and allow all investment fund securities to be traded by an adviser to managed accounts of the adviser's clients without the adviser having to register as a dealer. We have concluded that there is not a sufficient distinction between prospectus-qualified funds and pooled funds in the context of a managed account relationship to warrant treating them differently for purposes of this exemption. The section would be re-titled *Investment fund trades by adviser to managed accounts*. We do not propose to change the other conditions to the exemption.

(b) *Section 8.18 [International dealer]*

Technical change

We propose to repeal sub-paragraphs (e) and (f) from section 8.18(2) since we think these sub-paragraphs are redundant with sub-paragraphs (b), (c) and (d) of section 8.18(2) which deal with permitted clients, including by definition an investment dealer.

Clarifying the Canadian residency requirement for permitted clients

We propose to add an express Canadian residency requirement in the conditions of this exemption, by reformulating subsection 8.18(3)(d) to add that the permitted client must

be a resident of Canada; this change is proposed to clarify our intent that the exemption may not be relied upon to trade with foreign clients. A corresponding change is also proposed in section 8.26 [*International adviser*] of NI 31-103.

Client notice requirement

We seek to clarify the contents of the notice which must be provided to clients before any advice can be given to the client. The changes we propose are indicated in the following chart:

Current section 8.18	Proposed change	Comment
(4)(b)(i) the person is not registered in Canada	(4)(b)(i) the dealer is not registered in the local jurisdiction to make the trade	The exemption in section 8.18 of NI 31-103 is available to a firm that is registered in the local jurisdiction or elsewhere in Canada, as we indicated in our response to question 21 in the FAQ.
(4)(b)(ii) the person's jurisdiction of residence	(4)(b)(ii) the foreign jurisdiction in which the head office or principal place of business of the person or company is located	We propose this formulation to add clarity to the disclosure to clients.
4(b)(iii) the name and address of the agent for service of process of the person in the local jurisdiction	This subsection would become (4)(b)(v)	This would not be a substantive change.
4(b)(iv) there may be difficulty enforcing legal rights against the person because it is resident outside Canada and all or substantially all of its assets may be situated outside of Canada.	4(b)(iii) all or substantially all of the assets of the person or company may be situated outside of Canada 4(b)(iv) there may be difficulty enforcing legal rights against the person or company because of the above	We propose to separate the current subsection 4(b)(iv) into two distinct sections, for clarity.

Corresponding changes are also proposed in section 8.26 [*International adviser*] of NI 31-103.

Annual notice

We propose changing the date on which the regulator must be notified annually of the reliance on this exemption, to December 1. We are of the view that this change would simplify the administrative process. A corresponding change is also proposed in section 8.26 [*International adviser*] of NI 31-103.

Adviser registration exemption for advice given in connection with an activity or trade under the international dealer exemption

We propose to add, in a new subsection 8.18(7) of NI 31-103, an adviser registration exemption for the person or company relying on the section 8.18 dealer registration exemption. This exemption would be restricted to advice provided to the client in connection with trading activity permitted under section 8.18, and would not extend to a managed account of a client.

This new exemption parallels the adviser registration exemption for a registered dealer in section 8.23 of NI 31-103 and is proposed to provide greater certainty that it is not our intention for a dealer relying on section 8.18 to have to register as an adviser only because there is an element of advising associated with recommending trades made on reliance upon this exemption.

Exemption from other NI 31-103 requirements if the other requirements apply only to activities or trades under the international dealer exemption

We propose to clarify, in a new subsection 8.18(8) of NI 31-103, our intent that if a person or company relies on the registration exemption in section 8.18 for trades with permitted clients, but is also registered to conduct other activities in Canada, requirements applicable to its registration do not apply where it acts in reliance on the exemption.

For example, a foreign firm might register as a portfolio manager and also conduct trades contemplated under section 8.18. In respect of its portfolio management activities, the foreign firm would be required to provide the notice to clients required under section 14.5, and like all portfolio managers, to provide account statements to the clients.

However, the foreign firm would not be required to do so for the permitted clients on whose behalf it trades under the international dealer exemption, so long as it complied with the conditions of section 8.18.

A corresponding change is also proposed in section 8.26 [*International adviser*] of NI 31-103.

(c) <u>Section 8.22 [Small security holder selling and purchase arrangements]</u>

As indicated above, we propose to replace the term *market value* with *fair value* in section 8.22(2)(d) in view of the upcoming changeover to IFRS.

(d) <u>Section 8.26 [International adviser]</u>

Aggregate consolidated gross revenue

We propose to clarify, in section 8.26(4)(d) of NI 31-103, our intent that the adviser's aggregate consolidated gross revenue is to be determined as at the end of its most recently completed financial year, rather than on an ongoing basis during that year.

Clarifying Canadian residency requirement for permitted clients

We propose to add a Canadian residency requirement in the conditions of this exemption, by adding subsection 8.26(4)(g) of NI 31-103. Expressly stating that the permitted client must be a resident of Canada clarifies our intent that the exemption may not be relied upon to trade with foreign clients.

A corresponding change is also proposed in section 8.18 [*International dealer*] of NI 31-103.

Client notice requirement

We seek to clarify the contents of the notice which must be provided to clients before any advice can be given to the client. The changes we propose are indicated in the following chart:

Current section 8.26	Proposed change	Comment
(4)(e)(i) the adviser is not registered in Canada	(4)(e)(i) the adviser is not registered in the local jurisdiction to provide the advice described under subsection (3);	We take the view that the exemption in section 8.26 of NI 31-103 is available to a firm that is registered in the local jurisdiction or elsewhere in Canada, as we indicated in our response to question 27 in the FAQ.
(4)(e)(ii) the jurisdiction of residence of the adviser	(4)(e)(ii) the foreign jurisdiction in which the adviser's head office or principal place of business is located	We propose this formulation to add clarity to the disclosure to clients.
4(e)(iii) the name and address of the adviser's agent for service of process in the local jurisdiction	This subsection would become (4)(e)(v)	This would not be a substantive change.
4(e)(iv) there may be difficulty enforcing legal rights against the adviser because it is resident outside Canada and all or substantially all of its assets may be situated outside of Canada.	4(e)(iii) all or substantially all of the adviser's assets of the person or company may be situated outside of Canada 4(e)(iv) (iv) there may be difficulty enforcing legal rights against the adviser because of the above	We propose to separate the current subsection 4(e)(iv) into two distinct sections, for clarity.

Corresponding changes are also proposed in section 8.18 *[International dealer*] of NI 31-103.

Annual notice

We propose changing the date on which the regulator must be notified annually of the reliance on this exemption, to December 1. We are of the view that this change would simplify the administrative process. A corresponding change is also proposed in section 8.18 [*International dealer*] of NI 31-103.

Incidental advice on Canadian securities

We are proposing additional guidance on section 8.26(3) in the Companion Policy concerning what is meant by advice with respect to Canadian securities which is "incidental" to providing advice on a foreign security. We clarify that this is not a 'carve out' that allows some portion of a permitted client's portfolio to be made up of Canadian securities chosen by the international adviser without restriction.

Membership in a self regulatory organization (SRO)

(a) *Expanding the exemptions from certain requirements of NI 31-103 for SRO members*

Lending to clients

We propose to provide the MFDA with the same exemption provided to members of the Investment Industry Regulatory Association of Canada (IIROC) relating to the prohibition on lending to clients set out in section 13.12 on NI 31-103. This proposal is made on the basis that MFDA has a member rule prohibiting lending to clients except in very limited circumstances.

Handling complaints

As stated in the 2009 Notice, we take the view that SROs have a critical role in setting registration requirements and standards for their members. Following recent SRO rule amendments, we propose expanding the exemptions for SRO members by adding section 13.15 [*Handling complaints*] to sections 9.3 and 9.4 of NI 31-103.

Client accounts

We are considering providing an exemption from the application of section 14.14 [*Client statements*] for SRO members. Our final recommendation will depend on whether the SROs have rule amendments, which correlate with the amendments we are proposing to section 14.14, in force by the time the proposed amendments to NI 31-103 would come into force. We discuss the alternatives for changes to section 14.14 in this Notice (see *Account Statements* in this Notice).

(b) *MFDA member firms registered in other categories*

General principle

We remind firms that if an SRO member is registered in another category, sections 9.3 and proposed section 9.4 do not exempt them from their obligations as a registrant in that other category. To make this intent clear, we propose to add a Rule provision which would provide that a firm that is a member of the MFDA and is also registered as an

exempt market dealer, investment fund manager or scholarship plan dealer, is not exempt from certain sections of Part 12 *Financial Condition* of NI 31-103.

Specific exemption

We propose to allow SRO members to use the Financial Questionnaire and Report of their SRO instead of Form 31-103F1 *Calculation of Excess Working Capital* for the purpose of their annual and quarterly financial filings (subsections 12.12(2.1), 12.14(4) and 12.14(5)) and for the purpose of calculating excess working capital (subsections 12.1(5) and (6)) provided certain conditions are met.

(c) *Mutual fund dealers registered in Québec*

We propose to amend the drafting of section 9.3(6) (which would be renumbered 9.4(5)) to clarify the non application of certain provisions of the Rule to mutual fund dealers registered in Québec (Québec mutual fund dealers). Québec mutual fund dealers are not required to be members of the MFDA. The requirements listed in subsection 9.3(1) do not apply to Québec mutual fund dealers if equivalent requirements are applicable to them under the regulations in Québec. If no such equivalent requirements are applicable, they must comply with the provisions of NI 31-103.

Compliance system

Proposed revised guidance

We are proposing enhanced guidance in the Companion Policy on the risks that may be mitigated by a firm's internal controls and the distinction between monitoring and supervision.

Designating an ultimate designated person (UDP)

We propose to amend section 11.2 of NI 31-103 by adding a new subsection which would clarify that if the firm does not have a chief executive officer (CEO), the firm may designate, as its UDP, an individual acting in a capacity similar to a CEO.

We are also proposing to clarify in section 11.2 that the officer in charge of a division of the firm may be designated as the firm's UDP, but only to the extent that the firm has significant other business activities.

Finally, we propose enhanced guidance in the Companion Policy on the UDP designation.

Know your client (KYC)

Paragraph 13.2(2)(b) of NI 31-103 provides that a registrant must take reasonable steps to establish whether a client is an insider of a reporting issuer or any other issuer whose securities are publicly traded. We propose to

- codify in section 13.2 of NI 31-103 the omnibus / blanket relief order granted on February 26, 2010 by each CSA member in respect of mutual fund dealers and mutual fund dealer representatives; see Appendix G to this Notice for additional information on the omnibus / blanket relief order

- extend this exemption to scholarship plan dealers as well as their representatives, and

- include as a condition of the exemption that the registrant not be registered in any other category, as indicated in proposed section 13.2(7) of NI 31-103

The purpose of the omnibus / blanket relief order and the proposed amendment is to recognize that only in very rare circumstances will a trade in mutual fund or scholarship plan securities give rise to insider trading concerns. We think it would be a good practice when selling highly concentrated pooled funds to enquire whether a client is an insider of securities in the fund, notwithstanding this exemption, and we propose this practice as guidance in the Companion Policy.

Suitability

We propose to amend the Companion Policy to set out expressly our view that in all cases, we expect registrants to be able to demonstrate a process for making suitability determinations that are appropriate in the circumstances.

Conflicts of interest

We propose to amend section 13.5 of NI 31-103 by deleting the word *registered* before the word *adviser* in order for this section to apply to all advisers, including registered dealers that are members of IIROC and that conduct advising activities (IIROC advisers). IIROC advisers are not necessarily registered in the adviser category but we are of the view that they should be held to the same standards and restrictions on managed account transactions. Section 13.5 of NI 31-103 would therefore apply to both registered advisers and IIROC advisers. We expect that the IIROC rules would be amended to reflect this change.

We propose amending the Companion Policy by adding guidance on individuals who serve on a board of directors, by including guidance on section 4.1 of NI 31-103.

Referral arrangements

We propose to amend sections 13.8, 13.9 and 13.10 of NI 31-103 in order to

- clarify section 13.8(a) by stating that a registered firm, or a registered individual whose registration is sponsored by the registered firm (instead of the *registrant*), must not participate in a referral arrangement *with another person or company*

- clarify the contractual arrangement requirements: our intent is that only the registered firm is required to be a party to a written agreement, and therefore paragraph (a) of section 13.8 would require only a written agreement between the *registered firm* and the person or company

- provide in paragraph (b) of section 13.8 that the registered firm is required to record all referral fees, but repeal the words *on its records* in paragraph (b) of section 13.8 in favour of additional guidance on keeping records of referral fees

- adjusting the due diligence requirements in section 13.9 by providing that the registered firm, and not the *registrant*, is held to the due diligence requirement with respect of the qualifications of the person or company to whom the referral is made

- replacing the words *referral arrangement* with *agreement* in section 13.10 of NI 31-103, which better reflects our intent

We propose to further amend the guidance on referral arrangements in the Companion Policy in order to indicate that registered firms are responsible for monitoring and supervising all of their referral arrangements to ensure that they are compliant with the requirements of NI 31-103 and other applicable securities laws, and continue to be compliant for so long as they remain in place.

Complaints

Handling complaints

We stated in the 2009 Notice that the CSA was working with the SROs on a harmonized complaint handling regime. We indicated that once this harmonization work was completed, we would propose amendments to the Rule and the Companion Policy to give effect to the harmonized framework for handling complaints for non-SRO members.

We have now completed our development work with the SROs, whose rules and policies on complaints are now in force, and are proposing amendments to the Companion Policy which would guide registrants in meeting the requirement to document complaints and to fairly and effectively respond to them.

This guidance covers what the firm's complaint handling policies and procedures should include, recommendations as to the manner of responding to both verbal complaints and complaints in writing, as well as the time within which the complaint should be dealt with.

We are currently preparing a proposal for reporting complaints to the regulator, which we will publish subsequently.

Dispute resolution service

We propose an amendment to section 13.16 of NI 31-103 which would change the obligation of the registered firm to ensure independent dispute resolution or mediation services. These services would need to be made available with respect to complaints relating to the following matters:

- a trading or advising activity
- a breach of client confidentiality
- theft, fraud, misappropriation or forgery
- misrepresentation
- an undisclosed or prohibited conflict of interest
- personal financial dealings with a client

Québec registrants

We remind Québec registrants that they must comply at all times with sections 168.1.1 to 168.1.3 of the *Securities Act* (Québec).

Notice to clients by non-resident registrants

We propose to amend section 14.5 of NI 31-103 to codify the omnibus / blanket relief order issued by each member of the CSA on February 26, 2010 in order to exempt firms whose head office is in Canada from the requirement to provide the notice to clients required in section 14.5 if the firm has a physical place of business in the jurisdiction where the client resides.

The notice requirement in this section is more appropriate to a registrant that does not have a physical place of business in the jurisdiction.

See Appendix G to this Notice for details of the omnibus / blanket relief order.

Account activity reporting

(a) <u>Trade confirmations and account statements</u>

We propose to amend section 14.12(1) of NI 31-103 in order to allow a registered dealer to send a trade confirmation directly to the adviser acting for the client, if the client consents in writing to this arrangement.

We also propose to require, by adding subsection (5) to section 14.12, that a registered investment fund manager send a trade confirmation to a security holder when the investment fund manager executes a redemption order received directly from the security holder.

We think these changes would reflect current industry practice since security holders can address redemption orders to investment fund managers directly and there is, in our opinion, no policy rationale for clients not to receive a trade confirmation from the investment fund manager in these circumstances. We propose new guidance on section 14.12 in the Companion Policy.

Finally, we propose to require, by adding section 14.14(3.1) that the investment fund manager send an account statement to the security holder, at least once every 12 months, if there is no dealer of record for the security holder on the records of the investment fund manager.

We specifically invite comments on whether investment fund managers do or can have systems in place to send an account statement to the security holder if there is no dealer of record for the security holder on the records of the investment fund manager.

(b) <u>Fair value in account statements</u>

We propose to amend section 14.14 by adding subsection (5.1) in order to require registered firms, except in limited circumstances, to use fair value under IFRS for valuing securities in client statements. We are proposing detailed guidance in the Companion Policy on how we expect this requirement to be met, including the limited circumstances where a registered dealer or adviser concludes it is not able to determine a reliable fair value after using all reasonable efforts to apply IFRS valuation techniques.

We are also considering amending NI 31-103 in the future to codify that where the fair value of a security in an account statement is determined other than by reference to an active market, registered firms should provide additional disclosure concerning the valuation methodology used, including an explanation that fair value is not market value and is not necessarily representative of the amount that the client will receive should they sell the security. This is currently proposed as guidance in the Companion Policy.

(c) <u>Reporting on each security position in the account</u>

Should registered firms be required to include client name securities on account statements?

Section 14.14 requires a registered firm to deliver periodic account statements to each of its clients. The statements list the securities owned by a client that have been purchased through the registered firm. Currently, all registered firms report on securities they hold or control. They may or may not also report on securities that they have sold to clients, but do not hold or control, for example, securities registered in a client's name on an issuer's books ("client name" securities) or securities held in certificate form by the client.

Mutual fund dealers and scholarship plan dealers typically provide statements to clients that include all securities sold to them, regardless of how the securities are held. This is also the common practice for portfolio managers. Investment dealers do not usually include client name securities in their account statements. Currently, there is no established practice for the new category of exempt market dealer. Exempt market securities are typically held in client name.

We are considering amending section 14.14 to clarify whether client statements only need to include securities held or controlled by a firm or whether they need to also include client name securities.

Requiring registered firms to report on client name securities would provide investors with more complete information about the securities sold to them by a registered firm, including the fair value of their portfolio. It would also standardize client account reporting among registered firms.

We recognize that including client name securities in account statements would place a burden on registered firms to collect and send information about securities that they do not hold or control. We are seeking comments on how to balance what is a potential benefit to investors with the anticipated costs to industry of requiring client name securities to be included in account statements.

We would like your feedback on the following questions. We also welcome your comments on any other factors that we should consider and on this proposal in general. Until any new requirements relating to this issue come into force, we encourage registered firms that currently report on client name securities to continue to do so according to their existing practice. We will not consider registered firms that do not currently report on client name securities to have a compliance deficiency if they continue not to report on client name securities.

While our questions are directed with reference to dealers and advisers, investment fund managers are encouraged to comment on this issue as well, as we are also proposing to add a new requirement for them to provide account statements where there is no dealer of record for a security holder (see section 14.14(3.1)). Depending on the outcome of these amendments, we may need to revise the requirement for investment fund managers to

provide account statements where there is no dealer of record to ensure the requirement meets its objective.

Questions

1. Investors may not be aware that securities are held in different ways or understand the implications for account reporting of holding securities in one way or another. To what extent would investors benefit from including client name securities on their account statements? For example, would including client name securities ensure that account statements provide investors with a more complete picture of their portfolio?

2. If client name securities were required in account statements, we would require registered firms to use IFRS to determine the fair value of client name securities. Some securities held in client name are illiquid and do not have a value that can be determined by reference to an active market. Would including the fair value of illiquid securities on account statements be useful to investors?

3. We understand that many registered firms that currently include client name securities in their account statements have arrangements with the issuer to regularly update them on the securities owned by a client. In what circumstances does this practice work? In what circumstances might this practice be impractical or unduly burdensome? How common are those circumstances?

4. Other than entering into an arrangement with the issuer, how else could registered firms collect information on what client name securities a client owns? How would these alternatives work and what costs would be involved?

5. What changes would registered firms need to make to their account statement procedures to include client name securities? How difficult or costly would these be?

6. Under section 14.14, registered firms are only required to provide account statements to “clients”. When do you consider a client relationship to start and end? What factors should be considered in determining whether a client relationship has ended?

7. If client name securities were required in account statements, are there any circumstances where a registered firm should be exempt from the requirement to provide reporting on client name securities? For example, should certain types of clients, investment products or transactions be exempt? Why? (We would expect to exempt client name securities held in certificate form by the client, in Delivery against Payment (DAP) accounts and in Receipt against Payment (RAP) accounts.)

8. If client name securities were required in account statements, should there be a transition period to give registered firms time to change their account statement procedures? How long should the transition period be?

3. Summary and purpose of the proposed NRD Amendments

Definition of permitted individuals

Except in Québec and Alberta where this amendment is not necessary because it was made on September 28, 2009, we propose an amendment to the definition of permitted individual in section 1.1 of NI 33-109, by removing the word *and* between paragraphs (a) and (b), since a permitted individual who has beneficial ownership of, or direct or indirect control or direction over, 10 percent or more of the voting securities of a firm can also be a director, chief executive officer, chief financial officer, or chief operating officer of a firm, or who performs the functional equivalent of any of those positions.

Voluntary resignation

We propose to add the words "resigned voluntarily" in section 2.3(2)(b) to correlate with Form 33-109F7 *Reinstatement of Registered Individuals and Permitted Individuals.*

Amendments to certain forms

Fair value

We propose to amend question b) in new Schedule N to Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals* as well as question b) in Schedule E of Form 33-109F7 *Reinstatement of Registered Individuals and Permitted Individuals* in order to replace *market* value with *fair* value, in view of the upcoming changeover to IFRS.

The question would therefore read as follows: *State the fair value (approximate, if necessary) of any subordinated debentures or bonds of the firm to be held by you or any other subordinated loan to be made by you to the firm.*

Other proposed amendments

We also propose certain technical changes to the following forms to add clarity:

- Form 33-109F1 *Notice of Termination of Registered Individuals and Permitted Individuals*
- Form 33-109F2 *Change or Surrender of Individual Categories*
- Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals*

- Form 33-109F6 *Firm Registration,* and

- Form 33-109F7 *Reinstatement of Registered Individuals and Permitted Individuals*

4. Ongoing CSA work on the framework for registrant regulation

We continue our work on the matters that we indicated in the 2009 Notice would be addressed separately, including

- the application of the investment fund manager registration requirement with respect to an entity that directs the operation of an investment fund, from a head office or other physical location that is outside the jurisdiction

- the exemption for sub-advisers; for the time being, the exemption remains in section 7.3 of OSC Rule 35-502 *Non Resident Advisers*, and discretionary relief on a similar basis will continue to be granted in other jurisdictions

- the exemption for capital accumulation plans, and

- the requirements and guidance on cost disclosure and performance reporting to clients as part of our development of the client relationship model (CRM)

We may publish CSA staff notices or propose amendments to the Instrument with respect to these specific projects in the future.

5. Authority for the proposed amendments

In the jurisdictions where the proposed amendments are to be adopted, the securities legislation provides the securities regulatory authority with rule making authority in respect of the amendments.

6. Alternatives considered

The alternative to many of the proposed amendments is to not change the Instrument but continue to issue exemptive relief, whether on an omnibus / blanket basis or on a case by case basis, and to issue frequently asked questions (FAQs). We however think this alternative would be inappropriate considering the cost of exemptive relief and the immediate need to update the Instrument. As stated in this Notice, we are continuing to work on the framework for registrant regulation, and anticipate making further proposals to amend the Instrument.

7. Unpublished materials

In developing the proposed amendments, we have not relied on any significant unpublished study, report or other written materials.

8. Anticipated costs and benefits

The proposed amendments will make the Instrument clearer and the ongoing requirements more targeted, to the benefit of registrants and the investors they serve. The NRD Amendments will create efficiencies in the registration regime. We also anticipate that the proposed amendments will reduce the necessity to request exemptive relief.

Except where noted, the proposed amendments should not result in any additional costs to registrants. We are of the view that the reduced need for regulatory exemptions will result in reduced regulatory costs.

9. Request for comments

We would like your input on the Instrument and related amendments. We need to continue our open dialogue with all stakeholders if we are to achieve our regulatory objectives while balancing the interests of investors and registrants.

All comments will be posted on the Ontario Securities Commission website at www.osc.gov.on.ca and on the Autorité des marchés financiers website at www.lautorite.qc.ca.

All comments will be made publicly available.

Please note that we cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. In this context, you should be aware that some information which is personal to you, such as your e-mail and residential or business address, may appear in the websites. It is important that you state on whose behalf you are making the submission.

Thank you in advance for your comments.

Deadline for comments

Your comments must be submitted in writing by **September 30, 2010**.

Please send your comments electronically in Word, Windows format.

Where to send your comments

Please address your comments to all CSA members, as follows:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Registrar of Securities, Nunavut

Please send your comments **only** to the addresses below. Your comments will be forwarded to the remaining CSA member jurisdictions.

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Me Anne-Marie Beaudoin
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Fax : 514-864-6381
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Questions

Please refer your questions to any of:

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Surintendance de l'assistance à la clientèle, de l'indemnisation et de la distribution
Autorité des marchés financiers
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10. Where to find more information

We are publishing the proposed amendments with this Notice, as well as a blackline version of the Instrument, the NRD Amendments and the forms. The proposed amendments are also available on websites of CSA members, including:

www.lautorite.qc.ca
www.albertasecurities.com
www.bcsc.bc.ca
www.msc.gov.mb.ca
www.gov.ns.ca/nssc
www.nbsc-cvmnb.ca
www.sfsc.gov.sk.ca

June 25, 2010