British Columbia Securities Commission

P.O. Box 10142, Pacific Centre
701 West Georgia Street
Vancouver BC V7Y 1L2
Canada
Telephone: (604) 899-6500
Fax: (604) 899-6506
(BC only) 1-800-373-6393

BC Notice 2007/04

Request for Comment

Proposed National Instrument 31-103 *Registration Requirements*, Companion Policy 31-103CP *Registration Requirements,* related forms, and proposed BC Instrument 3*-5 *Registration Requirements***

In the attached notice, the Canadian Securities Administrators are publishing proposed National Instrument 31-103 *Registration Requirements* (national rule), Companion Policy 31-103CP *Registration Requirements* (CP), and proposed amendments to National Instrument 33-109 *Registration Information* (forms) for comment.

In this notice, the British Columbia Securities Commission (Commission) supplements the CSA notice. Under cover of this notice, the Commission is also publishing proposed BC Instrument 3*-5** *Registration Requirements* (local rule) and Appendix A *Proposed consequential amendments* for comment.

We suggest you first review the attached CSA Notice, which sets out in general terms the significant differences between today's registration regime and that proposed in the national rule. In this BC Notice, we provide British Columbia readers with a more detailed review of the changes from today's requirements in this province to those in the proposed national rule and local rules.

The CSA notice describes where you can send your comments and questions relating to the proposed national rule. All comments received **by June 20, 2007** will be considered. You should send your comments on the proposed local rule **by the same date**.

Although the CSA Notice indicates that Appendix B (Ontario consequential amendments) is attached, we did not attach it to this publication as it is irrelevant in British Columbia.

We invite comment on all aspects of the proposed national rule, the CP, the forms, and the local rule. In addition, we have asked specific questions in shaded boxes throughout this notice for your consideration.

Proposed NI 31-103 and the registration passport
The proposed national rule streamlines, harmonizes, and modernizes registration requirements. It is also the platform for a registration passport system for all registrants.

Most CSA jurisdictions are participating in the Council of Ministers of Securities Regulation. Under the Council's direction, securities regulators are working to create a passport system, which will allow a market participant to access the Canadian market by dealing with only one regulator and complying with laws that are highly harmonized. For registration, phase I of passport included the national registration system (National Instrument 31-101 *National Registration System* and National Policy 31-201 *National Registration System*) and the mobility exemption in Part 5 of National Instrument 11-101 *Principal Regulator System.*

We can further develop a passport for registration only if we succeed in making the requirements that apply to registrants significantly more harmonized. The proposed national instrument together with our proposed local rule would achieve this goal. The local rule's main purpose is to enact provisions, like the business trigger for registration and the duty to act fairly, honestly, and in good faith with clients, that are not in the national instrument because some other provinces have or will have them in statutes rather than rules. The combination of national instruments, local rules, and statutes would be substantively harmonized.

Business trigger for dealer registration
The national rule is built on the assumption that the requirement to register as a dealer is triggered when a person is *in the business of dealing in securities*. Some provinces plan to build this into their securities acts while others, including British Columbia, will implement it by a way of exemptions from the existing requirement to register for a trade. This is a technical, not a substantive, difference.[1]

The Commission chose to provide an exemption rather than seek a legislative amendment because this puts us in a better position to take corrective action if necessary. We have approximately 70 years of jurisprudence about what it means to "trade" in a "security". We cannot be certain how courts will interpret the term "in the business of dealing in securities." It would be easier to amend a rule than to obtain amendments to the Act if necessary to deal with an unexpected interpretation or application of this new term.

Capital raising and "safe" securities registration exemptions eliminated
The national rule and local rule set out all registration exemptions. Unlike today, the proposed registration exemptions do not include exemptions for capital raising and "safe" securities. This is a significant change everywhere but in Ontario and Newfoundland and Labrador. Registration relief in recent innovations like the offering memorandum and accredited investor exemptions (currently found in National Instrument 45-106

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[1] The local rule provides an exemption from the requirement to register for any person who is not in the business of dealing in securities. The definition of *dealing in securities* that will appear in the Securities Acts in some other CSA jurisdictions will appear in the local rule in British Columbia. This ensures that although we propose to take a different approach, the British Columbia registration requirement (or trigger) is substantively harmonized with the requirement in other CSA jurisdictions.

Prospectus and Registration Exemptions and introduced in Multilateral Instrument 45-103 *Prospectus and Registration Exemptions*) are eliminated. However, the prospectus relief will continue.

The effect of eliminating these registration exemptions is that those who sell prospectus-exempt securities and do not otherwise have a registration exemption must register as exempt market dealers. As there does not seem to be a market problem related to use of the current exemptions, the Commission is inclined not to participate in this part of the national rule.

We are concerned about what effect this part of the proposal will have on capital raising in British Columbia and about the costs that will be imposed on industry. Further, we are not persuaded that there is any reason to depart from our current policy approach as it recognizes that there are some investors who do not need the protection of either registration or the prospectus systems.

In the CSA Notice, you are encouraged to comment on whether the benefits of registering those that sell prospectus-exempt securities outweigh the costs of eliminating this registration relief. As we expect this part of the proposed national rule, if implemented, to have a significant impact in British Columbia, we strongly encourage you to comment on this part of the proposal.

Part 1 - Definitions and interpretation
Unlike today, the national rule defines "security" or "securities" as including both a security and an exchange contract (both as defined in the *Securities Act*). This definition is also in the local rule, so all requirements in both rules apply to dealing in securities and exchange contracts.

Part 2 - Categories
This table shows the relationship between our current registration categories and those in the national rule. One significant change in British Columbia is that today's limited dealer – exchange contracts dealers will need to register as investment dealers under the national rule. This means that they must become members of the Investment Dealers Association of Canada (IDA). This harmonizes the Commission's approach to regulating exchange contracts dealers with the approach in other CSA jurisdictions. The Commission and the IDA will work with British Columbia exchange contracts dealers to ensure a smooth transition.

The national rule does not include security issuer or securities adviser categories. However, the national rule adds exempt market dealer, investment fund manager, associate advising representative, ultimate designated person, and chief compliance officer registrations. (See CSA Notice for rationale behind these changes.)

Securities Rules (current)	Proposed national rule
Investment dealer	Investment dealer
Limited dealer – exchange contracts	Investment dealer
Limited dealer – mutual fund dealer	Mutual fund dealer
Limited dealer – security issuer	*No registration needed*
Limited dealer – real estate securities dealer	Restricted dealer
Limited dealer – scholarship plan dealer	Scholarship plan dealer
Special limited dealer	Restricted dealer
No registration needed	Exempt market dealer
Underwriter	Investment dealer
Adviser – portfolio manager	Adviser – portfolio manager OR Adviser – restricted portfolio manager
Adviser – investment counsel	Adviser
Adviser – securities adviser	*No registration needed*
No registration needed	Investment fund manager
Salesperson – registered representative	Dealing representative
Salesperson – investment adviser	Dealing representative
Trading partner, director or officer	Dealing representative
Advising employee	Advising representative
No registration available	Associate advising representative
No registration needed	Ultimate designated person
No registration needed	Chief compliance officer

Part 3 – SRO Membership
Part 3 of the national rule preserves our current exemption from the requirement to register as an adviser for investment dealers that follow IDA requirements for portfolio managers (section 86, Securities Rules; section 2.5, national rule).

Section 3.3 of the national rule also expands the number of exceptions for IDA and Mutual Fund Dealers Association of Canada (MFDA) members from securities legislation requirements if they comply with the requirements of their SROs dealing with the same subject matter. Section 3.3 further reduces, to the greatest extent possible, duplicative regulatory requirements.

Compliance policies and procedures
Today, IDA members and MFDA members are exempt from the requirement in section 44 of the Rules to keep prudent written business procedures if they follow their SROs' rules (section 46, Securities Rules). Under the national rule, the compliance requirements are written in an outcomes-based, principled way. IDA and MFDA members are not exempt from the outcomes-based requirement. We think it is appropriate that all registered firms be required to meet the compliance system outcomes

set out in section 5.26 of the national rule. The IDA and MFDA compliance system and supervision requirements supplement the requirements in the national rule.

Free credit balances and client subscriptions
The national rule eliminates the free credit balance and client subscription requirements (sections 57 and 58, Securities Rules), so it is unnecessary to exempt SRO members from these requirements as we do today (section 58.1, Securities Rules).

Suitability and know-your-client
Today, BC Instrument 32-502 *Exemption from suitability requirements* exempts IDA members from the know-your-client and suitability requirements in the Rules if they comply with the IDA's requirements on the same subject matter. The national rule preserves the suitability exemption for IDA members and expands it to MFDA members (section 3.3(h), national rule).

In the national rule, there are no exemptions from the know-your-client requirement. It is stated as a general principle (section 5.3). We think it is appropriate for all registrants to meet the know-your-client outcomes. IDA members that offer discount brokerage services, for example, must still conduct know-your-client assessments because they are gatekeepers to the securities markets.

Registrant ownership
Today, BC Instrument 33-508 *Exemption from sections 16 and 73 of the Securities Rules – Registrant Ownership* provides IDA and MFDA members with relief from registrant ownership disclosure requirements. The national rule eliminates the specific registrant ownership prohibition (section 16, Securities Rules) and the "early warning" requirement (section 73, Securities Rules). Instead, registered firm ownership is dealt with through more general disclosure requirements (section 6.7, national rule). It is unnecessary to provide relief as there is no longer any requirement.

Financial reporting
Today, BC Instruments 33-513 *Exemption from financial statement, capital and bonding requirements for MFDA members* and 33-515 *Exemption from financial statement, capital and bonding requirements for IDA members* provide relief if the mutual fund dealer or investment dealer complies with the MFDA or IDA requirements on the same subjects. This relief is continued in sections 3.3(a), (b), (c), (d), and (g) of the national rule.

Proficiency
Today, Blanket Order 33-502 *Registration Requirements for Members of the Investment Dealers Association of Canada* exempts IDA members from exam rewriting and conflicts disclosure requirements if they follow the IDA's similar requirements. The first exemption is no longer necessary as the national rule leaves all proficiency requirements to the IDA and MFDA for their members. The second exemption is eliminated. We think this is appropriate in the interests of harmonization.

Part 4 – Fit and proper requirements - Division 1 – Proficiency

Today, proficiency standards for BC applicants are set out in BC Policy 31-601 *Registration Requirements.* This policy will be repealed when the national rule comes into force.

The Executive Director will continue to have the legal obligation in section 35 of the *Securities Act* to consider in every case whether an applicant is suitable and not objectionable. The proficiency standards in the national rule communicate expected proficiencies for registration. However, the Executive Director must consider applicants with different proficiencies than those set out in the national rule.

Investment dealers – In British Columbia, the IDA is authorized to register investment dealers and their individual representatives. Under the national rule, applicants for dealer representative registration at IDA firms will still refer to IDA proficiency standards. The status quo is maintained.

Mutual fund dealers – Today, BC Policy 31-601 requires applicants for salesperson registration to complete the Canadian Securities Course, the Canadian Investment Funds Course, or the Investment Funds in Canada course. Under the national rule, applicants for registration as a mutual fund dealer representative will refer to MFDA proficiency standards.[2]

Today, BC Policy 31-601 requires applicants for compliance officer positions to have successfully completed specific courses, plus have five continuous years of relevant experience in the mutual fund industry, one year of which must have been as a manager. The national rule maintains the exam requirements but eliminates the experience requirement. We think this is appropriate for the sake of harmonization.

Scholarship plan dealers – Today, BC Policy 31-601 requires a scholarship plan dealer salesperson to pass the employer's in-house examination. The Sales Representative Proficiency Exam set by the RESP Dealers Association of Canada is also an acceptable standard. The national rule requires the Sales Representative Proficiency Exam. We think this is appropriate. The BC Policy 31-601 reference to an in-house exam pre-dates the RESP Dealers Association of Canada exam. The latter provides a consistent approach to examining proficiency of all scholarship plan dealing representative applicants.

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[2] Although the MFDA does not currently set proficiency standards, it is expected the MFDA will convert current requirements to exam-based requirements, but that the required exams will parallel those set out in the national rule for non-MFDA mutual fund dealers (section 4.3). Section 4.3 of the national rule essentially maintains the status quo, but adds the alternative that if an applicant has met the requirements to be a portfolio manager advising representative, that will also qualify the applicant for mutual fund dealing representative registration.

Today, BC Policy 31-601 requires a scholarship plan dealer compliance officer to meet the salesperson proficiency, plus pass the IFIC Officers, Partners and Directors exam, plus have four years relevant experience in the scholarship plan industry (or three years experience if one of them was as a manager). The national rule adds the Branch Manager Proficiency Exam but eliminates the experience requirement. We think this is appropriate in the interests of harmonization.

All dealers – Today, an applicant for registration as a salesperson is prohibited from acting as an officer or director of a reporting issuer (section 61, Securities Rules). This prohibition is eliminated in the national rule. However, Form 33-109F4 *Application for Registration of Individuals and Permitted Persons* requires that an applicant

- disclose this information (Item 10, Schedule G),
- identify any conflicts or client confusion issues, and
- describe how conflicts will be managed and confusion avoided.

Portfolio managers – The national rule reduces the requirements for applicants to be advising representatives. Currently, such applicants must have passed the CSI's Canadian Investment Management Program, plus the CSI's Derivatives Fundamentals Course, the CSI's Futures Licensing Course or the CFA Institute's Chartered Financial Analysts Course, plus have at least five continuous years of relevant experience in the advising industry, including three under the supervision of an advising employee managing at least $1 million in assets. The national rule only requires the CFA Charter and 12 months in the last 36 of investment management experience, or the CIM designation and 48 months of relevant experience, 12 of which must be in the 36 months preceding the application.

This eases the proficiency standard for advising representative applicants in British Columbia. We think it is appropriate because this will harmonize standards in all CSA jurisdictions.

Today, BC Policy 31-601 provides standards for applicants who will not be advising on forward contracts or commodity pools. Under the national rule, there are no standards set out for this kind of advising representative. However, if a registered adviser firm does not, in fact, advise on forward contracts or commodity pools it could apply for registration as a restricted portfolio manager. In that case, applicants to be advising representatives for such firms could work with the Commission's Registration Supervisor to work out what would be appropriate requirements.

Today, a compliance officer for a portfolio manager firm must have the same qualifications as an advising employee. The national rule provides more flexible proficiency standards for chief compliance officers. The standards allow the Commission to consider previous registration as an advising representative, professional qualifications, and a variety of combinations of securities industry exams and experience (section 4.11, national rule). We think this change is appropriate because it more closely reflects the flexibility we currently use when considering applicants for these positions.

All firms – Today, all firm applicants for registration must designate a compliance officer (section 65, Securities Rules). That requirement is maintained in the new registration regime. In many other CSA jurisdictions, we expect the requirement will be set out in the Securities Act. In British Columbia, the requirement is set out in local rule. The obligation to appoint a Chief Compliance Officer (CCO) goes to the firm's fitness and propriety for registration.

Today, a compliance officer must be a trading partner, director, or officer or an advising partner, director, or officer (BC Policy 31-601, section 6.1(a)). The national rule eliminates this requirement. We think that is appropriate because we have described the compliance officer's role by defining "chief compliance officer" in the national rule. The national rule sets proficiency standards for CCOs that match the proficiency standards for dealing or advising representatives.

Branch managers
Today, a firm must designate a branch manager and that branch manager must meet the Executive Director's proficiency standards (section 60, Securities Rules). In the national rule, there is no requirement to designate a branch manager and, therefore, no requirement that branch managers be proficient. However, in considering how to meet the outcomes-based compliance and supervision systems requirements, a registered firm is likely to consider whether designating qualified branch managers is an important way to achieve a firm-wide culture of compliance (section 5.26, national rule; related discussion in Companion Policy 31-103CP).

Residency
Today, applicants for firm registration must be incorporated or organized as a partnership under the laws of Canada, a province, or a territory (section 15, Securities Rules). The national rule eliminates this requirement. Non-resident registrants must meet some additional requirements (see discussion under Part 5, Division 8). We think this is appropriate. Whether an entity is registered in or extra-provincially into a Canadian jurisdiction is a corporate law concern and ought not to prevent an applicant from carrying on business as a dealer, adviser, or investment fund manager in British Columbia.

All individuals – Today, an applicant for registration as a salesperson or advising employee must have either been registered within the last three years or have passed required industry courses within the last three years. Under the national rule, an individual applicant must have passed the required exam within the last 36 months or, if it has been longer, been registered anywhere in Canada for 12 of the last 36 months or have gained relevant industry experience for 12 of the last 36 months (section 4.2, national rule). We think this change is appropriate because it gives applicants more flexibility and accounts for relevant industry experience.

Today, a salesperson is prohibited from working in part-time capacity. In the national rule, this prohibition is eliminated. Instead, we will continue to gather information in Form 33-109F4 *Application for Registration of Individuals and Permitted Persons* to identify any part-time work, any potential conflicts, and how the applicant's firm will manage the conflicts. We will consider all this information when deciding whether the individual applicant is suitable and not objectionable for registration. We think this change is appropriate because it closely reflects how we actually administer the rules today and it puts the onus on the firm and the individual, both, to manage any potential conflicts.

All applicants for registration
Today, the Executive Director may waive or vary registration or ongoing registrant requirements if it is not prejudicial to the public interest, and may add to them if it is in the public interest (section 17, Securities Rules). Before using this power, the Executive Director must first provide the applicant for registration or registrant with an opportunity to be heard. We have maintained this power in the local rule. This useful power allows the Executive Director, at the time of registration, to tailor the registration to the applicant without the need for the applicant to start a formal exemptive relief application process (either locally or through the MRRS for ERA system).

Today, a registration is annual (section 67, Securities Rules). In the national rule, this section is eliminated and registration is permanent. [See related discussions in this Notice about Part 7, Suspension and Revocation of Registration and discussion in attached CSA Notice.]

Today, the Executive Director is prohibited from registering, or renewing or reinstating registration, if a person's past conduct makes the Executive Director think the person's business will not be conducted with integrity or that the person's clients will not be dealt with fairly, honestly, and in good faith (section 13, *Securities Rules*). We have eliminated this prohibition in the national rule. The Executive Director has clear discretion to decide whether a person is suitable and not objectionable, so this extra provision is unnecessary.

Today, the Commission must provide a registrant with a summons for an examination under oath in the required form (section 18, *Securities Rules*). We have eliminated this requirement in the national rule. There is no need to impose this obligation on ourselves as the principles of administrative law and natural justice already apply. If the Commission issued an inappropriate summons, it would be subject to attack at any hearing.

Part 4 – Fit and Proper Requirements – Division 2 – Solvency
The following table shows how the national rule changes the requirements from today. Please refer to the earlier discussion about categories to see how today's categories migrate to the national rule categories.

Proposed category	Current capital required	Proposed capital requirement	Current bonding required	Proposed bonding requirement
Investment dealer	Set by IDA	Set by IDA	Set by IDA	Set by IDA
Mutual fund dealer	Set by MFDA	Set by MFDA	Set by MFDA	Set by MFDA
Scholarship Plan Dealer	$75,000 working capital + maximum deductible under bond	$50,000 excess working capital	$200,000 + certified resolution bonding adequate	Formula – see section 4.16
Restricted Dealer	$75,000 working capital + maximum deductible under bond	$50,000 excess working capital	$200,000 + certified resolution bonding adequate	Formula – see section 4.16
Exempt Market Dealer	Not registered today	$50,000 excess working capital	Not registered today	Formula – see section 4.16
Adviser	$25,000 working capital + maximum deductible under bond[3]	$25,000 excess working capital	$200,000 + certified resolution bonding adequate[4]	Formula or $50,000 (no client funds or assets) – see section 4.17
Restricted Adviser	$25,000 working capital + maximum deductible under bond	$25,000 excess working capital	$200,000 + certified resolution bonding adequate	Formula – see rule 4.17(2) or $50,000 (no client funds or assets)
Investment Fund Manager	Not registered today	$100,000 excess working capital	Not registered today	Formula – see section 4.18

Like today, registered firms must provide notice to the Commission when there is any change in, claim made under, or cancellation of required bonding (section 4.19, national rule).

[3] Today, an investment counsel firm that does not hold client funds or securities and is recognized by the Executive Director need only hold $5,000 working capital, plus the maximum deductible under the bond.

[4] Today, an investment counsel firm that does not hold client funds or securities and is permitted to hold $5,000 minimum working capital need only have coverage for fidelity, on-premises loss, and forgery or alteration. We understand, however, that the insurers that sell this bonding coverage will not sell it in this way – all of the financial institution bond coverage must be purchased at once.

Portfolio managers who also act as investment fund managers for prospectus-qualified or private funds must register as investment fund managers under the national rule. For those firms registered in both categories, the higher minimum capital requirement of $100,000 excess working capital (for an investment fund manager) must be met. The bonding coverage formulae for both categories is the same.

The Commission is not persuaded that investment fund managers need to maintain higher minimum capital than portfolio managers. We understand that it is standard practice for investment fund managers to contract with third party custodians to handle client funds and assets. We also understand that it is standard practice to contract net asset value calculations out to a third party. These two measures go a great distance to ensuring that risks to clients are managed.

Question: Given the risks associated with investment fund management and the regulatory goals of ensuring that clients of a registered firm are protected and the firm can meet its day-to-day business needs and wind up in an orderly fashion, is it appropriate to require all investment fund managers to maintain $100,000 excess working capital? Why or why not?

Part 4 – Fit and Proper Requirements – Division 3 – Financial Records

First financial statements

Today, all applicants for firm registration must deliver financial statements prepared not more than 90 days before and a calculation of positive risk adjusted capital or working capital, as the case may be (section 64, Securities Rules). This requirement is maintained in substance in the proposed Form 33-109F6 *Application for registration as a dealer, adviser, or investment fund manager.* In the proposed form, audited financial statements are required unless the firm is a start-up, in which case an opening balance sheet is required. If the statements are too old, we may well ask an applicant to provide more timely and relevant financial information.

Failing to cooperate with auditor

Today, a registrant is prohibited from withholding, destroying, or concealing information or records or otherwise failing to cooperate with a reasonable request made by a firm's auditor during an audit (section 71, Securities Rules). We maintain that prohibition in the national rule (section 4.26(2)).

Auditor appointment and instructions

The national rule imposes a positive obligation on registered firms to appoint an auditor. That auditor must be authorized to sign an auditor's report and that meets the professional standards of its jurisdiction. This requirement (section 4.20) replaces general requirements applying to registered firm issuers and other issuers (sections 2 and 3, Securities Rules).

Today, a registered firm must direct its auditor to carry out any audit required by the Commission (section 72, Securities Rules). We maintain and clarify that requirement in the national rule (section 4.21).

Ongoing financial reporting
Today, a registered dealer firm must deliver audited annual financial statements and calculations or positive risk adjusted capital or working capital, as the case may be, within 90 days of year end and within 30 days of each quarter (69, Securities Rules). We have maintained that requirement in the national rule, but without the prescriptive requirements for directors or partners to approve these reports (section 4.22).

Today, most registered dealers must file a Joint Regulatory Questionnaire and Report annually (section 70, Securities Rules). We eliminated that requirement in the national rule, but investment dealers and mutual fund dealers must still meet all financial filing requirements set by their SROs.

Today, registered adviser firms must deliver audited annual financial statements within 90 days of year end (section 69, Securities Rules). We have maintained this requirement in the national rule and added a requirement to deliver annual calculations of excess working capital (section 4.23, national rule). We think this is a reasonable addition to a registered adviser's regulatory burden because it provides information to us about how that registered adviser is managing its capital adequacy requirement and parallels the requirements for dealers.

Financial reporting for investment fund managers
The national rule imposes financial reporting requirements on investment fund managers (section 4.24(1)). These include the standard requirements for audited annual financial statements and a calculation of excess working capital to be provided within 90 days of year end. However, an investment fund manager must also provide a description of any net asset value adjustment made during the fiscal year. These same reports, with the exception that financial statements need not be audited, must be provided within 30 days of each quarter, too (section 4.24(2)).

We think these requirements are reasonable. The net asset value calculation requirement provides us with information about potential risk to the solvency of the fund.

Changes in year end
The national rule adds a requirement that when a registered firm changes its year end, it must notify us as soon as practicable of the new year end, the prior year end, and the reason for the change (section 4.25). We think this additional requirement is reasonable because it allows us to judge whether the change is cosmetic or substantive. Cosmetic changes may signal risk to the firm's solvency.

Financial reporting standards
Today, a registered firm's financial statements must be prepared in accordance with GAAP and GAAS (sections 3(3) and 3(6), Securities Rules; National Instrument 52-107

Acceptable Accounting Principles, Auditing Standards and Reporting Currency). In the national rule, those requirements are continued (section 4.26(1)).

The national rule prescribes the contents of a registered firm's financial statements (section 4.27). This is a new requirement. We think it is appropriate to specify the content in the interests of harmonization.

Part 5 – Conduct Rules – Division 1 – Account opening and know-your-client
In the national rule, the know-your-client (KYC) and suitability obligations found in today's rules (section 48, Securities Rules) are maintained and enhanced (sections 5.3 and 5.4, national rule). The connection between gathering personal and financial information about a client is clarified.

The national rule requires a registrant to make reasonable efforts to keep KYC information current. This is consistent with what we expect today.

Today, the KYC and suitability obligations are expressed together in one rule. In the national rule, these obligations are separated out into two rules for better clarity. The suitability requirement now sets out the criteria a registrant must consider when assessing suitability (today, we simply require that the registrant assess suitability, without listing the relevant criteria). We think these criteria reflect our current expectations for making suitability assessments.

In the national rule, if a client insists on making a trade that the registrant thinks is unsuitable, the registrant must not execute the trade without first informing the client of that opinion (section 5.4(2)). Today, the registrant need only make a reasonable effort to provide the client with that opinion (section 48, Securities Rules). We think the absolute obligation in the national rule is appropriate. We can think of no circumstances that would justify a registrant not communicating an opinion that a trade is unsuitable. If a registrant is concerned about how to communicate with a client, the registrant and client can agree on a standard method of communication as part of their contractual relationship.

Exemption from KYC and suitability
Today, we provide an exemption from the KYC and suitability obligations for trades instructed by another registrant or financial institution (section 48(3), Securities Rules). We maintain this exemption in the national rule (section 5.5). These clients are sophisticated and can reasonably be expected to bear the consequences of their investment decisions.

Part 5 – Conduct rules – Division 2 – Relationship disclosure
Exchange contracts
Today, a registered firm proposing to trade an exchange contract on behalf of a client must explain the nature of the exchange contract to the client and make a copy of it available to the client (section 49, Securities Rules). We have eliminated that requirement in the national rule.

Instead, the relationship disclosure document mandated by the national rule (section 5.10) is intended to ensure that this type of disclosure is made to clients in a timely way. It is difficult to imagine how a registrant could properly communicate a suitability assessment to a client, or carry out the obligation to act fairly, honestly, and in good faith with the client, without communicating the nature of the proposed trade to the client.

Responding to client requests
Today, a registrant must provide certain information to a client on request (including financial statements, proficiency information, and lists of partners, directors, and officers) (section 50, Securities Rules). We eliminated this requirement in the national rule. We did, however, maintain the requirements to provide financial statement and proficiency information on request in the local rule. This will ensure that information that is not available on our website, but is important to a client, will still be available.

Contingency fees
Today, a registrant is prohibited from charging a contingent fee without the client's consent (Securities Rules, s. 54). We eliminated this prohibition in the national rule. Instead, the relationship disclosure document that must be provided to a client before providing services requires that all fees and charges be disclosed to a client (section 5.12(1)(h)).

Plain language
A new requirement is that the disclosure must be in plain language (section 5.11). Between this relationship disclosure and the obligation to deal fairly, honestly, and in good faith with a client (local rule), we are confident that a registrant has a clear duty to communicate clearly to a client the nature of fees and charges that will be made, including any proposal to charge a contingent fee.

Communicating separate identities of financial institutions and related registered firms
The national rule preserves the requirement (currently found in Part 6, National Instrument 33-102 *Regulation of Certain Registrant Activities*) that registered firms conducting securities related activities in a Canadian financial institution or Schedule III bank provide retail clients with disclosure about the separate identities of the registered firm and the financial institution or Schedule III bank.

Leverage disclosure
Today's leverage disclosure requirements in National Instrument 33-102 *Regulation of Certain Registrant Activities* are continued in the national rule (section 5.6). The requirements for disclosure of confidential retail client information in NI 33-102 are eliminated in the national rule because private sector privacy legislation, SRO requirements, and the duty to act honestly, fairly, and in good faith provide a good framework already for how registrants handle confidential client information.

Part 5 – Conduct rules – Division 3 – Client assets

Today, we impose requirements on registrants when they are handling

- unencumbered securities held under a safekeeping agreement (section 55, Securities Rules)
- unencumbered securities that are not held under a safekeeping agreement (section 56, Securities Rules)
- clients' free credit balances (section 57, Securities Rules)
- clients' subscriptions or prepayments (section 58, Securities Rules)

The basic theme running through these requirements is the importance of holding a client's assets separate from those of the registrant and of other clients, and of being able to clearly account for dealings with those assets. The issue of offsetting client debts owed to the registrant against those assets is also covered in today's requirements. Finally, in the case of free credit balances or subscriptions and prepayments, interest must accrue to the credit of the client.

In the national rule, we have maintained, enhanced, and made more generally applicable these same requirements (sections 5.13, 5.14, 5.15, 5.16). The basic requirement to segregate, account separately, and have interest accrue to the client applies to client property or cash, not just free credit balances and subscriptions and prepayments (section 5.13). The national rule adds some prescription by requiring that client cash be held in certain financial institutions (section 5.13(2)). We think this is appropriate in the interest of harmonizing the rules across CSA jurisdictions.

Free credit balance and client subscription exemptions

In the national rule, we maintained today's exemption from the free credit balance and subscription and prepayment requirements for SRO members that comply with their SROs' similar requirements (section 58.1, Securities Rules; section 3.3(k), national rule).

In the national rule, we eliminated the current exemption from the free credit balance and subscription and prepayment requirements if National Instrument 81-102 *Mutual Funds* applies (section 58.2, Securities Rules). We think it is unnecessary. The NI 81-102 requirements are particular, and the national rule requirements are general, so the more particular requirements must be followed.

Margin rules

Today, dealers must follow an exchange's margin rules for purchases and sales of exchange contracts (section 59, Securities Rules). We eliminated this requirement in the national rule. It is unnecessary to require dealers to follow rules they must already follow.

Part 5 – Conduct rules – Division 4 – Record keeping

The CSA Notice explains these changes.

Part 5 – Conduct rules – Division 5 – Account activity reporting

Trade confirmations

All of our current requirements for trade confirmations (sections 36 and 37, Securities Rules) are also found in the national rule (sections 5.21 to 5.24). In addition, the national rule requires that confirmations set out the settlement date. Although our current requirements apply to purchases and sales, the national rule applies to trades. A "trade" includes the receipt of an order to purchase or sell a security or exchange contract, so the substantive application of the section has not changed.

Exchange contracts

Today, a trade confirmation for an exchange contract must set out a number of specific pieces of information that are different from information required for securities, and sets out specific requirements for how off-setting transactions are described (sections 36(3) to (5)). We maintained those requirements in the local rule. They are not in the national rule because not every CSA jurisdiction's Securities Act covers exchange contracts as well as securities.

Mutual funds

Unlike our current requirements, the national rule does not separate trade confirmation requirements for mutual fund purchases and sales from other trade confirmation requirements. Instead, the mutual fund requirements are part of the general trade confirmation rule (section 5.21, national rule). Our current requirements for contractual plans are unnecessary in the national rule as contractual plans are now prohibited and have been for some time.

Automatic withdrawal plans

We have maintained the semi-annual trade confirmation requirement for clients that participate in automatic withdrawal plan in the national rule (section 37(7), Securities Rules; section 5.23, national rule). We have expanded the provision to include scholarship plans, educational plans, and educational trusts. The national rule also sets an additional requirement that a registered dealer with notice from a client of participation in an automatic plan must send the first of these semi-annual confirmations promptly (section 5.23(c)).

Statements of account

Today, dealers must send a statement of account to a client at the end of every month in which there has been a transaction, and at least every three months even if there have been no transactions (section 38, Securities Rules). Under the national rule, dealers must send a statement of account at least every three months (5.25(1)). We think this is appropriate because clients get trade confirmations after each trade is made and, we suspect, many do not need monthly reporting. Clients can always request more frequent reporting if they desire it.

We eliminated the prescriptive requirements for the content of statements of account found in today's rules from the national rule.

Exemption from statement of account requirements
However, the national rule will no longer provide exemptions from the requirement to send statements of account when

- there have been no transactions for four consecutive quarters,
- the client is not requesting statements, and
- the dealer sends an annual statement for the five years following (section 38(4)).

Question: Should the registration regime continue to include this limited exemption from the requirement to send statements of account? Why or why not?

Other changes to account activity reporting requirements are set out in the CSA Notice.

Part 5 – Conduct rules – Division 6 – Compliance
Today's requirement that dealers and advisers establish and apply prudent business procedures for dealing with clients in compliance with securities legislation is maintained and enhanced in the national rule (section 44, Securities Rules). Today, we require compliance and underwriting due diligence. Under the national rule, registered firms must establish, maintain, and enforce a system of controls and supervision to achieve compliance with securities legislation and manage the risks of its business prudently (documented by written policies and procedures) (section 5.26).

Today, a registered portfolio manager must separately supervise each client account distinct from the others (section 51, Securities Rules). We eliminated this requirement in the national rule. We think that is appropriate because the outcomes-based compliance and supervision systems sets out high standards for supervision.

Today, when the ownership or control of an adviser firm materially changes, the adviser firm must provide a client with notice of the change, reasons for it, and particular disclosure if the adviser firm proposes to assign the client's account to another (section 52, Securities Rules). We eliminated this requirement in the national rule. We think this is appropriate in the interests of harmonization.

The national rule introduces new requirements for CCOs and registered firms. CCOs must report directly to the board as necessary and, at a minimum, annually about the registered firm's compliance (section 5.27, national rule). Registered firms must permit their CCOs and UDPs direct access to the board whenever they think that is necessary or advisable in view of their responsibilities (section 5.28, national rule).

The Commission is not persuaded that requiring these positions to register will improve a firm's culture of compliance. In large organizations, these registration requirements could have the unintended effect of focusing responsibility for compliance on two people instead of emphasizing that compliance is a shared responsibility. In small firms, especially sole proprietorships, these additional registrations may not be meaningful at all.

We strongly encourage you to respond to the questions we set out about this part of the proposal in the CSA Notice.

We think these requirements will ensure the independence and effectiveness of the CCO and UDP functions.

Part 5 – Conduct rules – Division 7 – Complaint handling
The CSA Notice discusses these new requirements. However, it is worth noting that registered firms that are IDA or MFDA members are required today to comply with SRO complaint handling requirements. These are really only new requirements for portfolio managers, restricted dealers, and investment fund managers.

Part 5 – Conduct rules – Division 8 – Non-resident registrants
The CSA Notice discusses these new requirements.

Part 6 – Conflicts
Outcomes-based approach
In the national rule, the biggest change from current rules is that the conflicts requirements open with an outcomes-based obligation to identify and manage potential and actual conflicts (section 6.1, national rule). Today, all of our conflicts requirements are directed at very specific conflicts situations and prescribe very specific ways of dealing with each kind of conflict.

We think that the outcomes-based general conflicts management requirement in the national rule holds registrants to a higher standard. It will be impossible to claim that a registrant has no obligation to do anything about a conflict or potential conflict because it was not described in the conflicts rules.

The CSA Notice highlights the fact that many of our current conflicts provisions have been eliminated. This notice discusses, in more detail, those that remain and how they have been changed, and those that have been eliminated.

Registrants owing interests in other registrants
Today, registrants and unregistered partners, directors, and officers must get permission from the Executive Director before having an interest in an unrelated, arm's length registered firm (section 73, Securities Rules). We eliminated this prohibition in the national rule.

Instead, the national rule requires a person (not just a registrant) to give the Commission at least 30 days' notice before a person acquires ownership, control or direction over 10% of a registered firm's securities and any increase afterward of more than 5%. This will give us enough time to consider whether the proposed acquisition is likely to raise conflicts of interest or hinder a registrant's ability to comply, will compromise investor protection, or is otherwise prejudicial to the public interest. The Commission can give the person a notice of objection and, if we do, the acquisition cannot happen until we approve it. Finally, the person affected may request a hearing. These requirements do not apply if

the registered firm acquires these securities in the ordinary course of its business of dealing in securities. (Section 6.7, national rule)

We think this approach is appropriate. We have shifted the focus from prohibiting a narrow range of ownership scenarios to putting the onus on the firm to show that conflicts and other regulatory concerns are handled appropriately.

Section 6.7 of the national rule also replaces today's requirement that registrants provide the Commission with notice when they know about others who are acquiring significant interests in a registered firm (section 73, Securities Rules).

Conducting other business

Today, a registrant must notify the Commission when it proposes to carry on another business (section 74, Securities Rules). We eliminated this requirement in the national rule. Instead, a registered firm must identify each potential and actual conflict and deal with it in a fair, equitable, and transparent way and exercise reasonable business judgment influenced only by the best interests of clients (section 6.1, national rule). Proposed Form 31-103F6 *Application for registration as a dealer, adviser or investment fund manager* also requires that a firm disclose the nature of its business (Item D-1). NI 33-109 *Registration Information* requires that a registrant provide notice of changes to registration information within 5 days of making that change (Parts 3 and 4).

We think it is appropriate to eliminate section 74 of the current Securities Rules because we already have a requirement (in NI 33-109) that we get notice of this information. Further, we think it is appropriate that registrants meet a higher standard under the national rule. Rather than wait for our approval of this kind of proposal, the registrant must, instead, actively manage the conflicts that arise from it.

Referral arrangements

Today's referral arrangements requirements (section 53, Securities Rules) are replaced by the requirements in the national rule (sections 6.11 to 6.14, national rule). The CSA Notice discusses these new rules.

Today, the Executive Director has a specific power to vary the provisions in Division 11 of Part 5 of the Securities Rules (section 76). We eliminated this power in the national rule. However, the local rule preserves the Executive Director's general power to waive, vary, or add requirements to the registration requirements. We think the local rule provision adequately preserves this power.

Conflicts of interest statement

Today, every registrant must file and provide to clients a conflicts of interest statement in the required form (section 77, Securities Rules). They have an alternative means of complying with section 77 set out in BC Instrument 32-504 *Registrant Disclosure of Conflicts of Interest.* These requirements are eliminated.

Selling securities of connected issuers
Under the national rule, registrants acting in a deal involving securities of a connected issuer must provide conflicts disclosure to the client (section 6.4, national rule). In addition, registrants must provide clients with a copy of policies and procedures for fair allocation of investment opportunities (section 6.6, national rule).

Today, we place limitations on acting as a dealer or adviser when trading securities of a related issuer and impose related issuer disclosure requirements (sections 79 to 81, Securities Rules). We replaced these requirements in the national rule with issuer disclosure statement requirements (section 6.4, national rule - see discussion, above).

Fully managed accounts
Today, we prohibit certain related party transactions in fully managed accounts (section 82, Securities Rules). We maintained these prohibitions in the national rule (section 6.2). The prohibition in the national rule is broader, but, like today, allows for client consent after full disclosure for agency-based securities transactions. Like today, principal-based securities transactions and loans and guarantees are completely prohibited.

Research reports and recommendations
In the national rule, we maintained and simplified our current limitations on research reports and recommendations (section 83, Securities Rules; section 6.5, national rule). Instead of prescribing the content of disclosure to clients, the national rule requires that registrants have policies and procedures for making recommendations about related party, connected party, or its own securities and follow them.

The national rule requires that a registered dealing, advising, or associate advising representative must comply with both the national rule's conflict requirements and those in National Instrument 33-105 *Underwriting Conflicts* when acting on behalf of a registered firm in a transaction (section 6.8). We think it is appropriate to clarify that both the specific and general requirements apply in these circumstances.

Tied selling
In the national rule (section 6.10), we maintained today's prohibition on tied selling (section 4.1, National Instrument 33-102 *Regulation of Certain Registrant Activities*).

Part 7 – Suspension and revocation of registration
The information-sharing requirement imposed on an individual's former registered firm is an important support for the permanent registration system (see discussion below).

Part 8 – Information sharing
This new requirement helps minimize some of the risks associated with permanent registration and automatic reinstatement. This requirement also provides a former registered firm with a qualified privilege defence if an aggrieved individual chooses to make a claim for libel.

Part 9 – Exemptions from registration

The only registration exemptions proposed for the new registration regime are those in

- Part 9 of the national rule, and
- the exemption from the requirement to register as a dealer for those not "in the business" of dealing in securities in the local rule.

Most of the registration relief in National Instrument 45-106 *Prospectus and Registration Exemptions* will be repealed and the instrument re-named. In addition, all of the British Columbia specific registration exemptions will also be repealed. These include

- BCI 32-505 *Exemption for Mutual Fund Dealer to Sell Securities of Certain Employee Venture Capital Corporations and Venture Capital Corporations*
- BCI 45-511 *Trades of Government Warrants*
- BCI 45-512 *Real Estate Securities*
- BCI 45-513 *Resale Relief for Eligible Real Estate Securities*
- BCI 45-514 *The Employee Investment Act*
- BCI 45-524 *Registration and Prospectus Exemption for Certain Capital Accumulation Plans* (and the instrument would be re-named)

We maintained the registration relief for trades in distribution reinvestment (DRIP) plans (BCI 45-525 – *Exemption for Distribution Reinvestment Plans*) in section 9.10 of the national rule (and expanded to cover all employer plans to enable employees to acquire securities).

As the CSA Notice notes, the list of investors an international dealer or adviser can serve under sections 9.13 and 9.14 of the national rule is narrower than the list of investors used when we grant discretionary relief. In general, retail accredited investors are not on the list. The rationale for structuring the exemptions this way is that retail accredited investors truly need the protection of the registration system.

Comments

The CSA notice describes where you can direct your comments and questions relating to the proposed instrument. All comments received by **June 20, 2007** will be considered.

February 20, 2007

Douglas M. Hyndman
Chair

Ref: National Instrument 31-103 *Registration Requirements*
Companion Policy 31-103CP *Registration Requirements*

Form 31-103F1 *Notice of Termination*
Form 31-103F4 *Application for Registration of Individuals and Permitted Individuals*
Form 31-103F6 *Application for registration as a dealer, adviser or investment fund manager for securities and/or derivatives*
BC Instrument 3*-5** *Registration Requirements*
Appendix A Consequential amendments related to proposed National Instrument 31-103 *Registration Requirements*

This Notice may refer to other documents. These documents can be found at the B.C. Securities Commission public website at www.bcsc.bc.ca in the section Securities Law & Policy: Policies & Instruments.

Appendix A to BC Notice 2007/04

Consequential amendments related to proposed National Instrument 31-103 *Registration Requirements*

- *Securities Rules,* sections 1, 2 and 3, Part 5, Part 6, section 92, Part 12
- BC Instrument 31-503 *Exchange Contracts Dealers Trading in Commodity Pool Certificates*
- BC Policy 31-601 *Registration Requirements*
- BC Interpretive Note 31-701 *Advising Under the Securities Act*
- BC Interpretive Note 31-702 *Web Posted Notice Confirming Registration*
- BC Form 31-901F *Application for Registration as a Dealer, Adviser, or Underwriter*
- BC Instrument 32-502 *Exemption from Suitability Requirements*
- BC Instrument 32-503 *Registration Exemption for Salespersons Corporations*[5]
- BC Instrument 32-504 *Registrant Disclosure of Conflicts of Interest*
- BC Instrument 32-505 *Exemption for Mutual Fund Dealers to Sell Securities of Certain Employee Venture Capital Corporations and Venture Capital Corporations*
- BC Instrument 33-502 *Registration Requirements for Members of the Investment Fund Dealers Association of Canada*
- BC Instrument 33-504 *Exemption from section 80(2) of the Securities Rules Confirmation and Reporting of Transactions*
- BC Instrument 33-506 *Exemptions from Cold Calling Restrictions for Registered Dealers*
- BC Instrument 33-508 *Exemption from Sections 16 and 73 of the Securities Rules – Registrant Ownership*
- BC Instrument 33-513 *Exemption from Financial Statement, Capital and Bonding Requirements for MFDA Members*
- BC Instrument 33-514 *Exemption from Capital, Bonding an Financial Reporting Requirements for Certain Portfolio Managers and Investment Counsel*
- BC Instrument 33-515 *Exemption from Financial Statement, Capital and Bonding Requirements for IDA Members*
- BC Interpretive Note 33-701 *Trading by Limited Dealers under Prospectus and Registration Exemptions*
- BC Interpretive Note 33-702 *Powers of Attorney and Trading Authorities*
- BC Interpretive Note *33-702 Dealers and their Salespersons*
- BC Form 33-902F *Joint Regulatory Financial Questionnaire and Report*
- BC Form 33-903F *Report of Risk Adjusted Capital*
- BC Form 33-904F *Subordination Agreement*

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[5] This publication does not include any rules or guidance on salespersons corporations, but the CSA's Registration Reform Working Group hopes to have a proposal for regulating these entities before the second publication of the national rule.

- BC Form 33-905F *Report of Working Capital*
- BC Form 33-906F *Statement of Financial Condition (Audited)*
- BC Form 33-907F *Conflict of Interest and Rules Statement*
- BC Form 33-908F *Statement and Undertaking*
- BC Form 34-901F *Summons for Examination Under s. 38(c)*
- BC Instrument 35-501 *Remote Exchange Trades on Canadian Venture Exchange*
- BC Form 35-901F *Additional Information from Out-of-Province Registrants*
- BC Instrument 45-504 *Trades to Trust Companies, Insurers and Portfolio Managers Outside BC*
- BC Instrument 45-510 *Trades in Self-Directed Registered Educational Savings Plans*
- BC Instrument 45-511 *Trades of Government Warrants*
- BC Instrument 45-512 *Real Estate Securities*
- BC Instrument 45-513 *Resale Relief for Eligible Real Estate Securities*
- BC Instrument 45-514 *The Employee Investment Act*
- BC Instrument 72-503 *Distribution of Securities Outside BC*
- BC Instrument 72-504 *Distribution of Eurobonds*
- BC Instrument 91-501 *Over-the-Counter Derivatives*
- BC Instrument 91-502 *Short Term Foreign Exchange Transactions*
- BC Instrument 91-503 *Contracts Providing for Physical Delivery of Commodities*
- BC Instrument 91-504 *Government Strip Bonds*