

## **APPENDIX E**

### **Analysis of Firm-Only Registration**

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### **1. The Registration Requirement**

#### **(a) Firm-only registration**

The Draft Legislation requires only the firm, and not the firm's representatives, to register before trading in securities. This approach differs from the current legislation, which requires both individuals and firms to register to trade or advise.

The firm-only registration system in the Draft Legislation maintains the integrity of the current registration system, but through alternative means. The Commission retains appropriate compliance and enforcement powers, but the ultimate responsibility for the conduct of representatives rests where it should — with the registered firm. The system preserves market integrity without the extremely high regulatory costs and burdens associated with the requirement to register individuals, and removes the risk that firms, investors, or clients take false comfort in the registration requirement (discussed below).

Requiring individual registration is costly and cumbersome for industry. We examined the objectives of the individual registration requirement and concluded that these objectives could be met in other ways. The objectives we identified are:

- Stop unsuitable individuals from becoming representatives at the outset.
- Monitor representatives when they change firms.
- Deal effectively with representatives who contravene the legislation or act contrary to the public interest.
- Make information about representatives available to the public.

An interesting issue when considering a firm-only registration system is the recently completed National Registration Database system (NRD) that became operational on March 31, 2003. NRD is a system designed to do one thing: register individuals. A cost-benefit study was done when NRD was being developed that showed it would confer significant benefits on industry. Some of those commenting on our June proposals said that even though NRD would benefit them, they believed a firm-only registration system would confer even greater benefits. As noted above, we are doing a regulatory impact and cost-benefit analysis of the firm-only registration system, and the base case for that study will reflect the current NRD environment.

#### ***Stopping unsuitable individuals***

The Draft Legislation shifts the responsibility for keeping unsuitable representatives out of the securities industry from the Commission to the registered firms. Under the Draft

Legislation, the Code of Conduct (see below) imposes an obligation on firms to hire only those representatives who are suitable, and to ensure that they are properly supervised. The Code maintains and enhances the ethical obligations expected of those working in the industry and applies to both registered firms and their representatives.

Because the directors and officers of a firm shape the firm's overall compliance culture, the Draft Legislation requires personal information from these individuals.

Firms are responsible to regulators for the conduct of their representatives, and the firm, and its directors and officers, face civil liability if a representative commits a material contravention of the legislation (see Part 15). Under this regime, firms are likely to be vigilant about those whom they hire.

This approach also makes it clear where the responsibility lies. There have been occasions when firms, in cases of a representative's misconduct, have attempted to shift at least part of the blame to the Commission, since it currently has the responsibility to screen applicants and to admit them to the industry. The involvement of the Commission in the registration process creates in some firms and investors a "seal of approval" perception. This is inappropriate, and creates a false sense of security. It is much more likely that both firms and investors will be inclined to look after their own best interests if they are not under the false impression that the Commission is doing it for them.

Firm-only registration also allows firms to make whatever arrangements they wish with representatives who wish to be "employed" through a corporation or partnership for tax purposes (see definition of *representative* in Part 1). Under the Draft Legislation, firms are responsible for those who work for them, be they employees or independent contractors in corporate form.

### ***Monitoring representatives when they change firms***

Under the current legislation, firms must file a uniform termination notice (UTN) when a representative leaves the employment of a firm. The UTN gives the Commission notice that the representative has left, and requires the firm to give detailed reasons for the employee's departure. The filing of this form triggers a review of the representative's file by Commission staff, and sometimes leads to compliance measures being taken.

Under the Draft Legislation, UTNs would no longer be filed with the Commission. Firms will be responsible for those whom they hire, whether the representative is new to the industry or coming from another firm. In fact, the hiring decision about someone coming from another firm is likely to be easier, because the Draft Legislation requires that the former firm provide the hiring firm with all of the information that the former firm has about the representative that would reasonably be considered relevant to the hiring decision. The former firm is protected against defamation suits brought by a representative through a common law qualified privilege defence. The defence arises because the obligation to disclose the information is imposed by statute. The Draft

Legislation also overrides private sector personal information protection laws for this purpose. These private sector privacy laws are expected to be in force by January 2004.

### ***Effective enforcement powers***

The Commission's current power to suspend, revoke or attach conditions to registration, as it applies to individual registrants, is replaced in the Draft Legislation by new powers that allow the Commission to prohibit any person from being a representative, either temporarily or permanently, or to restrict a person to being a representative only on terms and conditions. Under the current legislation, Commission staff has the authority to impose conditions and restrictions on a registrant. This is continued for registered firms under the Draft Legislation, and includes the right to impose conditions and restrictions relating to representatives.

### ***Public access to information***

In today's regime, the public can get information from the Commission by phone and over the internet about registered individuals. They can find out if the individual they are dealing with is registered, and if so, some details about the individual's registration history. Under the Draft Legislation, a firm must keep a publicly accessible current list of its representatives on its website. This will allow the public to confirm that the individual they are dealing with is a representative of the firm, and has the added benefit of focusing the investor or client on the firm, rather than the Commission, as the entity responsible for overseeing the representative.