

**Companion Policy 31-103CP**  
**Registration Requirements and Exemptions**

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## **Part 1 Definitions and fundamental concepts**

### **1.1 Introduction**

This Companion Policy sets out how the Canadian Securities Administrators (the CSA or we) interpret or apply the provisions of National Instrument 31-103 *Registration Requirements and Exemptions* (NI 31-103) and related securities legislation.

Except for Part 1, the numbering of Parts, Divisions and sections in this Companion Policy correspond to the numbering in NI 31-103. Any general guidance for a Part or a Division appears immediately after the Part or Division name. Any specific guidance on sections in NI 31-103 follows any general guidance. If there is no guidance for a Part, Division or section, the numbering in this Companion Policy will skip to the next provision that does have guidance.

All references in this Companion Policy to sections, Parts and Divisions are to NI 31-103, unless otherwise noted.

For additional requirements that may apply to them, registrants should refer to:

- National Instrument 31-102 *National Registration Database* (NI 31-102) and the Companion Policy to NI 31-102
- National Instrument 33-109 *Registration Information* (NI 33-109) and the Companion Policy to NI 33-109
- National Policy 11-204 *Process for Registration in Multiple Jurisdictions* (NP 11-204), and
- securities legislation in their jurisdiction

Registrants that are members of a self-regulatory organization (SRO) must also comply with their SRO's requirements.

#### **Delivering disclosure and notices**

Registrants must deliver all disclosure and notices required under NI 31-103 to the registrant's principal regulator, except for notices under sections:

- 8.18 *International dealer*
- 8.26 *International adviser*
- 11.9 *Registrant acquiring a registered firm's securities or assets*, and
- 11.10 *Registered firm whose securities are acquired*

Registrants must deliver these notices to the regulator in each jurisdiction where they are registered.

These documents may be delivered electronically. Registrants should refer to National Policy 11-201 *Delivery of Documents by Electronic Means* and, in Québec, Notice 11-201 *Delivery of Documents by Electronic Means*.

See Appendix A for contact information for each regulator.

### **1.2 Definitions**

Unless defined in NI 31-103, terms used in NI 31-103 and in this Companion Policy have the meaning given to them in the securities legislation of each jurisdiction or in National Instrument 14-101 *Definitions*. See Appendix B for a list of some terms that are not defined in NI 31-103 or this Companion Policy but are defined in other securities legislation.

In this Companion Policy, "regulator" means the regulator or securities regulatory authority in a jurisdiction.

#### **Permitted client**

The following discussion provides guidance on the term "permitted client", which is defined in section 1.1 of NI 31-103.

"Permitted client" is used in the following sections:

- 8.18 *International dealer*
- 8.26 *International adviser*

- 13.2 *Know your client*
- 13.3 *Suitability*
- 13.13 *Disclosure when recommending the use of borrowed money*
- 14.2 *Relationship disclosure information, and*
- 14.4 *When the firm has a relationship with a financial institution*

***Exemptions from registration when dealing with permitted clients***

NI 31-103 exempts international dealers and international advisers from the registration requirement if they deal with certain permitted clients and meet certain other conditions.

***Exemptions from other requirements when dealing with permitted clients***

Under section 13.3, permitted clients may waive their right to have a registrant determine that a trade is suitable. In order to rely on this exemption, the registrant must determine that a client is a permitted client at the time the client waives their right to suitability.

Under sections 13.13, 14.2 and 14.4, registrants do not have to provide certain disclosures to permitted clients. In order to rely on these exemptions, registrants must determine that a client is a permitted client at the time the client opens an account.

***Determining assets***

The definition of permitted client includes monetary thresholds based on the value of the client's assets. The monetary thresholds in paragraphs (o) and (q) of the definition are intended to create "bright-line" standards. Investors who do not satisfy these thresholds do not qualify as permitted clients under the applicable paragraph.

***Paragraph (o) of the definition***

Paragraph (o) refers to an individual who beneficially owns financial assets with an aggregate realizable value that exceeds \$5 million, before taxes but net of any related liabilities.

In general, determining whether financial assets are beneficially owned by an individual should be straightforward. However, this determination may be more difficult if financial assets are held in a trust or in other types of investment vehicles for the benefit of an individual.

Factors indicating beneficial ownership of financial assets include:

- possession of evidence of ownership of the financial asset
- entitlement to receive any income generated by the financial asset
- risk of loss of the value of the financial asset, and
- the ability to dispose of the financial asset or otherwise deal with it as the individual sees fit

For example, securities held in a self-directed RRSP for the sole benefit of an individual are beneficially owned by that individual. Securities held in a group RRSP are not beneficially owned if the individual cannot acquire and deal with the securities directly.

"Financial assets" is defined in section 1.1 of National Instrument 45-106 *Prospectus and Registration Exemptions* (NI 45-106).

Realizable value is typically the amount that would be received by selling an asset. Market value may be used to estimate realizable value when a market for an asset exists.

***Paragraph (q) of the definition***

Paragraph (q) refers to a person or company that has net assets of at least \$25 million. "Net assets" under this paragraph is total assets minus total liabilities. The value attributed to assets should reasonably reflect their estimated fair value.

**1.3 Fundamental concepts**

This section describes the fundamental concepts that form the basis of the registration regime:

- requirement to register
- business trigger for trading and advising, and

- fitness for registration

### **Requirement to register**

The requirement to register is found in securities legislation. Firms must register if they are:

- in the business of trading
- in the business of advising
- holding themselves out as being in the business of trading or advising
- acting as an underwriter, or
- acting as an investment fund manager

Individuals must register if they trade, underwrite or advise on behalf of a registered dealer or adviser, or act as the ultimate designated person (UDP) or chief compliance officer (CCO) of a registered firm. Individuals who act on behalf of a registered investment fund manager do not have to register.

There is no renewal requirement for registration, but fees must be paid every year to maintain registration.

### ***Multiple categories***

Registration in more than one category may be necessary. For example, an adviser that also manages an investment fund may have to register as a portfolio manager and an investment fund manager. An adviser that manages a portfolio and distributes units of an investment fund may have to register as a portfolio manager and as a dealer.

### ***Registration exemptions***

NI 31-103 provides exemptions from the registration requirement. Some exemptions do not need to be applied for if the conditions of the exemption are met. In other cases, on receipt of an application, the regulator has discretion to grant exemptions for specified dealers, advisers or investment fund managers, or activities carried out by them if registration is required but specific circumstances indicate that it is not otherwise necessary for investor protection or market integrity.

### **Business trigger for trading and advising**

We refer to trading or advising in securities for a business purpose as the “business trigger” for registration.

We look at the type of activity and whether it is carried out for a business purpose to determine if an individual or firm must register. We consider the factors set out below, among others, to determine if the activity is for a business purpose. For the most part, these factors are from case law and regulatory decisions that have interpreted the business purpose test for securities matters.

### ***Factors in determining business purpose***

This section describes factors that we consider relevant in determining whether an individual or firm is trading or advising in securities for a business purpose and, therefore, subject to the dealer or adviser registration requirement.

This is not a complete list. We do not automatically assume that any one of these factors on its own will determine whether an individual or firm is in the business of trading or advising in securities.

#### ***(a) Engaging in activities similar to a registrant***

We usually consider an individual or firm engaging in activities similar to those of a registrant to be trading or advising for a business purpose. Examples include promoting securities or stating in any way that the individual or firm will buy or sell securities. If an individual or firm sets up a business to carry out any of these activities, we may consider them to be trading or advising for a business purpose.

#### ***(b) Intermediating trades or acting as a market maker***

In general, we consider intermediating a trade between a seller and a buyer of securities to be trading for a business purpose. This typically takes the form of the business commonly referred to as a broker. Making a market in securities is also generally considered to be trading for a business purpose.

**(c) Directly or indirectly carrying on the activity with repetition, regularity or continuity**

Frequent or regular transactions are a common indicator that an individual or firm may be engaged in trading or advising for a business purpose. The activity does not have to be their sole or even primary endeavour for them to be in the business.

We consider regularly trading or advising in any way that produces, or is intended to produce, profits to be for a business purpose. We also consider any other sources of income and how much time an individual or firm spends on all activities associated with the trading or advising.

**(d) Being, or expecting to be, remunerated or compensated**

Receiving, or expecting to receive, any form of compensation for carrying on the activity, including whether the compensation is transaction or value based, indicates a business purpose. It does not matter if the individual or firm actually receives compensation or in what form. Having the capacity or the ability to carry on the activity to produce profit is also a relevant factor.

**(e) Directly or indirectly soliciting**

Contacting anyone to solicit securities transactions or to offer advice may reflect a business purpose. Solicitation includes contacting someone by any means, including advertising that proposes buying or selling securities or participating in a securities transaction, or that offers services or advice for these purposes.

**Business trigger examples**

This section explains how the business trigger might apply to some common situations.

**(a) Securities issuers**

A securities issuer is an entity that issues or trades in its own securities. In general, securities issuers with an active non-securities business do not have to register as a dealer if they:

- do not hold themselves out as being in the business of trading in securities
- trade in securities infrequently
- are not, or do not expect to be, compensated for trading in securities
- do not act as intermediaries, and
- do not produce, or intend to produce, a profit from trading in securities

However, securities issuers may have to register as a dealer if they:

- frequently trade in securities
- employ or otherwise contract individuals to perform activities on their behalf that are similar to those performed by a registrant (other than underwriting in the normal course of a distribution or trading for their own account)
- solicit investors actively, or
- act as an intermediary by investing client money in securities

For example, an investment fund manager that carries out the activities described above may have to register as a dealer.

Securities issuers that are in the business of trading should consider whether they qualify for the exemption from the registration requirement for trades through a registered dealer in section 8.5 of NI 31-103.

In most cases, securities issuers are subject to the prospectus requirements in securities legislation. Regulators have the discretionary authority to require an underwriter for a prospectus distribution.

**(b) Venture capital and private equity**

This guidance does not apply to labour sponsored or venture capital funds as defined in National instrument 81-106 *Investment Fund Continuous Disclosure* (NI 81-106).

Venture capital and private equity investing are distinguished from other forms of investing by the role played by venture capital and private equity management companies (collectively, VCs). This type of investing includes a range of activities that may require registration.

VCS typically raise money under one of the prospectus exemptions in NI 45-106, including for trades to “accredited investors”. The investors typically agree that their money will remain invested for a period of time. The VC uses this money to invest in securities of companies that are not publicly traded. The VC usually becomes actively involved in the management of the company, often over several years.

Examples of active management in a company include the VC having:

- representation on the board of directors
- direct involvement in the appointment of managers
- a say in material management decisions

The VC looks to realize on the investment either through a public offering of the company’s securities, or a sale of the business. At this point, the investors’ money can be returned to them, along with any profit.

Investors rely on the VC’s expertise in selecting and managing the companies it invests in. In return, the VC receives a management fee or “carried interest” in the profits generated from these investments. They do not receive compensation for raising capital or trading in securities.

Applying the business trigger factors to the VC activities as described above, there would be no requirement for the VC to register as:

- a portfolio manager, if the advice provided in connection with the purchase and sale of companies is incidental to the VC’s active management of these companies, or
- a dealer, if both the raising of money from investors and the investing of that money in companies are occasional and uncompensated activities

If the VC is actively involved in the management of the companies it invests in, the investment portfolio would generally not be considered an investment fund. As result, the VC would not need to register as an investment fund manager.

The business trigger factors and investment fund manager analysis may apply differently if the VC engages in activities other than those described above.

**(c) One-time activities**

In general, we do not require registration for one-time trading or advising activities. This includes trading or advising that:

- is carried out by an individual or firm acting as a trustee, executor, administrator, personal or other legal representative, or
- relates to the sale of a business

**(d) Incidental activities**

If trading or advising activity is incidental to a firm’s primary business, we may not consider it to be for a business purpose.

For example, merger and acquisition specialists that advise the parties to a transaction between companies are not normally required to register as dealers or advisers in connection with that activity, even though the transaction may result in trades in securities and they will be compensated for the advice. The primary business purpose in this example is to carry out the transaction. Any advice on trades in the securities is incidental to that purpose and is limited to the parties to the transaction.

Another example is professionals, such as lawyers, accountants, engineers, geologists and teachers, who may provide advice on securities in the normal course of their professional activities. We do not consider them to be advising on securities for a business purpose. For the most part, any advice on securities will be incidental to their professional activities. This is because they:

- do not regularly advise on securities
- are not compensated separately for advising on securities
- do not solicit clients on the basis of their securities advice, and
- do not hold themselves out as being in the business of advising on securities

### ***Registration trigger for investment fund managers***

Investment fund managers are subject to a registration trigger. This means that if a firm carries on the activities of an investment fund manager, it must register. However, investment fund managers are not subject to the business trigger.

### ***Fitness for registration***

The regulator will only register an applicant if they appear to be fit for registration. Following registration, individuals and firms must maintain their fitness in order to remain registered. If the regulator determines that a registrant has become unfit for registration, the regulator may suspend or revoke the registration. See Part 6 of this Companion Policy for guidance on suspension and revocation of individual registration. See Part 10 of this Companion Policy for guidance on suspension and revocation of firm registration.

### ***Terms and conditions***

The regulator may impose terms and conditions on a registration at the time of registration or at any time after registration. Terms and conditions imposed at the time of registration are generally permanent, for example, in the case of a restricted dealer who is limited to specific activities. Terms and conditions imposed after registration are generally temporary. For example, if a registrant does not maintain the required capital, it may have to file monthly financial statements and capital calculations until the regulator's concerns are addressed.

### ***Opportunity to be heard***

Applicants and registrants have an opportunity to be heard by the regulator before their application for registration is denied. They also have an opportunity to be heard before the regulator imposes terms and conditions on their registration if they disagree with the terms and conditions.

### ***Assessing fitness for registration - firms***

We assess whether a firm is or remains fit for registration through the information it is required to provide on registration application forms and as a registrant, and through compliance reviews. Based on this information, we consider whether the firm is able to carry out its obligations under securities legislation. For example, registered firms must be financially viable. A firm that is insolvent or has a history of bankruptcy may not be fit for registration.

In addition, when determining whether a firm whose head office is outside Canada is, and remains, fit for registration, we will consider whether the firm maintains registration or regulatory organization membership in the foreign jurisdiction that is appropriate for the securities business it carries out there.

### ***Assessing fitness for registration - individuals***

We use three fundamental criteria to assess whether an individual is or remains fit for registration:

- proficiency
- integrity, and
- solvency

#### ***(a) Proficiency***

Individual applicants must meet the applicable education, training and experience requirements prescribed by securities legislation and demonstrate knowledge of securities legislation and the products they recommend.

Registered individuals should continually update their knowledge and training to keep pace with new products, services and developments in the industry that are relevant to their business. See section 3.4 of this Companion Policy for more specific guidance on proficiency.

#### ***(b) Integrity***

Registered individuals must conduct themselves with integrity and have an honest character. The regulator will assess the integrity of individuals through the information they are required to provide on registration application forms and as registrants, and through compliance reviews. For example, applicants are required to disclose information about conflicts of interest, such as other employment or partnerships, service as a member of a board of directors, or relationships with affiliates, and about any regulatory or legal actions against them.

#### ***(c) Solvency***

The regulator will assess the overall financial condition of an individual applicant or registrant. An individual that is insolvent or has a history of bankruptcy may not be fit for registration. Depending on the circumstances, the



regulator may consider the individual's contingent liabilities. The regulator may take into account an individual's bankruptcy or insolvency when assessing their continuing fitness for registration.

## **Part 2 Categories of registration for individuals**

### **2.1 Individual categories**

#### **Multiple individual categories**

Individuals who carry on more than one activity requiring registration on behalf of a registered firm must:

- register in all applicable categories, and
- meet the proficiency requirements of each category

For example, an advising representative of a portfolio manager who is also the firm's CCO must register in the categories of advising representative and CCO. They must meet the proficiency requirements of both of these categories.

#### **Multiple firms**

We will not usually register an individual as a dealing, advising or associate advising representative for more than one registered firm even if the firms are affiliated. We will consider applications for individuals to act as a representative of more than one firm on a case-by-case basis. Before we approve an application, we must be satisfied that:

- there are valid business reasons for the individual to be registered with both firms
- the applicant's sponsoring firms have demonstrated that they have policies and procedures addressing any conflicts of interest that may arise as a result of the dual registration, and
- the sponsoring firms will be able to deal with these conflicts

We may consider other relevant factors.

#### **Individual registered in a firm category**

An individual can be registered in both a firm and individual category. For example, a sole proprietor who is registered in the firm category of portfolio manager must also be registered in the individual category of advising representative.

### **2.2 Client mobility exemption – individuals**

The mobility exemption in section 2.2 of NI 31-103 allows registered individuals to continue dealing with and advising clients who move to another jurisdiction, without registering in that other jurisdiction. Section 8.30 *Client mobility exemption – firms* contains a similar exemption for registered firms.

The exemption becomes available when the client (not the registrant) moves to another jurisdiction. An individual may deal with up to five "eligible" clients in each other jurisdiction. Each of the client, their spouse and any children are an eligible client.

An individual may only rely on the exemption if:

- they and their sponsoring firm are registered in their principal jurisdiction
- they and their sponsoring firm only act as a dealer, underwriter or adviser in the other jurisdiction as permitted under their registration in their principal jurisdiction
- they comply with Part 13 *Dealing with clients – individuals and firms*
- they act fairly, honestly and in good faith in their dealings with the eligible client, and
- their sponsoring firm has disclosed to the eligible client that the individual and if applicable, their sponsoring firm, are exempt from registration in the other jurisdiction and are not subject to the requirements of securities legislation in that jurisdiction

As soon as possible after an individual first relies on this exemption, their sponsoring firm must complete and file Form 31-103F3 *Use of mobility exemption* (Form 31-103F3) with the other jurisdiction.

## **Part 3 Registration requirements – individuals**

### *Division 1 General proficiency requirements*

Individuals must pass exams – not courses – to meet the education requirements in Part 3. For example, an individual must pass the Canadian Securities Course Exam, but does not have to complete the Canadian Securities Course. Individuals are responsible for completing the necessary preparation to pass an exam and for proficiency in all areas covered by the exam.

### **3.3 Time limits on examination requirements**

Under section 3.3 of NI 31-103, there is a time limit on the validity of exams prescribed in Part 3. Individuals must pass an exam within 36 months before they apply for registration. However, the time limit does not apply if the individual:

- was registered in the same category in Canada for a total of 12 months during the 36-month period, or
- gained relevant securities industry experience for a total of 12 months during the 36-month period

The 12 months of registration and relevant securities industry experience referred to in subsection 3.3(2) do not have to be consecutive, or with the same firm or organization. The individual must have been registered for a total of 12 months or obtained a total of 12 months of experience within the 36-month period before the date they apply for registration.

These time limits do not apply when individuals transfer to a new firm. This is because they do not have to apply for registration when they transfer. See Part 6 of this Companion Policy for guidance on individuals who transfer to a new firm.

### **Relevant securities industry experience**

The securities industry experience under subsection 3.3(2)(b) should be relevant to the category applied for. It may include experience acquired:

- during employment at a registered dealer, a registered adviser or an investment fund manager
- in related investment fields, such as investment banking, securities trading on behalf of a financial institution, securities research, portfolio management, investment advisory services or supervision of those activities
- in legal, accounting or consulting practices related to the securities industry
- in other professional service fields that relate to the securities industry, or
- in a securities-related business in a foreign jurisdiction

### *Division 2 Education and experience requirements*

See Appendix C for a chart that sets out the proficiency requirements for each individual category of registration.

### **Granting exemptions**

The regulator may grant an exemption from any of the education and experience requirements in Division 2 if it is satisfied that an individual has qualifications or relevant experience that is equivalent to, or more appropriate in the circumstances than, the prescribed requirements.

### **Proficiency for representatives of investment dealers**

IROC sets the proficiency requirements for dealing representatives of its members.

### **Proficiency for representatives of restricted dealers and restricted portfolio managers**

The regulator will decide on a case-by-case basis what education and experience are required for registration as:

- a dealing representative or CCO of a restricted dealer
- an advising representative or CCO of a restricted portfolio manager

The regulator will determine these requirements when it assesses the individual's fitness for registration.

### **3.4 Proficiency – initial and ongoing**

Under section 3.4 of NI 31-103, registered individuals, including CCOs, must not perform an activity that requires registration unless they have the education, training and experience that a reasonable person would consider necessary to perform the activity competently. Registered firms should ensure that registered individuals acting on their behalf meet this requirement at all times.

For example, firms should perform their own analysis of all products they recommend to clients and provide product training to ensure their registered representatives have a sufficient understanding of the products and their risks to meet their suitability obligations under section 13.3. Similarly, registered individuals should have a thorough understanding of a product before they recommend it to a client.

#### **3.11 Portfolio manager – advising representative**

#### **3.12 Portfolio manager – associate advising representative**

The 12 months of relevant investment management experience referred to in section 3.11 of NI 31-103 and 24 months of relevant investment management experience referred to in section 3.12 do not have to be consecutive, or with the same firm or organization. The individual must obtain a total of this experience within the 36-month period before the date they apply for registration.

For individuals with a CFA charter, the regulator will decide on a case-by-case basis whether the experience they gained to earn the charter qualifies as relevant investment management experience.

#### **Relevant investment management experience**

Relevant investment management experience under sections 3.11 and 3.12 may vary according to the level of specialization of the individual. It may include:

- securities research and analysis experience, demonstrating an ability in, and understanding of, portfolio analysis or portfolio security selection, or
- management of investment portfolios on a discretionary basis, including investment decision making, rebalancing and evaluating performance

#### ***Advising representatives***

Advising representatives may acquire relevant investment management experience during employment in a portfolio management capacity with a registered investment dealer or adviser firm.

#### ***Associate advising representatives***

Relevant investment management experience for associate advising representatives may include working at:

- an unregistered portfolio manager of a Canadian financial institution
- an adviser that is registered in another jurisdiction of Canada, or
- an adviser in a foreign jurisdiction

### *Division 3 Membership in a self-regulatory organization*

#### **3.16 Exemptions from certain requirements for SRO-approved persons**

Section 3.16 exempts registered individuals who are dealing representatives of IIROC or MFDA members from the requirements in NI 31-103 for suitability and disclosure when recommending the use of borrowed money. This is because IIROC and the MFDA have their own rules for these matters. In Québec, these requirements do not apply to dealing representatives of a mutual fund dealer who comply with the applicable Québec regulations.

This section also exempts registered individuals who are dealing representatives of IIROC from the know your client obligations in section 13.2.

## **Part 4 Restrictions on registered individuals**

### **4.2 Associate advising representatives – pre-approval of advice**

The associate advising representative category is primarily meant to be an apprentice category for individuals who intend to become an advising representative but who do not meet the education or experience requirements for that category when they apply for registration. It allows an individual to work at a registered adviser while completing the proficiency requirements for an advising representative. For example, a previously registered advising representative could work in an advising capacity while acquiring the relevant work experience required for an advising representative under section 3.11 of NI 31-103.

However, associate advising representatives are not required to subsequently register as a full advising representative. They can remain as an associate advising representative indefinitely. This category also accommodates, for example, individuals who provide specific advice to clients, but do not manage client portfolios without supervision.

As required by section 4.2, registered firms must designate an advising representative to approve the advice provided by an associate advising representative. The designated advising representative must approve the advice before the associate advising representative gives it to the client. The appropriate processes for approving the advice will depend on the circumstances, including the associate advising representative's level of experience.

Registered firms that have associate advising representatives must:

- document their policies and procedures for meeting the supervision and approval obligations as required under section 11.1
- implement controls as required under section 11.1
- maintain records as required under section 11.5, and
- notify the regulator of the names of the advising representative and the associate advising representative whose advice they are approving no later than the seventh day after the advising representative is designated

## **Part 5 Ultimate designated person and chief compliance officer**

Sections 11.2 and 11.3 of NI 31-103 require registered firms to designate a UDP and a CCO. The UDP and CCO must be registered and perform the compliance functions set out in sections 5.1 and 5.2. While the UDP and CCO have specific compliance functions, they are not solely responsible for compliance – it is the responsibility of the firm as a whole.

### **The same person as UDP and CCO**

The UDP and the CCO can be the same person if they meet the requirements for both registration categories. We prefer firms to separate these functions, but we recognize that it might not be practical for some registered firms.

### **UDP or CCO as advising or dealing representative**

The UDP or CCO may also be registered in trading or advising categories. For example, a small registered firm might conclude that one individual can adequately function as UDP and CCO, while also carrying on advising and trading activities. We may have concerns about the ability of a UDP or CCO of a large firm to conduct these additional activities and carry out their UDP, CCO and advising responsibilities at the same time.

### **5.1 Responsibilities of the ultimate designated person**

The UDP is responsible for promoting a culture of compliance and overseeing the effectiveness of the firm's compliance system. They do not have to be involved in the day-to-day management of the compliance group.

There are no specific education or experience requirements for the UDP. However, they are subject to the proficiency principle in section 3.4.

### **5.2 Responsibilities of the chief compliance officer**

The CCO is an operating officer who is responsible for the monitoring and oversight of the firm's compliance system. This includes:

- establishing or updating policies and procedures for the firm's compliance system, and
- managing the firm's compliance monitoring and reporting according to the policies and procedures

At the firm's discretion, the CCO may also have authority to take supervisory or other action to resolve compliance issues.

The CCO must meet the proficiency requirements set out in Part 3. No other compliance staff have to be registered unless they are also advising or trading. The CCO may set the knowledge and skills necessary or desirable for individuals who report to them.

If a firm is registered in multiple categories, the CCO must meet the most stringent of the proficiency requirements of the firm's categories of registration.

Firms must designate one CCO. However, in large firms, the scale and kind of activities carried out by different operating divisions may warrant the designation of more than one CCO. We will consider applications, on a case-by-case basis, for different individuals to act as the CCO of a firm's operating divisions.

We will not usually register the same person as CCO of more than one firm unless the firms are affiliated, and the scale and kind of activities carried out make it reasonable for the same person to act as CCO of more than one firm. We will consider applications, on a case-by-case basis, for the CCO of one registered firm to act as the CCO of another registered firm.

Subsection 5.2(c) of NI 31-103 requires the CCO to report to the UDP any instances of non-compliance with securities legislation that:

- create a reasonable risk of harm to a client or to the market, or
- are part of a pattern of non-compliance

The CCO should report non-compliance to the UDP even if it has been corrected.

Subsection 5.2(d) requires the CCO to submit an annual report to the board of directors.

## **Part 6 Suspension and revocation of registration – individuals**

The requirements for surrendering registration and additional requirements for suspending and revoking registration are found in the securities legislation of each jurisdiction. The guidance for Part 6 relates to requirements under both securities legislation and NI 31-103.

There is no renewal requirement for registration. A registered individual may carry on the activities for which they are registered until their registration is:

- suspended automatically under NI 31-103
- suspended by the regulator under certain circumstances, or
- surrendered by the individual

### **6.1 If individual ceases to have authority to act for firm**

Under section 6.1 of NI 31-103, if a registered individual ceases to have authority to act on behalf of their sponsoring firm because their working relationship with the firm ends or changes, the individual's registration with the registered firm is suspended until reinstated or revoked under securities legislation. This applies whether the individual or the firm ends the relationship.

If a registered firm terminates its working relationship with a registered individual for any reason, the firm must complete and file a notice of termination on Form 33-109F1 *Notice of Termination of Registered Individuals and Permitted Individuals* (Form 33-109F1) no later than five days after the effective date of the individual's termination. This includes when an individual resigns, is dismissed or retires.

The firm must file additional information about the individual's termination prescribed in Part 5 of Form 33-109F1 if:

- the individual resigned (either voluntarily or at the firm's request)

- the individual was dismissed (whether or not for cause), or
- the firm indicates “other” as the reason for termination on Form 33-109F1

The firm must file this information no later than 30 days after the date of termination. The regulator uses this information to determine if there are any concerns about the individual's conduct that may be relevant to their ongoing fitness for registration. Under NI 33-109, the firm must provide this information to the individual on request.

### **Suspension**

An individual whose registration is suspended must not carry on the activity they are registered for. The individual otherwise remains a registrant and is subject to the jurisdiction of the regulator. A suspension remains in effect until the regulator reinstates or revokes the individual's registration.

If an individual who is registered in more than one category is suspended in one of the categories, the regulator will consider whether to suspend the individual's registration in other categories or to impose terms and conditions, subject to an opportunity to be heard.

### ***Automatic suspension***

An individual's registration will automatically be suspended if:

- they cease to have working relationship with their sponsoring firm
- the registration of their sponsoring firm is suspended or revoked, or
- they cease to be an approved person of an SRO

An individual must have a sponsoring firm to be registered. If an individual leaves their sponsoring firm for any reason, their registration is automatically suspended. Automatic suspension is effective on the day that an individual no longer has authority to act on behalf of their sponsoring firm.

Individuals do not have an opportunity to be heard by the regulator in the case of any automatic suspension.

### ***Suspension in the public interest***

An individual's registration may be suspended if the regulator exercises its power under securities legislation and determines that it is no longer in the public interest for the individual to be registered. The regulator may do this if it has serious concerns about the ongoing fitness of the individual. For example, this may be the case if an individual is charged with a crime, in particular fraud or theft.

### **Reinstatement**

“Reinstatement” means that a suspension on a registration has been lifted. Once reinstated, an individual may resume carrying on the activity they are registered for. If a suspended individual joins a new sponsoring firm, they will have to apply for reinstatement under the process set out in NI 33-109. In certain cases, the reinstatement or transfer to the new firm will be automatic.

### ***Automatic transfers***

Subject to certain conditions set out in NI 33-109, an individual's registration may be automatically reinstated if they:

- transfer directly from one sponsoring firm to another registered firm in the same jurisdiction
- join the new sponsoring firm within 90 days of leaving their former sponsoring firm
- seek registration in the same category as the one previously held, and
- complete and file Form 33-109F7 *Reinstatement of Registered Individuals and Permitted Individuals* (Form 33-109F7)

This allows individuals to engage in activities requiring registration from their first day with the new sponsoring firm.

Individuals are not eligible for an automatic reinstatement if they:

- have new information to disclose regarding regulatory, criminal, civil or financial matters as described in Item 9 of Form 33-109F7, or
- as a result of allegations of criminal activity, breach of securities legislation or breach of SRO rules:
  - were dismissed by their former sponsoring firm, or
  - were asked by their former sponsoring firm to resign

In these cases, the individual must apply to have their registration reinstated under NI 33-109 using Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals*.

## **6.2 If IIROC approval is revoked or suspended**

## **6.3 If MFDA approval is revoked or suspended**

Registered individuals acting on behalf of member firms of an SRO are required to be an approved person of the SRO.

If an SRO suspends or revokes its approval of an individual, the individual's registration in the category requiring SRO approval will be automatically suspended. This automatic suspension of individuals does not apply to mutual fund dealers registered only in Québec.

If an SRO suspends an individual for reasons that do not involve significant regulatory concerns and subsequently reinstates the individual's approval, the individual's registration will usually be reinstated by the regulator as soon as possible.

## **Revocation**

### **6.6 Revocation of a suspended registration – individual**

If an individual's registration has been suspended under Part 6 of NI 31-103 but not reinstated, it will be automatically revoked on the second anniversary of the suspension.

"Revocation" means that the regulator has terminated the individual's registration. An individual whose registration has been revoked must submit a new application if they want to be registered again.

## **Surrender**

"Surrender" means an individual wants to terminate their registration in some, but not all, of the jurisdictions in which they are registered. An individual may apply to surrender their registration at any time by completing Form 33-109F2 *Change or Surrender of Individual Categories* (Form 33-109F2) and having their sponsoring firm file it.

An individual who is registered in one or more jurisdictions and wants to terminate their registration in all jurisdictions does not have to file Form 33-109F2. This is because their sponsoring firm is required to file Form 33-109F1.

## **Part 7 Categories of registration for firms**

The categories of registration for firms have two main purposes:

- to specify the type of business that the firm may conduct, and
- to provide a framework for the requirements the registrant must meet

### **Firms registered in more than one category**

A firm may be required to register in more than one category. For example, a portfolio manager that manages an investment fund must register both as a portfolio manager and as an investment fund manager.

### **Individual registered in a firm category**

An individual can be registered in both a firm and individual category. For example, a sole proprietor who is registered in the firm category of portfolio manager must also be registered in the individual category of advising representative.

## **7.1 Dealer categories**

Underwriting is a subset of dealing activity for specified categories. Investment dealers may underwrite any securities. Exempt market dealers may underwrite securities in limited circumstances.

### **Exempt market dealer**

Under subsection 7.1(2)(d) of NI 31-103, exempt market dealers may only act as a dealer in the “exempt market”. The permitted activities of an exempt market dealer are determined with reference to the prospectus exemptions in NI 45-106 and include trades to “accredited investors” and purchasers of at least \$150,000 of a security and trades to anyone under the offering memorandum exemption.

Exempt market dealers can sell investment funds (whether or not they are prospectus-qualified) under these exemptions without registering as a mutual fund dealer or being a member of the MFDA.

### **Restricted dealer**

The restricted dealer category in subsection 7.1(2)(e) permits specialized dealers that may not qualify under another dealer category to carry on a limited trading business. It is intended to be used only if there is a compelling case for the proposed trading to take place outside the other registration categories.

The regulator will impose terms and conditions that restrict the dealer’s activities. The CSA will co-ordinate terms and conditions for restricted dealers.

## **7.2 Adviser categories**

The registration requirement in section 7.2 of NI 31-103 applies to advisers who give “specific advice”. Advice is specific when it is tailored to the needs and circumstances of a client or potential client. For example, an adviser who recommends a security to a client is giving specific advice.

### **Restricted portfolio manager**

The restricted portfolio manager category in subsection 7.2(2)(b) permits individuals or firms to advise in specific securities, classes of securities or securities of a class of issuers.

The regulator will impose terms and conditions on a restricted portfolio manager’s registration that limit the manager’s activities to a specific area, for example, securities of oil and gas issuers.

## **7.3 Investment fund manager category**

Investment fund managers direct the business, operations or affairs of an investment fund. They organize the fund and are responsible for its management and administration.

If an entity is uncertain about whether it must register as an investment fund manager, it should consider whether the fund is an “investment fund” for the purposes of securities legislation. See section 1.2 of the Companion Policy to NI 81-106 for guidance on the general nature of investment funds.

An investment fund manager may:

- advertise to the general public a fund it manages without being registered as an adviser, and
- promote the fund to registered dealers without being registered as a dealer

If an investment fund manager acts as portfolio manager for a fund it manages, it should consider whether it may have to be registered as an adviser. If it distributes units of the fund directly to investors, it should consider whether it may have to be registered as a dealer.

An investment fund manager may delegate or outsource certain functions to other service providers. However, the investment fund manager is responsible for these functions and must supervise the service provider. See Part 11 of this Companion Policy for more guidance on outsourcing.

### **Limited partnerships**

Investment funds organized as limited partnerships of investment vehicles should consider which entity or entities may need to be registered as an investment fund manager. Multiple registrations may not be necessary if each general partner in the affiliated group enters into a contract with a single registered investment fund manager within the group. In this case, the investment fund manager may not be one of the general partners.



## **Part 8 Exemptions from the requirement to register**

NI 31-103 provides several exemptions from the registration requirement. There may be additional exemptions in securities legislation. If a firm is exempt from registration, the individuals acting on its behalf are also exempt from registration.

### *Division 1 Exemptions from dealer and underwriter registration*

We provide no specific guidance for the following exemptions because there is guidance on them in the Companion Policy to NI 45-106:

- 8.12 *Mortgages*
- 8.17 *Reinvestment plan*
- 8.20 *Exchange contract – Alberta, British Columbia, New Brunswick and Saskatchewan*

### **8.5 Trades through or to a registered dealer**

This exemption is available when no intermediary is involved in a trade, for example, when an individual or firm trades their own securities directly with a registered dealer. An individual or firm will have to register, however, if they trade another party's securities with a registered dealer.

### **8.6 Adviser – non-prospectus qualified investment fund**

Under the exemption in section 8.6 of NI 31-103, registered advisers do not have to register as a dealer for a trade in a security of a non-prospectus qualified investment fund if they:

- act as the fund's adviser and investment fund manager, and
- distribute units of the fund only into their clients' managed accounts

The exemption is also available to those who qualify for the international adviser exemption under section 8.26.

Registered advisers often create non-prospectus qualified investment funds as a way to efficiently invest their clients' money. In issuing units of those funds to clients, they are in the business of trading in securities.

Subsection 8.6(2) limits the availability of this exemption to legitimate fully managed accounts. We do not intend for the exemption to be used to distribute the adviser's own non-prospectus qualified investment funds on a retail basis.

Advisers relying on the exemption in section 8.6 should consider whether they may have to register as an investment fund manager.

### **8.19 Self-directed registered education savings plan**

We consider the creation of a self-directed registered education savings plan, as defined in section 8.19 of NI 31-103, to be a trade in a security, whether or not the assets held in the plan are securities. This is because the definition of "security" in securities legislation of most jurisdictions includes "any document constituting evidence of an interest in a scholarship or educational plan or trust".

Section 8.19 provides an exemption from the dealer registration requirement for the trade when the plan is created but only under the conditions described in subsection 8.19(2).

### *Division 2 Exemptions from adviser registration*

### **8.25 Advising generally**

Section 8.25 of NI 31-103 contains an exemption from the requirement to register as an adviser if the advice is not tailored to the needs of the recipient.

In general, we would not consider advice about specific securities to be tailored to the needs of the recipient if it:

- is a general discussion of the merits and risks of the security
- is delivered through investment newsletters, articles in general circulation newspapers or magazines, websites, e-mail, Internet chat rooms, bulletin boards, television or radio, and
- does not claim to be tailored to the needs and circumstances of any recipient

This type of general advice can also be given at conferences. However, if a purpose of the conference is to solicit the audience and generate specific trades in specific securities, we may consider the advice to be tailored or we may consider the individual or firm giving the advice to be engaged in trading activity.

Under subsection 8.25(3), if an individual or firm relying on the exemption has a financial or other interest in the securities they recommend, they must disclose the interest to the recipient when they make the recommendation.

### *Division 3 Exemptions from investment fund manager registration*

#### **8.28 Capital accumulation plan exemption**

Section 8.28 of NI 31-103 provides an exemption from the investment fund manager registration requirement to an individual or firm that administers a capital accumulation plan. If an investment fund manager is also required to register as a dealer or adviser, this exemption only applies to their activities as an investment fund manager.

### *Division 4 Mobility exemption – firms*

#### **8.30 Client mobility exemption – firms**

The mobility exemption in section 8.30 of NI 31-103 allows registered firms to continue dealing with and advising clients who move to another jurisdiction, without registering in that other jurisdiction. Section 2.2 *Client mobility exemption – individuals* contains a similar exemption for registered individuals.

The exemption becomes available when the client (not the registrant) moves to another jurisdiction. A registered firm may deal with up to 10 “eligible” clients in each other jurisdiction. Each of the client, their spouse and any children are an eligible client.

A firm may only rely on the exemption if:

- it is registered in its principal jurisdiction
- it only acts as a dealer, underwriter or adviser in the other jurisdiction as permitted under its registration in its principal jurisdiction
- the individual acting on its behalf is eligible for the exemption in section 2.2
- it complies with Parts 13 *Dealing with clients-individuals and firms* and 14 *Handling client accounts-firms*, and
- it acts fairly, honestly and in good faith in its dealings with the eligible client

#### **Firm’s responsibilities for individuals relying on the exemption**

In order for a registered individual to rely on the exemption in section 2.2, their sponsoring firm must disclose to the eligible client that the individual and if applicable, the firm, are exempt from registration in the other jurisdiction and are not subject to the requirements of securities legislation in that jurisdiction.

As soon as possible after an individual first relies on the exemption in section 2.2, their sponsoring firm must complete and file Form 31-103F3 in the other jurisdiction.

The registered firm must have appropriate policies and procedures for supervising individuals who rely on a mobility exemption. Registered firms must also keep appropriate records to demonstrate they are complying with the conditions of the mobility exemption.

## **Part 9 Membership in a self-regulatory organization**

### **9.3 Exemptions from certain requirements for SRO members**

Section 9.3 of NI 31-103 contains an exemption from certain requirements for investment dealers that are IIROC members and, except in Québec, for mutual fund dealers that are MFDA members. However, if an SRO member is registered in another category, this section does not exempt them from their obligations as a registrant in that

category. For example, if a firm is registered as an investment fund manager and as an investment dealer with IIROC, section 9.3 does not exempt them from their obligations as an investment fund manager under NI 31-103.

## **Part 10 Suspension and revocation of registration – firms**

The requirements for surrendering registration and additional requirements for suspending and revoking registration are found in the securities legislation of each jurisdiction. The guidance for Part 10 relates to requirements under both securities legislation and NI 31-103.

There is no renewal requirement for registration but firms must pay fees every year to maintain their registration and the registration of individuals acting on their behalf. A registered firm may carry on the activities for which it is registered until its registration is:

- suspended automatically under NI 31-103
- suspended by the regulator under certain circumstances, or
- surrendered by the firm

### *Division 1 When a firm's registration is suspended*

#### **Suspension**

A firm whose registration has been suspended must not carry on the activity it is registered for. The firm otherwise remains a registrant and is subject to the jurisdiction of the regulator. A suspension remains in effect until the regulator reinstates or revokes the firm's registration.

If a firm that is registered in more than one category is suspended in one of the categories, the regulator will consider whether to suspend the firm's registration in other categories or to impose terms and conditions, subject to an opportunity to be heard.

#### ***Automatic suspension***

A firm's registration will automatically be suspended if:

- it fails to pay its annual fees within 30 days of the due date
- it ceases to be a member of IIROC, or
- except in Québec, it ceases to be a member of the MFDA

Firms do not have an opportunity to be heard by the regulator in the case of any automatic suspension.

#### **10.1 Failure to pay fees**

Under section 10.1 of NI 31-103, a firm's registration will be automatically suspended if it has not paid its annual fees within 30 days of the due date.

#### **10.2 If IIROC membership is revoked or suspended**

Under section 10.2 of NI 31-103, if IIROC suspends or revokes a firm's membership, the firm's registration as an investment dealer is suspended until reinstated or revoked.

#### **10.3 If MFDA membership is revoked or suspended**

Under section 10.3 of NI 31-103, if the MFDA suspends or revokes a firm's membership, the firm's registration as a mutual fund dealer is suspended until reinstated or revoked. Section 10.3 does not apply in Québec.

#### ***Suspension in the public interest***

A firm's registration may be suspended if the regulator exercises its power under securities legislation and determines that it is no longer in the public interest for the firm to be registered. The regulator may do this if it has serious concerns about the ongoing fitness of the firm or any of its registered individuals. For example, this may be the case if a firm or one or more of its registered or permitted individuals is charged with a crime, in particular fraud or theft.

### **Reinstatement**

“Reinstatement” means that a suspension on a registration has been lifted. Once reinstated, a firm may resume carrying on the activity it is registered for.

*Division 2 Revoking a firm’s registration*

### **Revocation**

#### **10.5 Revocation of a suspended registration – firm**

#### **10.6 Exception for firms involved in a hearing**

Under sections 10.5 and 10.6 of NI 31-103, if a firm’s registration has been suspended under Part 10 and has not been reinstated, it is revoked on the second anniversary of the suspension, except if a hearing concerning the suspended registrant has commenced. In this case the registration remains suspended.

“Revocation” means that the regulator has terminated the firm’s registration. A firm whose registration has been revoked must submit a new application if it wants to be registered again.

### **Surrender**

A firm may apply to surrender its registration in one or more categories at any time. There is no prescribed form for an application to surrender. A firm should file an application to surrender registration with its principal regulator. If Ontario is a non-principal jurisdiction, it should also file the application with the regulator in Ontario. See the Companion Policy to Multilateral Instrument 11-102 *Passport System* for more details on filing an application to surrender.

Before the regulator accepts a firm’s application to surrender registration, the firm must provide the regulator with evidence that the firm’s clients have been dealt with appropriately. This evidence does not have to be provided when a registered individual applies to surrender registration. This is because the sponsoring firm will continue to be responsible for meeting obligations to clients who may have been served by the individual.

The regulator does not have to accept a firm’s application to surrender its registration. Instead, the regulator can act in the public interest by suspending, or imposing terms and conditions on, the firm’s registration.

When considering a registered firm’s application to surrender its registration, the regulator typically considers the firm’s actions, the completeness of the application and the supporting documentation.

### **The firm’s actions**

The regulator may consider whether the firm:

- has stopped carrying on activity requiring registration
- proposes an effective date to stop carrying on activity requiring registration that is within six months of the date of the application to surrender, and
- has paid any outstanding fees and submitted any outstanding filings at the time of filing the application to surrender

### **Completeness of the application**

Among other things, the regulator may look for:

- the firm’s reasons for ceasing to carry on activity requiring registration
- satisfactory evidence that the firm has given all of its clients reasonable notice of its intention to stop carrying on activity requiring registration, including an explanation of how it will affect them in practical terms, and
- satisfactory evidence that the firm has given appropriate notice to the SRO, if applicable

### **Supporting documentation**

The regulator may look for:

- evidence that the firm has resolved all outstanding client complaints, settled all litigation, satisfied all judgments or made reasonable arrangements to deal with and fund any payments relating to them, and any subsequent client complaints, settlements or liabilities

- confirmation that all money or securities owed to clients has been returned or transferred to another registrant, where possible, according to client instructions
- up-to-date audited financial statements with an auditor's comfort letter
- evidence that the firm has satisfied any SRO requirements for withdrawing membership, and
- an officer's or partner's certificate supporting these documents

## **Part 11 Internal controls and systems**

### **General business practices – outsourcing**

Registered firms are responsible and accountable for all functions that they outsource to a service provider. Firms should have a written, legally binding contract that includes the expectations of the parties to the outsourcing arrangement.

Registered firms should follow prudent business practices and conduct a due diligence analysis of prospective third-party service providers. This includes third-party service providers that are affiliates of the firm. Due diligence should include an assessment of the service provider's reputation, financial stability, relevant internal controls and ability to deliver the services.

Firms should also:

- ensure that third-party service providers have adequate safeguards for keeping information confidential and, where appropriate, disaster recovery capabilities
- conduct ongoing reviews of the quality of outsourced services
- develop and test a business continuity plan to minimize disruption to the firm's business and its clients if the third-party service provider does not deliver its services satisfactorily, and
- note that other legal requirements, such as privacy laws, may apply when entering into outsourcing arrangements

The regulator, the registered firm and the firm's auditors should have the same access to the work product of a third-party service provider as they would if the firm itself performed the activities. Firms should ensure this access is provided and include a provision requiring it in the contract with the service provider, if necessary.

## *Division 1      Compliance*

### **11.1 Compliance system**

#### **General principles**

Section 11.1 of NI 31-103 requires registered firms to establish, maintain and apply policies and procedures that establish a system of controls and supervision (a compliance system) that:

- provides assurance that the firm and individuals acting on its behalf comply with securities legislation, and
- manages the business risks in accordance with prudent business practices

Operating an effective compliance system is essential to a registered firm's continuing fitness for registration. It provides reasonable assurance that the firm is meeting, and will continue to meet, all requirements of applicable securities laws and SRO rules and is managing risk prudently. A compliance system should include internal controls and mechanisms that are reasonably likely to identify non-compliance at an early stage and allow the firm to correct non-compliant conduct in a timely manner.

Compliance is a firm-wide responsibility. Everyone in the firm should understand the standards of conduct for their role. This includes the board of directors, partners, management, employees and agents, whether or not they are registered. Having a UDP and CCO, and in larger firms, a compliance group and other supervisory staff, does not relieve anyone else in the firm of the obligation to report and act on compliance issues. A compliance system should identify those who will act as alternates in the absence of the UDP or CCO.

#### **Elements of an effective compliance system**

While policies and procedures are essential, they do not make an acceptable compliance system on their own. An effective compliance system also includes internal controls and supervision.

### **Internal controls**

Internal controls are an important part of a firm's compliance system. They should mitigate risk and protect firm and client assets. They should be designed to assist firms in monitoring compliance with securities legislation and managing the risks that affect their business, including risks that may arise from:

- money laundering
- trading
- business interruption
- hedging strategies

### **Supervision**

Supervision is an essential component of a firm's compliance system. It consists of day-to-day supervision and systemic monitoring.

#### **(a) Day-to day supervision**

Day-to-day supervision includes:

- identifying specific cases of non-compliance
- taking action to correct them, and
- minimizing the compliance risk in key areas of a firm's operations

Minimizing risk usually involves approving new account documents, monitoring and in some cases, approving transactions, approving marketing materials and preventing inappropriate use or disclosure of non-public information.

Anyone who supervises registered individuals has a responsibility on behalf of the firm to take all reasonable measures to ensure that each of these individuals:

- deals fairly, honestly and in good faith with their clients
- complies with securities legislation
- complies with the firm's policies and procedures, and
- maintains an appropriate level of proficiency

#### **(b) Systemic monitoring**

Systemic monitoring involves assessing, and advising and reporting on the effectiveness of the firm's compliance system. This includes ensuring that:

- the firm's day-to-day supervision is reasonably effective in identifying and promptly correcting compliance deficiencies
- policies and procedures are enforced and kept up to date, and
- everyone at the firm generally understands and complies with the policies and procedures, and with securities legislation

### **Specific elements**

More specific elements of an effective compliance system include:

#### **(a) Visible commitment**

Senior management and the board of directors or partners should demonstrate a visible commitment to compliance.

#### **(b) Sufficient resources and training**

The firm should have sufficient resources to operate an effective compliance system. Qualified individuals (including anyone acting as an alternate during absences) should have the responsibility and authority to monitor the firm's compliance, identify any instances of non-compliance and take supervisory action to correct them.

The firm should provide training to ensure that everyone at the firm understands the standards of conduct and their role in the compliance system, including ongoing communication and training on changes in regulatory requirements or the firm's policies and procedures.

**(c) Detailed policies and procedures**

The firm should have detailed written policies and procedures that:

- identify the internal controls the firm will use to ensure compliance with legislation and manage risk
- set out the firm's standards of conduct for compliance with securities and other applicable legislation and the systems for monitoring and enforcing compliance with those standards
- clearly outline who is expected to do what, when and how
- are readily accessible by everyone who is expected to know and follow them
- are updated when regulatory requirements and the firm's business practices change, and
- take into consideration the firm's obligation under securities legislation to deal fairly, honestly and in good faith with its clients

**(d) Detailed records**

The firm should keep records of activities conducted to identify compliance deficiencies and the action taken to correct them.

**Setting up a compliance system**

It is up to each registered firm to determine the most appropriate compliance system for its operations. Registered firms should consider the size and scope of their operations, including products, types of clients or counterparties, risks and compensating controls, and any other relevant factors.

For example, a large registered firm with diverse operations may require a large team of compliance professionals with several divisional heads of compliance reporting to a CCO dedicated entirely to a compliance role.

All firms must have policies, procedures and systems to demonstrate compliance. However, some of the elements noted above may be unnecessary or impractical for smaller registered firms.

We encourage firms to meet or exceed industry best practices in complying with regulatory requirements.

**11.2 Designating an ultimate designated person**

Under subsection 11.2(1) of NI 31-103, registered firms must designate an individual to be the UDP. Firms should ensure that the individual understands and is able to perform the obligations of a UDP under section 5.1.

The UDP must be:

- the chief executive officer of the registered firm
- the sole proprietor of the registered firm
- an officer in charge of a division of the firm that carries on all of the activity that requires registration, or
- an individual acting in a similar capacity

If the UDP no longer meets any of the above conditions and the registered firm is unable to designate another UDP, the firm should promptly advise the regulator of the actions it is taking to designate an appropriate UDP.

**11.3 Designating a chief compliance officer**

Under subsection 11.3(1) of NI 31-103, registered firms must designate an individual to be the CCO. Firms should ensure that the individual understands and is able to perform the obligations of a CCO under section 5.2.

The CCO must meet the applicable proficiency requirements in Part 3 of NI 31-103 and be:

- an officer or partner of the registered firm, or
- the sole proprietor of the registered firm

If the CCO no longer meets any of the above conditions and the registered firm is unable to designate another CCO, the firm should promptly advise the regulator of the actions it is taking to designate an appropriate CCO.

Under securities legislation, the regulator may access, examine and take copies of a registered firm's records. The regulator may also conduct regular and unscheduled compliance reviews of registered firms.

### 11.5 General requirements for records

Under subsection 11.5(1) of NI 31-103, registered firms must maintain records to accurately record their business activities, financial affairs and client transactions, and demonstrate compliance with securities legislation.

The following discussion provides guidance for the various elements of the records described in subsection 11.5(2).

#### Financial affairs

The records required under subsections 11.5(2)(a), (b) and (c) are records firms must maintain to help ensure they are able to prepare and file financial information, determine their capital position, including the calculation of excess working capital, and generally demonstrate compliance with the capital and insurance requirements.

#### Client transactions

The records required under subsections 11.5(2)(g), (h), (i), (l) and (n) are records firms must maintain to accurately and fully document transactions entered into on behalf of a client. We expect firms to maintain notes of oral communications with clients, and all e-mail, regular mail, fax and other written communications with clients to the extent these communications could have an impact on the client's account or the client's relationship with the firm. However, we do not expect registered firms to save every voicemail or e-mail, or to record all telephone conversations with clients.

The records required under subsection 11.5(2)(g) should document buy and sell transactions, referrals, margin transactions and any other activities relating to a client's account. They include records of all actions leading to trade execution, settlement and clearance, such as trades on exchanges, alternative trading systems, over-the-counter markets, debt markets, and distributions and trades in the prospectus-exempt market.

Examples of these records are:

- trade confirmation statements
- summary information about account activity
- communications between a registrant and its client about particular transactions, and
- records of transactions resulting from securities a client holds, such as dividends or interest paid, or dividend reinvestment program activity

Subsection 11.5(2)(l) requires firms to maintain records that demonstrate compliance with the know your client obligations in section 13.2 and the suitability obligations in section 13.3. This includes records for unsuitable trades in subsection 13.3(2).

#### Client relationship

The records required under subsection 11.5(2)(k) and (m) should document information about a registered firm's relationship with its client and relationships that any representatives have with that client.

These records include:

- communication between the firm and its clients, such as disclosure provided to clients and agreements between the registrant and its clients
- account opening information
- change of status information provided by the client
- disclosure and other relationship information provided by the firm
- margin account agreements
- communications regarding a complaint made by the client
- actions taken by the firm regarding a complaint
- communications that do not relate to a particular transaction, and
- conflicts records



Each record required under subsection 11.5(2)(k) should clearly indicate the name of the accountholder and the account the record refers to. A record should include information only about the accounts of the same accountholder or group. For example, registrants should have separate records for an individual's personal accounts and for accounts of a legal entity that the individual owns or jointly holds with another party.

Where applicable, the financial details should note whether the information is for an individual or a family. This includes spousal income and net worth. The financial details for accounts of a legal entity should note whether the information refers to the entity or to the owner(s) of the entity.

If the registered firm permits clients to complete new account forms themselves, the forms should use language that is clear and avoids terminology that may be unfamiliar to unsophisticated clients.

### **Internal controls**

The records required under subsection 11.5(2)(d), (e), (f), (j) and (o) are records firms must maintain to support the internal controls and supervision components of their compliance system.

## **11.6 Form, accessibility and retention of records**

### **Third party access to records**

Subsection 11.6(1)(b) of NI 31-103 requires registered firms to keep their records in a safe location. This includes ensuring that no one has unauthorized access to information, particularly confidential client information. Registered firms should be particularly vigilant if they maintain books and records in a location that may be accessible by a third party. In this case, the firm should have a confidentiality agreement with the third party.

### *Division 3 Certain business transactions*

## **11.8 Tied selling**

Section 11.8 of NI 31-103 prohibits an individual or firm from engaging in abusive sales practices such as selling a security on the condition that the client purchase another product or service from the registrant or one of its affiliates. These types of practices are known as "tied selling". In our view, this section would be contravened if, for example, a financial institution agreed to lend money to a client only if the client acquired securities of mutual funds sponsored by the financial institution.

However, section 11.8 is not intended to prohibit relationship pricing or other beneficial selling arrangements similar to relationship pricing. Relationship pricing refers to the practice of industry participants offering financial incentives or advantages to certain clients.

## **11.9 Registrant acquiring a registered firm's securities or assets**

Under section 11.9 of NI 31-103, registrants must give the regulator notice if they propose to purchase securities or assets of a registered firm or the parent of a registered firm. For purposes of this section, a registered firm's book of business would be a substantial part of the assets of the registered firm. This notice gives the regulator an opportunity to consider ownership issues that may affect a firm's fitness for registration.

Subsection 11.9(4) does not apply in British Columbia. However, the regulator in British Columbia may exercise discretion under section 36 or 161 of the BC *Securities Act* (BCSA) to impose conditions, restrictions or requirements on the registrant's registration or to suspend or revoke the registration if it decides that an acquisition would affect the registrant's fitness for registration or be prejudicial to the public interest. In these circumstances, the registrant would be entitled to an opportunity to be heard, except if the regulator issues a temporary order under section 161 of the BCSA.

## **11.10 Registered firm whose securities are acquired**

Under section 11.10 of NI 31-103, registered firms must notify the regulator if they know or have reason to believe that any individual or firm is about to purchase more than 10% of the voting securities of the firm or the firm's parent. This notice gives the regulator an opportunity to consider ownership issues that may affect a firm's fitness for registration.

We expect any individual or firm that buys assets of a registered firm and is not already a registrant will have to apply for registration. We will assess their fitness for registration when they apply.

Subsection 11.10(5) does not apply in British Columbia. However, the regulator in British Columbia may exercise discretion under section 36 or 161 of the BCSA to impose conditions, restrictions or requirements on the registrant's registration or to suspend or revoke the registration if it decides that an acquisition would affect the registrant's fitness for registration or be prejudicial to the public interest. In these circumstances, the registrant would be entitled to an opportunity to be heard, except if the regulator issues a temporary order under section 161 of the BCSA.

## **Part 12 Financial condition**

### *Division 1 Working capital*

#### **12.1 Capital requirements**

Section 12.1 of NI 31-103 requires registered firms to notify the regulator if their excess working capital is less than zero.

Registered firms should know their working capital position at all times. This may require a firm to calculate its working capital every day. The frequency of working capital calculations depends on many factors, including the size of the firm, the nature of its business and the stability of the components of its working capital. For example, it may be sufficient for a sole proprietor firm with a dedicated and stable source of working capital to do the calculation on a monthly basis.

#### **Working capital requirements are not cumulative**

The working capital requirements for registered firms set out in section 12.1 are not cumulative. If a firm is registered in more than one category, it must meet the highest capital requirement of its categories of registration, except for those investment fund managers who are also registered as portfolio managers and meet the requirements of the exemption in section 8.6. These investment fund managers need only meet the lower capital requirement for portfolio managers.

#### **If a registrant becomes insolvent or declares bankruptcy**

The regulator will review the circumstances of a registrant's insolvency or bankruptcy on a case-by-case basis. If the regulator has concerns, it may impose terms and conditions on the registrant's registration, such as close supervision and delivering progress reports to the regulator, or it may suspend the registrant's registration.

### *Division 2 Insurance*

#### **Insurance coverage limits**

Registrants must maintain bonding or insurance that provides for a "double aggregate limit" or a "full reinstatement of coverage" (also known as "no aggregate limit"). Most insurers offer aggregate limit policies that contain limits based on a single loss and on the number or value of losses that occur during the coverage period.

Double aggregate limit policies have a specified limit for each claim. The total amount that may be claimed during the coverage period is twice that limit. For example, if an adviser maintains a financial institution bond of \$50,000 for each clause with a double aggregate limit, the adviser's coverage is \$50,000 for any one claim and \$100,000 for all claims during the coverage period.

Full reinstatement of coverage policies and no aggregate limit policies have a specified limit for each claim but no limit on the number of claims or losses during the coverage period. For example, if an adviser maintains a financial institution bond of \$50,000 for each clause with a full reinstatement of coverage provision, the adviser's maximum coverage is \$50,000 for any one claim, but there is no limit on the total amount that can be claimed under the bond during the coverage period.

#### **12.4 Insurance – adviser**

The insurance requirements for advisers depend in part on whether the adviser holds or has access to client assets.

An adviser will be considered to hold or have access to client assets if they do any of the following:

- hold client securities or cash for any period

- accept funds from clients, for example, a cheque made payable to the registrant
- accept client money from a custodian, for example, client money that is deposited in the registrant's bank or trust accounts before the registrant issues a cheque to the client
- have the ability to gain access to client assets
- have, in any capacity, legal ownership of, or access to, client funds or securities
- have the authority, such as under a power of attorney, to withdraw funds or securities from client accounts
- have authority to debit client accounts to pay bills other than investment management fees
- act as a trustee for clients, or
- act as fund manager or general partner for investment funds

## **12.6 Global bonding or insurance**

Registered firms may be covered under a global insurance policy. Under this type of policy, the firm is insured under a parent company's policy that covers the parent and its subsidiaries or affiliates. Firms should ensure that the claims of other entities covered under a global insurance policy do not affect the limits or coverage applicable to the firm.

*Division 4 Financial reporting*

## **12.14 Delivering financial information – investment fund manager**

### **NAV errors and adjustments**

Section 12.14 of NI 31-103 requires investment fund managers to periodically deliver to the regulator, among other things, a description of any net asset value (NAV) adjustment. A NAV adjustment is necessary when there has been a material error and the NAV per unit does not accurately reflect the actual NAV per unit at the time of computation.

Some examples of the causes of NAV errors are:

- mispricing of a security
- corporate action recorded incorrectly
- incorrect numbers used for issued and outstanding units
- incorrect expenses and income used or accrued
- incorrect foreign exchange rates used in the valuation, and
- human error, such as inputting an incorrect value

We expect investment fund managers to have policies that clearly define what constitutes a material error that requires an adjustment, including threshold levels, and how to correct material errors. If an investment fund manager does not have a threshold in place, it may wish to consider the threshold in IFIC Bulletin Number 22 or adopt a more stringent policy.

## **Part 13 Dealing with clients – individuals and firms**

*Division 1 Know your client and suitability*

### **13.2 Know your client**

#### **General principles**

Registrants act as gatekeepers of the integrity of the capital markets. They should not, by act or omission, facilitate conduct that brings the market into disrepute. As part of their gatekeeper role, registrants are required to establish the identity of, and conduct due diligence on, their clients under the know your client (KYC) obligation in section 13.2 of NI 31-103. Complying with the KYC obligation can help ensure that trades are completed in accordance with securities laws.

KYC information forms the basis for determining whether trades in securities are suitable for investors. This helps protect the client, the registrant and the integrity of the capital markets. The KYC obligation requires registrants to take reasonable steps to obtain and periodically update information about their clients.

### **Verifying a client's reputation**

Subsection 13.2(2)(a) requires registrants to make inquiries if they have cause for concern about a client's reputation. The registrant must make all reasonable inquiries necessary to resolve the concern. This includes making a reasonable effort to determine, for example, the nature of the client's business.

### **Identifying insiders**

Under subsection 13.2(2)(b), a registrant must take reasonable steps to establish whether the client is an insider of a reporting issuer or any other issuer whose securities are publicly traded. We consider "reasonable steps" to include explaining to the client what an insider is and what it means for securities to be publicly traded.

For purposes of this paragraph, "reporting issuer" has the meaning given to it in securities legislation and "other issuer" means any issuer whose securities are traded in any public market. This includes domestic, foreign, exchange-listed and over-the-counter markets. This definition does not include issuers whose securities have been distributed through a private placement and are not freely tradeable.

### **Keeping KYC information current**

Under subsection 13.2(4), registrants are required to make reasonable efforts to keep their clients' KYC information current.

We consider information to be current if it is sufficiently up-to-date to support a suitability determination. For example, a portfolio manager with discretionary authority should update its clients' KYC information frequently. A dealer that only occasionally recommends trades to a client should ensure that the client's KYC information is up-to-date at the time a proposed trade or recommendation is made.

## **13.3 Suitability**

Subsection 13.3(1) of NI 31-103 requires registrants to take reasonable steps to ensure that a proposed trade is suitable for a client before making a recommendation or accepting instructions from the client.

To meet this suitability obligation, registrants should have in-depth knowledge of all products that they buy and sell for, or recommend to, their clients. This is often referred to as the "know your product" or KYP obligation. Registrants should know each product well enough to understand and explain to their clients the product's risks, key features, and initial and ongoing costs and fees. Having the registered firm's approval for representatives to sell a product does not mean that the product will be suitable for all clients. Individual registrants must still determine the suitability of each transaction for every client.

Registrants should also be aware of, and act in compliance with, the terms of any exemption being relied on for the trade or distribution of the product.

In all cases, we expect registrants to be able to demonstrate a process for making suitability determinations that are appropriate in the circumstances.

### **Suitability obligations cannot be delegated**

Registrants may not:

- delegate their suitability obligations to anyone else, or
- satisfy the suitability obligation by simply disclosing the risks involved with a trade

Only permitted clients may waive their right to a suitability determination. Registrants must make a suitability determination for all other clients. If a client instructs a registrant to make a trade that is unsuitable, the registrant may not allow the trade to be completed until they warn the client as required under subsection 13.3(2).

### **KYC information for suitability depends on circumstances**

The extent of KYC information a registrant needs to determine suitability of a trade will depend on the:

- client's circumstances
- type of security
- client's relationship to the registrant, and
- registrant's business model

In some cases, the registrant will need extensive KYC information, for example, if the registrant is a portfolio manager with discretionary authority. In these cases, the registrant should have a comprehensive understanding of the client's:

- investment needs and objectives, including the client's time horizon for their investments
- overall financial circumstances, including net worth, income, current investment holdings and employment status, and
- risk tolerance for various types of securities and investment portfolios, taking into account the client's investment knowledge

In other cases, the registrant may need less KYC information, for example, if the registrant only occasionally deals with a client who makes small investments relative to their overall financial position.

If the registrant recommends securities traded under the prospectus exemption for accredited investors in NI 45-106, the registrant should determine whether the client qualifies as an accredited investor.

If a client is opening more than one account, the registrant should indicate whether the client's investment objectives and risk tolerance apply to a particular account or to the client's whole portfolio of accounts.

### **Registered firm and financial institution clients**

Under subsection 13.3(3), there is no obligation to make a suitability determination for a client that is a registered firm, a Canadian financial institution or a Schedule III bank.

### **Permitted clients**

Under subsection 13.3(4), registrants do not have to make a suitability determination for a permitted client if:

- the permitted client has waived their right to suitability in writing, and
- the registrant does not act as an adviser for a managed account of the permitted client

A permitted client may waive their right to suitability for all trades under a blanket waiver.

### **SRO exemptions**

SRO rules may also provide conditional exemptions from the suitability obligation, for example, for dealers who offer order execution only services.

## *Division 2 Conflicts of interest*

### **13.4 Identifying and responding to conflicts of interest**

Section 13.4 of NI 31-103 covers a broad range of conflicts of interest. It requires registered firms to take reasonable steps to identify existing material conflicts of interest and material conflicts that the firm reasonably expects to arise between the firm and a client. As part of identifying these conflicts, a firm should collect information from the individuals acting on its behalf regarding the conflicts they expect to arise with their clients.

We consider a conflict of interest to be any circumstance where the interests of different parties, such as the interests of a client and those of a registrant, are inconsistent or divergent.

### **Responding to conflicts interest**

A registered firm's policies and procedures for managing conflicts should allow the firm and its staff to:

- identify conflicts of interest that should be avoided
- determine the level of risk that a conflict of interest raises, and
- respond appropriately to conflicts of interest

When responding to any conflict of interest, registrants should consider their standard of care for dealing with clients and apply consistent criteria to similar types of conflicts of interest.

In general, three methods are used to respond to conflicts of interest:

- avoidance

- control, and
- disclosure

If a registrant allows a serious conflict of interest to continue, there is a high risk of harm to clients or to the market. If the risk of harming a client or the integrity of the markets is too high, the conflict needs to be avoided. If a registered firm does not avoid a conflict of interest, it should take steps to control or disclose the conflict, or both. The firm should also consider what internal structures or policies and procedures it should use or have to reasonably respond to the conflict of interest.

### ***Avoiding conflicts of interest***

Registrants must avoid all conflicts of interest that are prohibited by law. If a conflict of interest is not prohibited by law, registrants should avoid the conflict if it is sufficiently contrary to the interests of a client that there can be no other reasonable response.

For example, some conflicts of interest are so contrary to another person's or company's interest that a registrant cannot use controls or disclosure to respond to them. In these cases, the registrant should avoid the conflict, stop providing the service or stop dealing with the client.

### ***Controlling conflicts of interest***

Registered firms should design their organizational structures, lines of reporting and physical locations to control conflicts of interest effectively. For example, the following situations would likely raise a conflict of interest:

- advisory staff reporting to marketing staff
- compliance or internal audit staff reporting to a business unit, and
- registered representatives and investment banking staff in the same physical location

Depending on the conflict of interest, registered firms may control the conflict by:

- assigning a different representative to provide a service to the particular client
- creating a group or committee to review, develop or approve responses
- monitoring trading activity, or
- using information barriers for certain internal communication

### ***Disclosing conflicts of interest***

#### ***(a) When disclosure is appropriate***

Registered firms should ensure that their clients are adequately informed about any conflicts of interest that may affect the services the firm provides to them. This is in addition to any other methods the registered firm may use to manage the conflict.

#### ***(b) Timing of disclosure***

Under subsection 13.4(3), if a reasonable investor would expect to be informed of a conflict, a registered firm must disclose the conflict in a timely manner. Registered firms and their representatives should disclose conflicts of interest to their clients before or at the time they recommend the transaction or provide the service that gives rise to the conflict. This is to give clients a reasonable amount of time to assess the conflict. For example, if a registered individual recommends a security that they own, they should disclose that to the client before or at the time of the recommendation.

#### ***(c) When disclosure is not appropriate***

Disclosure may not be appropriate if a conflict of interest involves confidential or commercially sensitive information, or the information amounts to "inside information" under insider trading provisions in securities legislation.

In these situations, registered firms will need to assess whether there are other methods to adequately respond to the conflict of interest. If not, the firm may have to decline to provide the service to avoid the conflict of interest.

Registered firms should also have specific procedures for responding to conflicts of interest that involve inside information and for complying with insider trading provisions.

**(d) How to disclose a conflict of interest**

Registered firms should provide disclosure about material conflicts of interest to their clients if a reasonable investor would expect to be informed about them. When a registered firm provides this disclosure, it should:

- be prominent, specific, clear and meaningful to the client, and
- explain the conflict of interest and how it could affect the service the client is being offered

Registered firms should not:

- provide generic disclosure
- give partial disclosure that could mislead their clients, or
- obscure conflicts of interest in overly detailed disclosure

**Examples of conflicts of interest**

This section describes specific situations where a registrant could be in a conflict of interest and how to manage the conflict.

***Relationships with related or connected issuers***

When a registered firm trades in, or recommends securities of, a related or connected issuer, it should respond to the resulting conflict of interest by disclosing it to the client.

To provide disclosure about conflicts with related issuers, a registered firm may maintain a list of the related issuers for which it acts as a dealer or adviser. It may make the list available to clients by:

- posting the list on its website and keeping it updated
- providing the list to the client at the time of account opening, or
- explaining to the client at the time of account opening how to contact the firm to request a copy of the list free of charge

The list may include examples of the types of issuers that are related or connected and the nature of the firm's relationship with those issuers. For example, a firm could generally describe the nature of its relationship with an investment fund within a family of investment funds. This would mean that the firm may not have to update the list when a new fund is added to that fund family.

However, this type of disclosure may not meet the expectations of a reasonable investor when a specific conflict with a related or connected issuer arises, for example, when a registered individual recommends a trade in the securities of a related issuer. In these circumstances, a registered firm should provide the client with disclosure about the specific conflict with that issuer. This disclosure should include a description of the nature of the firm's relationship with the issuer.

Like all disclosure, information regarding a conflict with a related or connected issuer should be made available to clients before or at the time of the advice or trade giving rise to the conflict, so that clients have a reasonable amount of time to assess it. Registrants should use their judgment for the best way and time to inform clients about these conflicts. Previous disclosure may no longer be relevant to, or remembered by, a client, while disclosure of the same conflict more than once in a short time may be unnecessary and confusing.

Firms do not have to disclose to clients their relationship with a related or connected issuer that is a mutual fund and an affiliate of the firm if the names of the firm and the fund are similar enough that a reasonable person would conclude they are affiliated.

***Relationships with other issuers***

Firms should assess whether conflicts of interest may arise in relationships with issuers that do not fall within the definitions of related or connected issuers. Examples include non-corporate issuers such as a trust, partnership or special purpose vehicle or conduit issuing asset-backed commercial paper. This is especially important if a registered firm or its affiliates are involved in sponsoring, manufacturing, underwriting or distributing these securities.

The registered firm should disclose the relationship with these types of issuers if it may give rise to a conflict of interest that a reasonable client would expect to be informed about.

### ***Competing interests of clients***

If clients of a registered firm have competing interests, the firm should make reasonable efforts to be fair to all clients. Firms should have internal systems to evaluate the balance of these interests.

For example, a conflict of interest can arise between investment banking clients, who want the highest price, lowest interest rate or best terms in general for their issuances of securities, and retail clients who will buy the product. The firm should consider whether the product meets the needs of retail clients and is competitive with alternatives available in the market.

### ***Individuals who serve on a board of directors***

Conflicts of interest can arise when registered individuals serve on a board of directors. Examples include conflicting fiduciary duties owed to the company and to a registered firm or client, possible receipt of inside information and conflicting demands on the representative's time.

Registered firms should consider controlling the conflict by:

- requiring their representatives to seek permission from the firm to serve on the board of directors of an issuer, and
- having policies for board participation that identify the circumstances where the activity would not be in the best interests of the firm or its clients

The regulator will take into account the potential conflicts of interest that may arise when an individual serves on a board of directors when assessing that individual's continuing fitness for registration.

### ***Individuals who have outside business activities***

Conflicts can arise when registered individuals are involved in outside business activities, for example, because of the compensation they receive for these activities or because of the nature of the relationship between the individual and the outside entity. Before approving any of these activities, registered firms should consider potential conflicts of interest. If the firm cannot properly control a potential conflict of interest, it should not permit the outside activity.

The regulator will take into account the potential conflicts of interest that may arise as a result of an individual's outside business activities when assessing that individual's application for registration or continuing fitness for registration.

### ***Compensation practices***

Registered firms should consider whether any particular benefits, compensation or remuneration practices are inconsistent with their obligations to clients, especially if the firm relies heavily on commission-based remuneration. For example, if there is a complex product that carries a high commission, the firm may decide that it is not appropriate to offer that product.

## **13.5 Restrictions on certain managed account transactions**

Section 13.5 of NI 31-103 prohibits a registered adviser from engaging in certain transactions in investment portfolios it manages for clients on a discretionary basis where the relationship may give rise to a conflict of interest or a perceived conflict of interest. The prohibited transactions include trades in securities in which a responsible person or an associate of a responsible person may have an interest or over which they may have influence or control.

### ***Disclosure when responsible person is partner, director or officer of issuer***

Subsection 13.5(2)(a) prohibits a registered adviser from purchasing securities of an issuer in which a responsible person or an associate of a responsible person is a partner, officer or director for a client's managed account. The prohibition applies unless the conflict is disclosed to the client and the client's written consent is obtained prior to the purchase.

If the client is an investment fund, the disclosure should be provided to, and the consent obtained from, each security holder of the investment fund in order for it to be meaningful. This disclosure may be provided in the offering memorandum that is provided to security holders. Like all disclosure about conflicts, it should be prominent, specific, clear and meaningful to the client. Consent may be obtained in the investment management agreement signed by security holders.



This approach may not be practical for prospectus qualified mutual funds. Investment fund managers and advisers of these funds should also consider the specific exemption from the prohibition under section 6.2 of National Instrument 81-107 *Independent Review Committee for Investment Funds* (NI 81-107) for prospectus-qualified investment funds.

### **Restrictions on trades with certain investment portfolios**

Subsection 13.5(2)(b) prohibits certain trades, including, for example, those between the managed account of a client and the managed account of:

- a spouse of the adviser
- a trust for which a responsible person is the trustee, or
- a corporation in which a responsible person beneficially owns 10% or more of the voting securities

It also prohibits inter-fund trades. An inter-fund trade occurs when the adviser for an investment fund knowingly directs a trade in portfolio securities to another investment fund that it acts for or instructs the dealer to execute the trade with the other investment fund. Investment fund managers and their advisers should also consider the exemption from the prohibition that exists for inter-fund trades by public investment funds under section 6.1 of NI 81-107.

### **13.6 Disclosure when recommending related or connected securities**

Section 13.6 of NI 31-103 restricts the ability of a registered firm to recommend a trade in a security of a related or connected issuer. The restrictions apply to recommendations made in any medium of communication. This includes recommendations in newsletters, articles in general circulation newspapers or magazines, websites, e-mail, Internet chat rooms, bulletin boards, television and radio.

It does not apply to oral recommendations made by registered individuals to their clients. These recommendations are subject to the requirements of section 13.4.

#### *Division 3 Referral arrangements*

Division 3 sets out the requirements for permitted referral arrangements. Regulators want to ensure that under any referral arrangements:

- individuals and firms that engage in registerable activities are appropriately registered
- the roles and responsibilities of the parties are clear, including responsibility for compliance with securities legislation, and
- clients are provided with disclosure about the referral arrangement to help them evaluate the referral arrangement and the extent of any conflicts of interest

### **Obligations to clients**

A client who is referred to an individual or firm becomes the client of that individual or firm for the purposes of the services provided under the referral arrangement.

The registrant receiving a referral must meet all of its obligations as a registrant toward its referred clients, including know your client and suitability determinations.

Registrants involved in referral arrangements should manage any related conflicts of interest in accordance with the applicable provisions of Part 13 *Dealing with clients – individuals and firms*. For example, if the registered firm is not satisfied that the referral fee is reasonable, it should assess whether an unreasonably high fee may create a conflict that could motivate its representatives to act contrary to their duties toward their clients.

### **13.7 Definitions – referral arrangements**

Section 13.7 of NI 31-103 defines “referral arrangement” in broad terms. The definition is not limited to referrals for providing investment products, financial services or services requiring registration. It also includes receiving a referral fee for providing a client name and contact information to an individual or firm. “Referral fee” is also broadly defined. It includes sharing or splitting any commission resulting from the purchase or sale of a security.

### **13.8 Permitted referral arrangements**

Under section 13.8 of NI 31-103, parties to a referral arrangement are required to set out the terms of the arrangement in a written agreement. This is intended to ensure that each party's roles and responsibilities are made clear.

We expect referral agreements to include:

- the roles and responsibilities of each party
- limitations on any party that is not a registrant (to ensure that it is not engaging in any activities requiring registration)
- the disclosure to be provided to referred clients, and
- who provides the disclosure to referred clients

If the individual or firm receiving the referral is a registrant, they are responsible for:

- carrying out all activity requiring registration that results from the referral arrangement, and
- communicating with referred clients

Registered firms are required to be parties to referral agreements entered into by their representatives. This ensures that they are aware of these arrangements so they can adequately supervise their representatives and monitor compliance with the agreements. This does not preclude the individual registrant from also being a party to the agreement.

A party to a referral arrangement may need to be registered depending on the activities that the party carries out. Registrants cannot use a referral arrangement to assign, contract out of or otherwise avoid their regulatory obligations.

### **13.9 Verifying the qualifications of the person or company receiving the referral**

Section 13.9 of NI 31-103 requires the registrant making a referral to satisfy itself that the party receiving the referral is appropriately qualified to perform the services, and if applicable, is appropriately registered. The registrant is responsible for determining the steps that are appropriate in the particular circumstances. For example, this may include an assessment of the types of clients that the referred services would be appropriate for. This is consistent with the registrant's obligation to act in the best interest of its clients.

### **13.10 Disclosing referral arrangements to clients**

The disclosure of information to clients required under section 13.10 of NI 31-103 is intended to help clients make an informed decision about the referral arrangement and to assess any conflicts of interest. The disclosure should be provided to clients before or at the time the referred services are provided.

Registrants should take reasonable steps to ensure that clients understand:

- which entity they are dealing with
- what they can expect that entity to provide to them
- the registrant's key responsibilities to them
- the limitations of the registrant's registration category
- any relevant terms and conditions imposed on the registrant's registration
- the extent of the referrer's financial interest in the referral arrangement, and
- the nature of any potential or actual conflict of interest that may arise from the referral arrangement

#### *Division 5 Complaints*

Registered firms in Québec comply with Division 5 if they comply with sections 168.1.1 to 168.1.3 of the Québec *Securities Act*, which has provided a substantially similar regime since 2002.

The guidance in Division 5 applies to firms registered in any jurisdiction, including Québec.

### **13.15 Handling complaints**

Section 13.15 of NI 31-103 requires registered firms to document complaints, and to effectively and fairly respond to them. Registered firms must consider all complaints, not just those relating to possible violations of securities legislation.

An effective complaint system deals with all formal and informal complaints or disputes internally, or refers them to the appropriate external person or process in a timely and fair manner.

### **13.16 Dispute resolution service**

If a registered firm receives a complaint about any of its trading or advising activities, it must ensure that the complainant is aware of the dispute resolution or mediation services that are available to them and that the firm will pay for the services. Registered firms should know all applicable mechanisms and processes for dealing with different types of complaints, including those prescribed by the applicable SRO.

#### **Québec registrants**

In Québec, registrants must inform each complainant, in writing and without delay, that if the complainant is dissatisfied with how the complaint is handled or with the outcome, they may request the registrant to forward a copy of the complaint file to the Autorité des marchés financiers. The registrant must forward a copy of the complaint file to the Autorité des marchés financiers, which will examine the complaint. The Autorité des marchés financiers may act as a mediator if it considers it appropriate to do so and the parties agree.

#### **Registrants who do business in other sectors**

Some registrants are also registered or licensed to do business in other sectors, such as insurance. These registrants should inform their clients of the complaint mechanisms for each sector in which they do business and how to use them.

## **Part 14 Handling client accounts – firms**

### *Division 2 Disclosure to clients*

Registrants should ensure that clients understand who they are dealing with. They should carry on all registerable activities in their full legal or registered trade name. Contracts, confirmation and account statements, among other documents, should contain the registrant's full legal name.

### **14.2 Relationship disclosure information**

#### **Content of relationship disclosure information**

There is no prescribed form for the relationship disclosure information required under section 14.2 of NI 31-103. A registered firm may provide this information in a single document or in separate documents, which together give the client the prescribed information.

#### **Disclosure of costs**

Under subsection 14.2(2)(g), registered firms must provide clients with a description of the costs they will pay in making, holding and selling investments. We expect this description to include all costs a client may pay during the course of holding a particular investment. For example, for a mutual fund, the description should briefly explain each of the following and how they may affect the investment:

- the management expense ratio
- the sales charge options available to the client
- the trailing commission
- any short-term trading fees
- any switch or change fees

#### **Permitted clients**

Under subsection 14.2(6), registrants do not have to provide relationship disclosure information to permitted clients if:

- the permitted client has waived the requirements in writing, and

- the registrant does not act as an adviser for a managed account of the permitted client

### **Promoting client participation**

Registered firms should help their clients understand the registrant-client relationship. They should encourage clients to actively participate in the relationship and provide them with clear, relevant and timely information and communications.

In particular, registered firms should encourage clients to:

- **Keep the firm up to date.** Clients should provide full and accurate information to the firm and the registered individuals acting for the firm. Clients should promptly inform the firm of any change to information that could reasonably result in a change to the types of investments appropriate for them, such as a change to their income, investment objectives, risk tolerance, time horizon or net worth.
- **Be informed.** Clients should understand the potential risks and returns on investments. They should carefully review sales literature provided by the firm. Where appropriate, clients should consult professionals, such as a lawyer or an accountant, for legal or tax advice.
- **Ask questions.** Clients should ask questions and request information from the firm to resolve questions about their account, transactions or investments, or their relationship with the firm or a registered individual acting for the firm.
- **Stay on top of their investments.** Clients should pay for securities purchases by the settlement date. They should review all account documentation provided by the firm and regularly review portfolio holdings and performance.

#### **14.4 When the firm has a relationship with a financial institution**

As part of their duty to clients, registrants who have a relationship with a financial institution should ensure that their clients understand which legal entity they are dealing with. In particular, clients may be confused if more than one financial services firm is carrying on business in the same location. Registrants may differentiate themselves through various methods, including signage and disclosure.

*Division 3 Client assets*

#### **14.6 Holding client assets in trust**

Section 14.6 of NI 31-103 requires a registered firm to segregate client assets and hold them in trust. We consider it prudent for registrants who are not members of an SRO to hold client assets in client name only. This is because the capital requirements for non-SRO members are not designed to reflect the added risk of holding client assets in nominee name.

*Division 4 Client accounts*

#### **14.10 Allocating investment opportunities fairly**

If the adviser allocates investment opportunities among its clients, the firm's fairness policy should, at a minimum, indicate the method used to allocate the following:

- price and commission among client orders when trades are bunched or blocked
- block trades and initial public offerings among client accounts
- block trades and initial public offerings among client orders that are partially filled, such as on a pro-rata basis

The fairness policy should also address any other situation where investment opportunities must be allocated.

*Division 5 Account activity reporting*

Each trade should be reported in the currency in which it was executed. If a trade is executed in a foreign currency through a Canadian account, the exchange rate should be reported to the client.

#### **14.14 Client statements**

Section 14.14 of NI 31-103 requires registered dealers and advisers to deliver statements to clients at least once every three months. There is no prescribed form for these statements but they must contain the information in subsections 14.14(4) and (5).

We expect all dealers and advisers to provide client statements. For example, an exempt market dealer should provide a statement that contains the information prescribed for all transactions the exempt market dealer has entered into or arranged on a client's behalf.

### Appendix A - Contact information

Jurisdiction	E-mail	E-mail	E-mail
Alberta	<a href="mailto:registration@asc.ca">registration@asc.ca</a>	(403) 297-4113	Alberta Securities Commission, 4th Floor, 300 - 5th Avenue S.W. Calgary, AB T2P 3C4 Attention: Registration
British Columbia	<a href="mailto:registration@bcsc.bc.ca">registration@bcsc.bc.ca</a>	(604) 899-6506	British Columbia Securities Commission P.O. Box 10142, Pacific Centre 701 West Georgia Street Vancouver, BC V7Y 1L2 Attention: Registration
Manitoba	<a href="mailto:registrationmsc@gov.mb.ca">registrationmsc@gov.mb.ca</a>	(204) 945-0330	The Manitoba Securities Commission 500-400 St. Mary Avenue Winnipeg, MB R3C 4K5 Attention: Registrations
New Brunswick	<a href="mailto:nrs@nbsec-cvmnb.ca">nrs@nbsec-cvmnb.ca</a>	(506) 658-3059	New Brunswick Securities Commission Suite 300, 85 Charlotte Street Saint John, NB E2L 2J2 Attention: Registration Officer
Newfoundland & Labrador	<a href="mailto:scon@gov.nl.ca">scon@gov.nl.ca</a>	(709) 729-6187	Financial Services Regulation Division Department of Government Services Government of Newfoundland and Labrador P.O. Box 8700, 2nd Floor, West Block Confederation Building St. John's, NL A1B 4J6 Attention: Registration Section
Northwest Territories	<a href="mailto:SecuritiesRegistry@gov.nt.ca">SecuritiesRegistry@gov.nt.ca</a>	(867) 873-0243	Government of the Northwest Territories P.O. Box 1320 Yellowknife, NWT X1A 2L9 Attention: Deputy Superintendent of Securities
Nova Scotia	<a href="mailto:nrs@gov.ns.ca">nrs@gov.ns.ca</a>	(902) 424-4625	Nova Scotia Securities Commission 2nd Floor, Joseph Howe Building 1690 Hollis Street P.O. Box 458 Halifax, NS B3J 2P8 Attention: Deputy Director, Capital Markets
Nunavut	<a href="mailto:CorporateRegistrations@gov.nu.ca">CorporateRegistrations@gov.nu.ca</a>	(867) 975-6590 (Faxing to NU is unreliable. The preferred method is e-mail.)	Legal Registries Division Department of Justice Government of Nunavut P.O. Box 1000 Station 570 Iqaluit, NU X0A 0H0 Attention: Deputy Registrar
Ontario	<a href="mailto:registration@osc.gov.on.ca">registration@osc.gov.on.ca</a>	(416) 593-8283	Ontario Securities Commission Suite 1903, Box 55 20 Queen Street West Toronto, ON M5H 3S8 Attention: Registrant Regulation
Prince Edward Island	<a href="mailto:ccis@gov.pe.ca">ccis@gov.pe.ca</a>	(902) 368-6288	Consumer and Corporate Services Division, Office of the Attorney General P.O. Box 2000, 95 Rochford Street Charlottetown, PE C1A 7N8 Attention: Superintendent of Securities

<b>Jurisdiction</b>	<b>E-mail</b>	<b>E-mail</b>	<b>E-mail</b>
Québec	<a href="mailto:inscription@lautorite.qc.ca">inscription@lautorite.qc.ca</a>	(514) 873-3090	Autorité des marchés financiers Service de l'encadrement des intermédiaires 800 square Victoria, 22e étage C.P 246, Tour de la Bourse Montréal (Québec) H4Z 1G3
Saskatchewan	<a href="mailto:registrationsfsc@gov.sk.ca">registrationsfsc@gov.sk.ca</a>	(306) 787-5899	Saskatchewan Financial Services Commission Suite 601 1919 Saskatchewan Drive Regina, SK S4P 4H2 Attention: Registration
Yukon	<a href="mailto:corporateaffairs@gov.yk.ca">corporateaffairs@gov.yk.ca</a>	(867) 393-6251	Department of Community Services Yukon Yukon Securities Office P.O. Box 2703 C-6 Whitehorse, YT Y1A 2C6 Attention: Superintendent of Securities

## Appendix B - Terms not defined in NI 31-103 or this Companion Policy

Terms defined in National Instrument 14-101 *Definitions*:

- adviser registration requirement
- Canadian securities regulatory authority
- dealer registration requirement
- foreign jurisdiction
- jurisdiction or jurisdiction of Canada
- local jurisdiction
- investment fund manager registration requirement
- prospectus requirement
- registration requirement
- regulator
- securities directions
- securities legislation
- securities regulatory authority
- SRO
- underwriter registration requirement

Terms defined in National Instrument 45-106 *Prospectus and Registration Exemptions*:

- accredited investor
- eligibility adviser
- financial assets

Terms defined in National Instrument 81-102 *Mutual Funds*:

- money market fund

Terms defined in the Securities Act of most jurisdictions:

- adviser
- associate
- company
- control person
- dealer
- director
- distribution
- exchange contract (BC, AB, SK and NB only)
- insider
- individual
- investment fund
- investment fund manager
- issuer
- mutual fund
- officer
- person
- promoter
- records
- registrant
- reporting issuer
- security
- trade
- underwriter



## Appendix C - Proficiency requirements for individuals acting on behalf of a registered firm

The tables in this Appendix set out the education and experience requirements, by firm registration category, for individuals who are applying for registration under securities legislation.

An individual must not perform an activity that requires registration unless the individual has the education, training and experience that a reasonable person would consider necessary to perform the activity competently.

### Acronyms used in the tables

BMP	Branch Manager Proficiency Exam	CSC	Canadian Securities Course Exam
CA	Chartered Accountant	EMP	Exempt Market Products Exam
CCO	Chief Compliance Officer	IFIC	Investment Funds in Canada Course Exam
CFA	CFA Charter	MFDC	Mutual Funds Dealer Compliance Exam
CGA	Certified General Accountant	PDO	Officers', Partners' and Directors' Exam/Partners, Directors
CMA	Certified Management Accountant		and Senior Officers Course Exam
CIF	Canadian Investment Funds Exam	SRP	Sales Representative Proficiency Exam
CIM	Canadian Investment Manager designation		

<b>Investment dealer</b>		
<b>Dealing representative</b>		<b>CCO</b>
Proficiency requirements set by IIROC		Proficiency requirements set by IIROC
<b>Mutual fund dealer</b>		
<b>Dealing representative</b>		<b>CCO</b>
One of these four options: 1. CIF 2. CSC 3. IFIC 4. Advising representative requirements – portfolio manager		One of these two options: 1. CIF, CSC or IFIC; and PDO or MFDC 2. CCO requirements – portfolio manager
<b>Exempt market dealer</b>		
<b>Dealing representative</b>		<b>CCO</b>
One of these three options: 1. CSC 2. EMP 3. Advising representative requirements – portfolio manager		One of these three options: 1. PDO and CSC 2. PDO and EMP 3. CCO requirements – portfolio manager
<b>Scholarship plan dealer</b>		
<b>Dealing representative</b>		<b>CCO</b>
SRP		SRP, BMP and PDO
<b>Restricted dealer</b>		
<b>Dealing representative</b>		<b>CCO</b>
Regulator to determine on a case-by-case basis		Regulator to determine on a case-by-case basis
<b>Portfolio manager</b>		
<b>Advising representative</b>	<b>Associate advising representative</b>	<b>CCO</b>
One of these two options: 1. CFA and 12 months of relevant investment management experience in the 36-month period before applying for registration 2. CIM and 48 months of relevant investment management experience (12 months gained in the 36-month period for applying for registration)	One of these two options: 1. Level 1 of the CFA and 24 months of relevant investment management experience 2. CIM and 24 months of relevant investment management experience	One of these three options: 1. CSC, PDO, and CFA or a professional designation as a lawyer, CA, CGA, CMA, notary in Quebec or the equivalent in a foreign jurisdiction, and: • 36 months of relevant securities experience working at an investment dealer, registered adviser or investment fund manager, or • 36 months providing

		<p>professional services in the securities industry and 12 months working at a registered dealer, registered adviser or investment fund manager, for a total of 48 months</p> <p>2. CSC, PDO and five years working at:</p> <ul style="list-style-type: none"> <li>• an investment dealer or a registered adviser (including 36 months in a compliance capacity), or</li> <li>• a Canadian financial institution in a compliance capacity relating to portfolio management and 12 months at a registered dealer or registered adviser, for a total of six years</li> </ul> <p>3. PDO and advising representative requirements – portfolio manager</p>
<b>Restricted portfolio manager</b>		
<b>Advising representative</b>	<b>Associate advising representative</b>	<b>CCO</b>
Regulator to determine on case-by-case basis	Regulator to determine on case-by-case basis	Regulator to determine on case-by-case basis
<b>Investment fund manager</b>		
<b>CCO</b>		
<p>One of these three options:</p> <p>1. CSC, PDO, and CFA or a professional designation as a lawyer, CA, CGA, CMA, notary in Quebec or the equivalent in a foreign jurisdiction, and:</p> <ul style="list-style-type: none"> <li>• 36 months of relevant securities experience working at a registered dealer, registered adviser or investment fund manager, or</li> <li>• 36 months providing professional services in the securities industry and 12 months working in a relevant capacity at an investment fund manager, for a total of 48 months</li> </ul> <p>2. CIF, CSC or IFIC; PDO and five years of relevant securities experience working at a registered dealer, registered adviser or an investment fund manager (including 36 months in a compliance capacity)</p> <p>3. CCO requirements for portfolio manager</p>		