



BC Interpretation Note 33-705

**Conditions of Registration and Order of the Executive Director  
for Investment Dealers with a BC Office that  
Trade in the U.S. Over-the-Counter Markets**

On October 28, 2009, the Director, Capital Markets Regulation first imposed revised conditions of registration for all British Columbia investment dealers that trade in securities of specified OTC issuers through an office in British Columbia.

In 2012, the conditions of registration were revoked and the Director, Capital Markets Regulation, imposed updated conditions, *Conditions of Registration – Investment Dealers with a BC Office that Trade in the U.S. Over-the-Counter Markets* (the conditions), to record and report information.

The Executive Director issued BC Instrument BCI 13-5\*\* *Electronic Delivery of Reports Under Conditions of Registration – Investment Dealers with a BC Office that Trade in the U.S. Over-the-Counter Markets* (BCI 13-5\*\*), which requires that information reported under the conditions be delivered electronically.

**1. Interpretation**

A term that is defined in the *Securities Act* (Act), National Instrument 14-101 *Definitions*, National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103), National Instrument 45-106 *Prospectus and Registration Exemptions* (NI 45-106), Multilateral Instrument 51-105 *Issuers Quoted in the U.S. Over-the-Counter Markets*, or BCI 13-5\*\* has the same meaning in the conditions, forms, or BCIN 33-705.

**2. Application**

The conditions expire (\* three years from their effective date). The conditions do not apply to dealers that provide the Commission with an undertaking not to trade in securities of specified OTC issuers through a BC office (Form A Undertaking).

A dealer that has filed the undertaking may wish to make an isolated trade in securities of a specified OTC issuer through a BC office for a client. If a dealer wants to do this, it must rely on the undertaking's exception for isolated trades and must record the relevant details of the trade, including all of the following:

- the name of the issuer
- the number of securities traded
- the date of the trade
- the price

- the circumstances that constituted the isolated nature of the trade

Dealers should consider what additional information the trade's audit trail requires.

Dealers that file an undertaking, and later decide to withdraw it, must provide the Commission with 10 days' advance written notice before they can trade in securities of specified OTC issuers through a BC office.

### **3. Risk management**

Condition 3 requires dealers to manage the risks of trading securities of specified OTC issuers through a BC office.

The risks include those associated with trading by market participants who engage in illegal, manipulative market activities through the over-the-counter markets in the United States.

Arrangements that could hide abusive market practices are risk indicators. A primary indicator of risk is a deposit – or an attempted deposit – of shares of specified OTC issuers by insiders, control persons, founders and persons who conduct or cause to be conducted investor relations activities relating to the specified OTC issuer (closely related persons). These deposits can enable a closely related person to sell the securities to public investors at inflated prices through the U.S. OTC markets.

Another key risk indicator is holding securities of a specified OTC issuer through opaque or convoluted arrangements, which can enable an individual or group to manipulate the market. These arrangements can involve secrecy jurisdictions or complex transactions that obscure who controls the securities. Difficulty identifying the individuals who control a beneficial owner that is not an individual also indicates a risk. Similarly, complex transfers add risk: difficulty tracing a transaction makes it hard for dealers and the Commission to assess it, especially if the transfer of securities does not involve a registrant.

We expect dealers to implement systems that are effective in managing these risks. An effective system includes regular monitoring to ensure that it is working as intended.

### **4. Monitoring, recordkeeping and reporting**

#### ***(a) Requirement***

Conditions 4 and 5 require dealers to record and report data related to trading in securities of specified OTC issuers through a BC office. The Commission will use this data to monitor the impact of the conditions on trading in those securities.

Condition 5 requires dealers to deliver reports to the Commission within 30 days of the end of each calendar quarter. Under BCI 13-5\*\*, this delivery must be by electronic means using OTC e-services. BCI 13-5\*\* provides a limited exception for unanticipated technical difficulties.

Some information recorded under the conditions does not have to be reported quarterly. However, dealers must retain this information as part of their books and records obligation under section 11.5 of NI 31-103.

**(b) *Trading in specified OTC issuers***

The definition of specified OTC issuer excludes issuers that have American Depository Receipts (ADRs) and issuers with a class of securities listed on certain exchanges. We intend all reporting of OTC trading – including commissions, significant holdings, and significant trading – to exclude reporting about ADRs and issuers listed on those specified exchanges. Reporting should reflect only trading in issuers actually caught by the definition of specified OTC issuer.

**(c) *Refused deposits of specified OTC issuer securities***

Condition 4(f) requires a dealer to record the number of deposits of specified OTC issuer securities they refuse under condition 11. A refused deposit includes a dealer returning to a client, or a would-be client, a certificate that was presented for deposit or trading at the dealer. A refused deposit includes a casual attempt to deposit securities of a specified OTC issuer that a dealer turns away. For each refused deposit, a dealer must report in Form B *Investment Dealer Trading in Specified OTC Issuer Securities* (Form B) all relevant information about the securities and the reason the deposit was refused. Relevant information includes:

- the date of the attempted deposit
- the name of the issuer
- the number of securities
- the name of the client
- the jurisdictions linked to the attempted deposit, and
- from the reasons for refusal provided in Form B, the one that best describes why a dealer refused the deposit, together with other relevant information

The jurisdictions linked in the chain of control to the attempted deposit include jurisdictions where:

- an individual resides or holds citizenship, or
- if a person is not an individual (for example a corporation or a trust), the person is organized, controlled, directed, or managed.

If a beneficial owner is not an individual, then the report should name each jurisdiction in the chain of control between the beneficial owner and the individuals with ultimate control or direction. That includes any jurisdiction linked to persons through which an individual identified under condition 6(b) exercises direct or indirect control or direction.

***(d) Accepted deposits of specified OTC issuer securities***

Conditions 4(g) and (h) apply to a dealer that accepts specified OTC issuer securities. The conditions require reporting in Form B of related information.

Condition 4(g) relates to securities of a specified OTC issuer held, controlled, or under the direction of an individual identified under condition 6. A dealer must calculate and record the total number of securities of a specified OTC issuer and the percentage of a specified OTC issuer's outstanding securities that an individual identified under condition 6 holds, controls, or directs through the dealer. The conditions require reporting in Form B, items 9 and 10 of:

- the total units of a specified OTC issuer, as an absolute number of securities and as a percentage of the securities outstanding, if, at the time of deposit, their percentage was 10 percent or greater, and
- the three largest percentages that were less than the 10 percent threshold in Form B, item 9 but that exceeded 20,000 units

Condition 4(h) relates to trading in a specified OTC issuer facilitated by a dealer through BC offices. It aggregates trades in a specified OTC issuer by volume from all accounts trading the issuer. For example, if two client accounts and a house account traded a specified OTC issuer through a dealer's BC offices, then the dealer would determine whether the trading from those three accounts triggered the reporting requirement for significant trading.

Condition 5 requires quarterly reporting of weekly aggregated trading volume facilitated by the dealer that meets or exceeds 20 percent of the units traded in the specified OTC issuer on all markets, as specified in Form B, item 11. Since quarterly reporting periods include partial weeks, include a week in a quarter only if the Monday falls in that quarter.

Condition 5 also requires reporting in Form B, item 12 of aggregate trading of the equity securities of the three specified OTC issuers with the largest aggregate trades in excess of 100,000 units by volume facilitated by the dealer during the quarter.

If a dealer accepts securities held in an opaque or convoluted arrangement for an account to which condition 4(c) applies, then, under conditions 3, 4, 6, and 7 and section 11.1 of NI 31-103, the dealer must know and maintain the details of that arrangement, including jurisdictions linked to it. However, that information is not part of the Form B filing.

**(e) *Obligations of introducing and carrying brokers***

An introducing broker is responsible for monitoring, recording, and reporting OTC trading activity through BC offices. If the introducing broker is not subject to the conditions (because, for example, it is located outside British Columbia), but the carrying broker is subject to the conditions, the carrying broker is responsible for monitoring, recording, and reporting OTC trading activity through BC offices.

**(f) *Derivatives***

When calculating commissions under condition 4, a dealer should not include commissions earned from derivatives transactions. The reports required under the conditions relate to equity securities, rather than derivatives.

**(g) *Fee-based accounts***

The conditions require a dealer to report commissions earned by the dealer from trading specified OTC issuer securities through a BC office. The conditions enable the Commission to obtain a full picture of all activity in specified OTC issuers at a dealer.

If trading in specified OTC issuer securities occurs through fee-based accounts, a dealer should report using either of the following approaches.

**(I) *Proportional fee calculation***

the pro-rated portion of all fees earned during the reporting period based on the proportional value of specified OTC issuer securities traded in the fee-based account as follows:

- (i) calculate the total value of all specified OTC issuer securities traded in the fee-based account for the quarter
- (ii) calculate the total value of all securities, including specified OTC issuer securities, traded in the fee-based account for the quarter
- (iii) divide (i) by (ii) to calculate the proportional value of specified OTC issuer securities traded in the fee based account, and
- (iv) multiply (iii) with the fees earned from the fee-based account for the quarter

**(II) *Segregated account fees***

the total fees collected from one or more segregated accounts created for the purpose of trading specified OTC issuer securities

**(h) *Joint commissions***

If a dealing representative has joint or shared commissions with another dealing representative, a dealer should specify in Form B the amount of commissions that each dealing representative receives from the dealer.

**(i) *Salaried dealing representatives***

If a dealing representative receives a salary from the dealer, rather than commissions, the dealer's Form B should:

- include in item 4 of Form B the Chief Compliance Officer's name (rather than the dealing representative's names) with the commissions earned from trading specified OTC issuer securities through BC offices, and
- state in Form B, "Additional comments" that dealing representatives receive salaries from the dealer, not commissions

**(j) *Submitting reports***

BCI 13-5\*\* requires dealers to submit Form B electronically through BCSC e-services, rather than through fax, mail or e-mail. If a dealer is unable to submit Form B electronically because of unanticipated technical difficulties, it should refer to BCI 13-5\*\*, which provides for alternative arrangements.

**(k) *Nil report***

For securities of a specified OTC issuer, if a dealer has not:

- rejected a deposit
- added or maintained holdings that must be reported under the conditions, or
- engaged in trading that must be reported under the conditions

through a BC office during a quarter, then we require a nil report for that quarter.

**5. *Establishing beneficial ownership***

Conditions 6 and 7 require a dealer to identify the beneficial owner of securities of a specified OTC issuer a client seeks to sell through a BC office and to determine that person's relationship with the issuer. Such relationships range from being a small shareholder to being involved with the issuer as an insider or promoter. A dealer needs to understand the nature of the relationship to assess and manage risk. Relevant risks include influencing the issuer or an account holder or benefiting from material non-public information.

**(a) *Dealer's responsibility***

A dealer must be able to form a reasonable belief when the account is opened and during the operation of the account that they know the true identity of each beneficial owner of the specified OTC issuer securities. If a dealer's inquiries show that an entity other than an individual is the beneficial owner, the conditions require the dealer to make further inquiries to establish the identity of the individual, or individuals, who control that entity. Control includes determining or directing the entity's activity while being concealed by

an opaque arrangement. This configuration increases the risk of individuals manipulating an issuer for their benefit.

A dealer's obligation to identify individuals under conditions 6 and 7 applies in addition to the rules of the Investment Industry Regulatory Organization of Canada (IIROC), including IIROC rule 1300 *Supervision of Accounts*, and anti-money laundering legislation. However, conditions 6 and 7 do not affect trading in many major issuers because the conditions do not apply to ADRs or securities traded on specified exchanges.

We expect dealers to use reasonable and reliable methods to determine beneficial ownership and the relationship between:

- the beneficial owner and the specified OTC issuer, and
- the person who gives trading instructions on the account and the specified OTC issuer

Such methods include:

- if its client is not the beneficial owner, making direct contact with the individual the client identified as the beneficial owner or with the individuals controlling or directing a beneficial owner that is not an individual
- confirming information with the specified OTC issuer
- making independent inquiries with third parties
- reviewing account activity

We expect dealers to do this when the account is opened, since a client could give a sell order at any time, and during the operation of the account. A dealer must determine the relationship between any beneficial owner and the specified OTC issuer as well as any relationship between the person giving instructions and the specified OTC issuer. Significant changes in trading volume or frequency, or unusual deposits of securities into the client account may suggest that circumstances have changed sufficiently for the dealer to make further inquiries.

A dealer is responsible for achieving the desired outcome: identifying the beneficial owner (and those who control non-individual beneficial owners) of the specified OTC issuer securities to be traded through a BC office.

***(b) Obligations of custodians for omnibus or institutional client accounts***

To comply with the conditions for omnibus or institutional client accounts, a dealer will have to apply the requirements of the conditions to the beneficial owner.

If the account holder is a dealer subject to the requirements of the conditions, the dealer that is the custodian should enter into an agreement with the dealer that is the account holder stating that the account holder agrees to be responsible for meeting the requirements of the conditions.

The custodian's Form B should identify the account holder and state that the account holder has agreed to be responsible for meeting the requirements of the conditions for that account. The custodian may provide this information in "Additional comments".

***(c) Accounts of foreign institutions or foreign dealers***

To comply with the conditions, a dealer must identify the actual beneficial owner of securities of a specified OTC issuer for accounts of foreign institutions or foreign dealers. If the dealer cannot satisfy itself of the information required by the conditions, the conditions prohibit the dealer from selling the securities.

**6. Responsibility of designated individual**

Conditions 8, 10, and 11 impose obligations on the dealer's designated individual.

A dealer must not accept physical deposits of securities of a specified OTC issuer through a BC office without the approval of the designated individual. A dealer can accept other forms of transfers of securities of specified OTC issuers, such as Depository Trust Company transfers and delivery against payment orders, but cannot execute orders to sell those securities until it complies with conditions 6 and 7.

A dealer may appoint the most appropriate individual who qualifies under condition 8 as its designated individual to manage and enforce the conditions. A dealer's supervision and compliance system should identify who will act as an alternate in the absence of the designated individual. The designated individual remains responsible for the activities of any delegate and should ensure the delegate has adequate knowledge and experience to perform the role.

, 2012

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Ref: Conditions of Registration – Investment Dealers with a BC Office that Trade in the U.S. Over-the-Counter Markets  
Form A *Undertaking*  
Form B *Investment Dealer Trading in Specified OTC Issuer Securities*



*BC Instrument 13-5\*\* Electronic Delivery of Reports Under Conditions of Registration – Investment Dealers with a BC Office that Trade in the U.S. Over-the-Counter Markets*

*This Interpretation Note may refer to other documents. These documents can be found at the B.C. Securities Commission public website at [www.bcsc.bc.ca](http://www.bcsc.bc.ca) in the section Securities Law & Policy: Policies & Instruments.*