



BC Notice 2012/20

**Notice and Request for Comment –
Proposed Changes to Conditions of Registration – Investment Dealers with a BC
Office that Trade in the U.S. Over-the-Counter Markets and
Imposition of an Order of the Executive Director**

The BCSC is publishing for comment changes that would

- replace current conditions of registration for investment dealers in BC that trade in U.S. over-the-counter markets
- require electronic reporting

The changes would apply to the existing *Conditions of Registration – Investment Dealers with a BC Office that Trade in the U.S. Over-the-Counter Markets* (the conditions), its forms, and the guidance in 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* (BCIN 33-705)¹.

The BCSC has been imposing the current conditions on dealers since June 2008 as part of our response to abusive practices in U.S. over-the-counter markets.

A proposed order of the Executive Director, 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* (BCI 13-5**), would make electronic reporting under the conditions mandatory.

Objectives

The proposed amendments would further increase investment dealers' accountability for their trading activities in the U.S. over-the-counter (OTC) markets and would improve regulatory understanding of activity involving specified OTC issuers.

Amended requirements

The proposed amendments would expand reporting requirements for investment dealers to include all of the following:

- clients' jurisdictions when BC investment dealers refuse to accept securities of specified OTC issuers
- significant client holdings of shares in specified OTC issuers

¹ See BC Notices 2009/29, 2008/24, and 2007/33 for information about the current conditions and the problem of abusive conduct in the over-the-counter markets.

- significant trading in a single specified OTC issuer facilitated by a BC investment dealer

The other changes to the conditions, forms, and BCIN 33-705 update terminology, clarify the information we seek, and reflect changes in Canadian market structure.

We are also revising the guidance in BCIN 33-705 to reflect the proposed amendments, clarify existing guidance, and provide information about electronic delivery.

Anticipated impact of the amended conditions

The proposed amendments further address the risk of abusive practices in U.S. OTC markets involving an investment dealer with a BC office. Since the proposed amendments would require investment dealers to disclose more information, they may have to increase monitoring to comply. This will give investment dealers and regulators more information about trading in securities of specified OTC issuers.

Jurisdictions linked to dealer refusals to accept securities of a specified OTC issuer

The anonymity that secrecy jurisdictions provide aids a person who controls or directs abusive market practices. Identifying the jurisdictions linked to a person that deposits or attempts to deposit securities of a specified OTC issuer helps investment dealers identify risk. This reduces the likelihood of abusive practices occurring through the investment dealer. For regulators, knowing the jurisdictions linked to these arrangements helps identify higher-risk jurisdictions.

Significant specified OTC issuer holdings

Reporting significant client holdings requires an investment dealer to identify which of its clients control a concentration of securities in a specified OTC issuer. Large holdings that meet or exceed the concentration threshold may reveal insider-like influence over an issuer. Identifying those with significant holdings will help investment dealers focus on those whose trading may increase risk to the dealer, the public, and the market.

The significant holdings reporting would also identify how close client holdings of a specified OTC issuer are to the concentration levels we set. Requiring investment dealers to report the three highest-percentage client holdings that are under the concentration threshold decreases the likelihood of a client avoiding reporting by maintaining holdings just below that threshold. This reporting applies only beyond a de minimus amount.

Significant specified OTC issuer trading through a dealer

Reporting significant trading in a single specified OTC issuer focuses dealers on risks across the firm. Significant, short-term spikes in trading, originating from one or multiple accounts, may indicate abusive practices. Identifying trading patterns will direct investment dealer attention to this risk. The significant trading reporting will also identify major trends over months. This reporting applies only beyond a de minimus threshold.

Additional guidance about reporting

We are providing additional guidance about the information dealers must report to comply with the conditions because today some dealers seem to over-report their activity. The updated guidance about reporting focuses firms on filing reports reflecting only activity actually caught by the conditions.

Proposed expiry of amended conditions

We propose that the amended conditions and the Executive Director's order requiring electronic filing would be in effect for three years, when we will reassess their impact.

Opportunity to be heard

Investment dealers will have an opportunity to be heard before the amended conditions are imposed on them.

Consultations and information sources

Staff consulted with a number of OTC dealers about their experience with the conditions. We thank them for their time and insights. We also reviewed IIROC's and our own experience with the conditions, including information from Form B *Investment Dealer Trading in OTC Issuer Securities*. Information from these sources informed the proposal.

To further our understanding of the current conditions' impact on dealers, we will survey dealers about aspects of their experience complying with these conditions and in particular the resources required to report to us. We will conduct this survey before we finalize the proposed amended conditions and the order requiring electronic filing.

Request for comment

We welcome your comments about the proposed changes to the conditions and the proposed new order of the Executive Director requiring electronic filing.

We particularly invite comments about the following questions:

1. The amended conditions would replace today's definition of *OTC-quoted securities* with the definition of *OTC-quoted securities* from Multilateral Instrument 51-105 *Issuers Quoted in the U.S. Over-the-Counter Markets*. In the conditions, *OTC-quoted securities* helps to limit reporting to specified OTC issuers at risk of abusive practices. Today, the definition names two marketplaces but the proposed amendment would refer to U.S. OTC markets generally. FINRA has a role in overseeing OTC trading and in assigning ticker symbols to OTC securities.

Your firm might need to expand its reporting because of FINRA's role in U.S. OTC markets (not just OTC equity markets) and your firm's trading through its offices in BC,

Under the proposed definition of *OTC-quoted securities*, would your firm have to expand its reporting beyond trading on the two markets in today's definition?

2. How much time will you require to implement the proposal, if we adopt it?

Please submit your comments in writing on or before October 30, 2012.

Please address your comments to the Executive Director.

Deliver your comments and refer your questions regarding the proposed changes to the conditions and the proposed new order of the Executive Director to:

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We will not keep submissions confidential.

August 31, 2012

Brenda M. Leong
Chair

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 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

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*
Multilateral Instrument 51-105 *Issuers Quoted in the U.S. Over-the-Counter Markets*

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