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## Do you know...

- that [NI 23-102 Use of Client Brokerage Commissions](#) is coming into effect on June 30, 2010? This instrument sets out how advisers can utilize clients' brokerage commissions and what advisers must disclose to their clients about it.
- that you no longer need to obtain formal, written permission from the BCSC to repay any amount of a subordinated debt? The more streamlined NI 31-103 process requires that you need only provide the BCSC with a **minimum five days' notice before you repay** any amount of subordinated debt and you must still maintain positive excess working capital after repayment. You still need to file new subordination agreements with the BCSC.
- that you no longer need to file a copy of the annual financial institution bond (FIB) with the BCSC, if your FIB has not changed? Registrants must still have a FIB in place with the appropriate amount of coverage for the category of registration. For more information on appropriate coverage, please see the article on insurance in [issue 12 of the Registrant](#).

## News and announcements

The BCSC appointed Paul Bourque Q.C., as the Executive Director. Mr. Bourque, who has extensive regulatory experience, started on May 17, 2010. A graduate of Osgoode Hall Law School, Mr. Bourque is a member of the bars of Ontario, Alberta and British Columbia.

## Karin Armstrong – Registration Supervisor

If you are a portfolio manager in BC then you know Karin Armstrong, who is the key Registration contact for this category of registrants.

Karin is a long-time veteran of the BCSC, having worked at the BCSC since 1986 – that's 24 years and still going strong! After one year in the Records department as a filing clerk and just over a year as the Receptionist, Karin joined the Registration Branch as a Registration Clerk in 1989 and became the Registration Supervisor in 2000.

The BC market is the third largest in Canada and the Registration section of the Registration and Compliance Branch at the BCSC is one of the smallest with only three staff. Working with Karin are Kent Waterfield, who has been with the BCSC since 1989 and in Registration since 1990, and Toni Mavrogeorge, who joined the BCSC in 1993.

"The most interesting and challenging part of this job is watching how the securities industry changes and how we keep up with those changes; in particular the recent work done on the harmonized Registration Rules," says Karin.



## Some common questions and answers (Q&As)

These are some recent questions answered by the CMR Examinations team. Most of these reference [National Instrument 31-103 Registration Requirements and Exemptions](#). In future issues of the Registrant, we will publish more Q&As. If you have a question that we did not address in this

### Question about updating policies and procedures

*When are we required to update our policies and procedures to the new requirements set out in NI 31-103?*

NI 31-103 is now law and your policies and procedures should be updated already to reflect the new requirements. We expect all firms conducting securities business in BC to keep current and to understand and comply with applicable laws, rules and regulations.

### Question on using the Form 31-103F1 Calculation of Excess Working Capital

*I monitor capital at a portfolio management firm. Do I need to complete the new capital form, Form 31-103F1 Calculation of Excess Working Capital?*

[CSA Staff Notice 31-313 NI 31-103 Registration Requirements and Exemptions and Related Instruments Frequently Asked Questions as of December 18, 2009](#) states that there is no transition provision applicable to the requirement to use [Form 31-103F1 Calculation of Excess Working Capital](#). Registered firms are required to deliver Form 31-103F1 Calculation of Excess Working Capital. However, if a firm relies on the transitional relief provided under section 16.11, it must also deliver the capital calculations required under former requirements.

### Question on filing frequency for the Form 31-103F1

*I work at an advising firm. Do I now need to file the new Form 31-103F1 quarterly?*

No, section 12.13 of NI 31-103 requires advising firms to only file annual audited financial statements with a completed and signed Form 31-103F1. Quarterly filings are not required for advising firms unless the firm is also a dealer, or the firm is also already registered as an investment fund manager.

### Question on market risk calculation for rights and warrants

*Some of the language in Form 31-103F1 is not straightforward. Specifically, how should we calculate the market risk for rights and warrants for an underlying stock that is a constituent of a composite index? For example, subsection (ii) of section E in the Form 31-103F1, states the following:*

*For positions in securities (other than bonds and debentures but including warrants and rights), 50% of the market value of the security is a constituent security on a major broadly-based index of one of the following exchanges: (A list of exchanges follows this subsection)*

*There seem to be a few ways to interpret this subsection, which is why we need some clarity:*

- 1. Is it the intent of the language to imply that so long as a stock is a constituent of an exchange's index, its related rights and warrants can also benefit from the 50% market value calculation, even if the rights and warrants are not traded on an exchange? Or*
- 2. Do the rights and warrants of the constituent security also need to be exchange traded? Or*
- 3. Do the rights and warrants also need to be constituent securities of an index?*

The CSA interprets this to mean that the rights and warrants need to be exchange traded independently of the underlying common stock, even if that common stock is a constituent of a broadly based index. The purpose of requiring the rights and warrants to be exchange traded is to ensure that they have liquidity independent of the underlying common stock. This requirement is consistent with how IROC would treat rights and warrants for capital calculations.

### Question on market risk calculation for futures contracts

*Our firm holds futures contracts as a current asset, but under (f) in Schedule 1 of the Form 31-103F1, 100% of the market (notional) value of exchange traded futures contracts is to be deducted when calculating the market risk. This appears to be quite onerous when brokers around the world have decided that the margin amount required by the investor is enough to offset the risk.*

We found it acceptable for a firm to utilize the brokerage account at a futures dealer as a current asset. Instead of calculating a market risk, which could lead to a very onerous way to calculate capital, you can:

1. include the amount under deposit with the futures dealer in its entirety as a current asset in Line 1 of the Form 31-103F1,
2. deduct the margin required by the futures dealers for your open contracts in Line 2 for assets not readily convertible to cash
3. complete the rest of the Form 31-103F1 as follows and only fill out Line 9 for market risk if you have other securities as current assets.

### Question about informal bond exemption

*We are a portfolio manager and hold an informal exemption from 2001 that exempts us from having a Financial Institution Bond (FIB). Does this exemption still hold under the new rules set out in NI 31-103?*

No. You should have received a letter from our Registration Supervisor, Karin Armstrong, indicating that your informal exemption was going to be revoked when NI 31-103 came into force and effect. Under NI 31-103, all advising firms must meet the FIB requirements set out in section 12.4(2) *Insurance – Adviser* under NI 31-103. Section 12.4(2) requires portfolio managers to have clauses A to E in place in their FIBs by March 28, 2010.

If you did not receive a letter from Ms. Armstrong, please contact her at 604-899-6692.

### Question about advertising and marketing

*Some of our branches issue their own general market newsletters. We are setting out controls to require pre-approval of all newsletters to ensure strict compliance with the content and any advertising. Are we on the right track?*

Yes, setting out policies and controls to approve your branches' newsletters helps strengthen your firm's compliance regime. [BC Policy 47-601 Advertising](#) sets out guidelines about advertising and that it should be factual and not misleading.

### Question about disclosure for registrants acting as directors

*Some of our portfolio managers hold director positions. Do these require disclosure?*

Item 10 on Page 5 of [Form 33-109F4 Registration of Individuals and Review of Permitted Individuals](#), requires disclosure of any director position held by a registrant. The firm can submit the information via the National Registration Database.

Registrants that act as directors of public companies should also be aware of the potential conflict of interests and how to manage the conflicts. Additional guidance is in [MI 34-202 Registrants acting as Corporate Directors](#).

Parts 13 and 14 of NI 31-103 enhance the disclosure requirements registrants have to their clients. Registrants must take reasonable steps to identify and respond to conflicts of interests and disclose those conflicts to their clients.

Comparing the provisions of the Act and the Rules and Policies in place prior to the coming into force of National Instrument 31-103 *Registration Requirements and Exemptions*

We provide this comparative table as a starting point to assist registered advisers in updating a firm's policies and procedures manual to meet the requirements of [National Instrument 31-103 \*Registration Requirements and Exemptions\*](#). The table is a quick reference guide and a more fulsome description follows the table.

**This document is not a table of concordance** and it is not a substitute for a thorough review of the new requirements applicable to advisers in the *Securities Act*, *Securities Rules* and [National Instrument 31-103 \*Registration Requirements and Exemptions\*](#).

The former provisions are in the left column and the new provisions are in the right column.

<b>A. Registration Requirements and Categories</b>	
Section 34 of the Act set out the registration requirements for people acting as advisers.  Section 8 of the Rules prescribed the categories of advisers.  Section 10 of the Rules prescribed the categories for individuals registered to advise.	Section 34 of the Act was revised and Sections 8 and 10 of the Rules were repealed.  Section 7.2 of NI 31-103 sets out the categories of registration for advisers.  Section 2.1 sets out the categories of registration for an individual who is acting on behalf of a registered adviser.
<b>B. Working Capital, Subordination Agreements and Reporting</b>	
Section 20 of the Rules required advisers to maintain working capital calculated in accordance with BC Form 33-905.  Section 25 of the Rules required an adviser that borrowed to meet the working capital requirements to enter into a subordination agreement.  Section 41 of the Rules required the report on working capital in Form 33-905 to be prepared within 30 days of month end.	Sections 12.1 and 12.2 of NI 31-103 contain new working capital requirements.  Section 12.2 contains new provisions relating to subordination agreements.  Section 12.13 of NI 31-103 requires registered advisers to deliver a completed Form 31-103F1, no later than 90 days after the end of their financial year.
<b>C. Bonding</b>	
Section 21 of the Rules set out the bonding requirements for advisers.	All advisers are now required to comply with the requirements for bonding set out in Section 12.4 of NI 31-103.
<b>D. Records and Statements</b>	
Division 5 of Part 5 of the Rules set out the record keeping and reporting requirements for advisers.	Subsection 11.5(1) of NI 31-103 provides that a registered adviser must maintain records to accurately record its business activities, financial affairs, and client transactions, and demonstrate the extent of the firm's compliance with applicable requirements of securities legislation.  Subsection 11.5(2) sets out a list of records required under Subsection 11.5(1). The list is not limited to just those stated.  Section 11.6 provides the form, manner and time period that records must be kept.  Subsection 14.14(3) provides that a registered adviser must provide a client with a statement at least once every three months. Subsections 14.14(4) and 14.14(5) set out the information that must be included in a statement.
<b>E. Compliance and Supervision</b>	
Sections 44 of the Rules required advisers to establish and apply written prudent business procedures for dealing with clients in compliance with the Act and the regulations.  Sections 60-63 of the Rules set out proficiency and qualification standards.	Section 11.1 of NI 31-103 provides that a registered adviser must establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to  (a) provide reasonable assurance that the adviser and each individual acting on its behalf complies with securities legislation, and

## Comparing the provisions of the Act and the Rules and Policies in place prior to the coming into force of National Instrument 31-103 *Registration Requirements and Exemptions*

The former provisions are in the left column and the new provisions are in the right column.

<b>E. Compliance and Supervision continued</b>	
<p>Sections 44 of the Rules required advisers to establish and apply written prudent business procedures for dealing with clients in compliance with the Act and the regulations.</p> <p>Sections 60-63 of the Rules set out proficiency and qualification standards.</p>	<p>(b) manage the risks associated with its business in accordance with prudent business practices.</p> <p>Section 5.1 and 11.2 of NI 31-103 requires the designation of an ultimate designated person.</p> <p>Section 5.2 and 11.3 of NI 31-103 requires the designation of a chief compliance officer.</p> <p>Section 11.4 of NI 31-103 provides that a registered adviser must permit its ultimate designated person and its chief compliance officer to directly access the firm's board of directors.</p> <p>Sections 3.4, 3.11, 3.12 and 3.13 of NI 31-103 set out the education, training and experience required for a chief compliance officer and the portfolio managers.</p> <p>Section 4.1 of NI 31-103 provides that portfolio managers should not act as an officer, partner or director of another registered adviser.</p> <p>Section 4.2 of NI 31-103 provides that an associate advising representative must not advise on securities until it is pre-approved by a designated advising representative.</p>
<b>F. Financial Reporting and Audits</b>	
<p>Section 69 of the Rules required registered advisers to file financial statements annually and at any other time requested.</p> <p>Sections 71 and 72 of the Rules set out the requirements relating to audits requested by the executive director.</p>	<p>Sections 12.10 and 12.13 of NI 31-103 provide that a registered adviser must no later than 90 days after the end of its financial year deliver to the regulator audited annual financial statements.</p> <p>Section 12.8 of NI 31-103 require a registered adviser to direct its auditor in writing to conduct any audit or review required by the regulator during its registration.</p> <p>Section 12.9 of NI 31-103 provides that a registrant must not withhold, destroy or conceal any information or documents or otherwise fail to cooperate with a reasonable request made by an auditor of the registered adviser in the course of an audit.</p>
<b>G. Know Your Client and Suitability</b>	
<p>Section 48 of the Rules required registrants to make enquiries to learn essential facts about every client (including identity) and to determine general investment needs and objectives of the client, the appropriateness of a recommendation made to the client and the suitability of a proposed purchase or sale for that client.</p>	<p>Sections 13.2 and 13.3 of NI 31-103 now cover the requirements for knowing a client and determining the suitability of investments.</p>
<b>H. Conflicts</b>	
<p>Division 11 of Part 5 of the Rules contained the requirements relating to conflict of interest.</p> <p>Section 16 of the Rules restricted an adviser and its partners, directors, officers and associates from having a direct or indirect interest in any other dealer, underwriter or adviser without the consent of the executive director.</p>	<p>Sections 13.4–13.6 of NI 31-103 set out the new requirements relating to conflicts of interest.</p>
<b>I. Referral Arrangements, Referral Fees and Contingent Fees</b>	
<p>Prior to March 28, 2010, Section 53 of the Rules specified the disclosure required in respect of referral fees and commission splitting.</p>	<p>Sections 13.7-13.11 of NI 31-103 set out the new requirements relating to referral arrangements and referral fees</p>



## Comparing the provisions of the Act and the Rules and Policies in place prior to the coming into force of National Instrument 31-103 *Registration Requirements and Exemptions*

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<b>J. Loans</b>	
No former provision	<p>Section 13.12 of NI 31-103 provides that a registrant may not loan money, extend credit or provide margin to a client.</p> <p>Section 13.13 of NI 31-103 requires a registrant to provide a client with a prescribed written statement if it makes a recommendation that a client use borrowed money to finance any part of a purchase of a security.</p>
<b>K. Complaints</b>	
Section 44 of the Rules required advisers to establish and apply written prudent business procedures for dealing with clients in compliance with the Act and the regulations.	<p>Section 13.15 of NI 31-103 now specifies how complaints are to be handled.</p> <p>Section 13.16 of NI 31-103 contains new dispute resolution provisions.</p>
<b>L. Disclosure to Clients</b>	
<p>Subsection 44(1) of the Rules required advisers to establish and apply written prudent business procedures for dealing with clients in compliance with the Act and the regulations.</p> <p>Subsection 44(5) of the Rules required advisers to include as part of their written business procedures, written standards or fairness for the allocation of investment opportunities among its clients and to provide a copy of the standards to each client.</p> <p>Section 50 of the Rules provided a list of information that an adviser must provide a client or prospective client on request.</p> <p>Subsection 52(2) of the Rules required an adviser that proposed to sell or assign a client's account to provide the client with a written explanation and to advise the client of their right to close the account.</p> <p>Section 11 of the Rules prohibited any person from using the terms portfolio manager, investment counsel or securities adviser in a manner that would deceive or mislead the public about the proficiency and qualifications of such person or give a false impression that the person was authorized to act as a portfolio manager, investment counsel or securities adviser.</p>	Division 2 of Part 14 of NI 31-103 sets forth certain disclosure that must be provided by advisers to clients.
<b>M. Business Transactions</b>	
<p>Section 52(1) of the Rules require an adviser that had a material change in ownership or control to provide the client with a written explanation of the change and to advise the client of their right to close the account.</p> <p>Section 73 required that written notice be given of an acquisition of 10% or more of the outstanding voting securities of a registrant.</p> <p>National Instrument 33-102 <i>Regulation of Certain Registrant Activities</i> prohibited tied settling and selling transactions.</p>	<p>Sections 11.9 and 11.10 of NI 31-103 now require an adviser who is acquiring a registered firm's securities or assets or an adviser whose securities or assets are being acquired to notify the regulator in writing.</p> <p>Sections 11.7 and 11.8 of NI 31-103 prohibit tied settling and selling transactions.</p>
<b>N. Holding Assets</b>	
<p>Sections 55-58 of the Rules set out requirements for handling client assets.</p> <p>Section 51 of the Rules required an adviser to supervise the account of each client separately and distinctly from the accounts of other clients.</p>	Sections 14.6-14.9 of NI 31-103 now contain the requirements for handling client assets.
<b>O. Mobility</b>	
Multilateral Instrument 11-101 <i>Principal Regulator System</i> provided mobility exemptions.	Section 2.2 of NI 31-103 now contains mobility exemptions.

## Comparing the provisions of the Act and the Rules and Policies in place prior to the coming into force of National Instrument 31-103 *Registration Requirements and Exemptions*

We provide this comparison as a starting point to assist registered advisers in updating a firm's policies and procedures manual to meet the requirements of [National Instrument 31-103 \*Registration Requirements and Exemptions\*](#).

**This document is not a table of concordance** and it is not a substitute for a thorough review of the new requirements applicable to advisers in the *Securities Act*, *Securities Rules* and [National Instrument 31-103 \*Registration Requirements and Exemptions\*](#).

### A. Registration Requirement and Categories

#### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

Section 34 of [the Act](#) provided that a person must not act as an adviser unless the person is registered in accordance with the regulations as

- (i) an adviser, or
- (ii) an advising employee, partner, director or officer of a registered adviser and is acting on behalf of that adviser.

Section 8 of the Rules prescribed three categories of registered advisers:

- portfolio manager
- investment counsel
- securities adviser

Section 10 of the Rules prescribed the categories for individuals registered to advise on behalf of a registered adviser:

- advising employee
- advising partner, director or officer

#### **Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009**

Section 34 of the Act was revised and Sections 8 and 10 of the Rules were repealed.

Section 34 of the Act now simply provides that a person must not act as an adviser unless the person is registered in accordance with the regulations and in the category prescribed for the purpose of the activity.

Section 7.2 of NI 31-103 sets out the categories of registration for advisers:

- portfolio manager
- restricted portfolio manager

Section 2.1 sets out the categories of registration for an individual who is acting on behalf of a registered adviser:

- advising representative
- associate advising representative

### B. Working Capital, Subordination Agreements and Reporting

#### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

##### *Working capital*

Section 20 of the Rules required advisers to maintain working capital calculated in accordance with BC Form 33-905, equal to or greater than \$25,000 plus the advisers deductible under any bond required by Section 21 of the Rules. However, an investment counsel that does not hold client funds or securities and is recognized by the executive director was only required to maintain working capital calculated in accordance with BC Form 33-905, equal to or greater than \$5,000 plus the deductible under any bond required by Section 21 of the Rules.

##### *Subordination agreement*

Section 25 of the Rules required an adviser that borrowed to meet the working capital requirements to enter into a subordination agreement. The form of the subordination agreement was set out in BC Form 33-904F and under BC Policy 31-601 the agreement was required to be filed with the executive director.

##### *Reporting*

Section 41 of the Rules required the report on working capital in Form 33-905 to be prepared within 30 days of month end. If the report indicated that the adviser did not meet the working capital requirements set out in Section 20 of the Rules, the adviser was required to notify the executive director in writing.

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## B. Working Capital, Subordination Agreements and Reporting continued

### Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009

#### *Working capital*

Sections 12.1 and 12.2 of NI 31-103 contain new working capital requirements. These provisions already apply to any new advisers (advisers that were not registered before September 28, 2009) and will apply to all advisers (including advisers that were registered before September 28, 2009) on September 28, 2010.

Section 12.1 requires a registered adviser to maintain excess working capital in the amounts set out in Section 12.1. The minimum capital for a registered adviser (that is not a registered dealer or investment fund manager) is \$25,000. Section 12.1 also requires a registered adviser to notify the regulators as soon as possible if excess working capital is less than zero and to ensure that excess working capital is not less than zero for 2 consecutive days.

Advisers registered before September 28, 2009, may continue to rely on the capital requirements in Section 20 of the Rules until September 28, 2010. However, as there are no transitional provisions applicable to the requirement to use the new form, advisers are required to monitor excess working capital using [Form 31-103F1 Calculation of Excess Working Capital](#). Although advisers may continue to file the old BC Form 33-905F *Report of Working*, our preference is that throughout the transition period advisers use and file only Form 31-103F1.

#### *Subordination agreement*

Section 12.2 contains new provisions relating to subordination agreements. Advisers that have entered into a subordination agreement to exclude an amount from their long-term related party debt for the purposes of calculating excess working capital as required by Section 12.1 must notify the Commission 5 days before they

- (a) repay the loan or any part of the loan, or
- (b) terminate the agreement.

The form of subordination agreement is now set out in Appendix B to NI 31-103.

#### *Reporting*

Section 12.13 of NI 31-103 requires registered advisers to deliver a completed Form 31-103F1, no later than 90 days after the end of their financial year, showing the calculation of excess working capital as at the end of the financial year and the immediately preceding financial year, if any.

## C. Bonding

### Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009

Section 21 of the Rules set out the bonding requirements for advisers. Effective September 28, 2009, these requirements were replaced with the requirements in NI 31-103 for any new advisers (advisers that were not registered on September 28, 2009). Advisers that were registered before September 28, 2009 were permitted to continue to comply with the bonding requirements contained in Section 21 of the Rules until March 28, 2010. On March 28, 2010, Section 21 of the Rules was repealed.

Prior to March 28, 2009, Section 22 of the Rules required a registered adviser to file notice of any change in, or claim under, a bond required by the executive director.

### Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009

The transition period in respect of the bonding requirements ended on March 28, 2010. All advisers are now required to comply with the requirements for bonding set out in Section 12.4 of NI 31-103.

All registered advisers must have bonding and insurance that contains clauses for fidelity, on premises, in transit, forgery and alterations, and securities. If the registered adviser does not hold or have access to client assets, they must maintain \$50,000 in coverage for each clause.

Registered adviser that hold or have access to client assets must maintain coverage for each clause based on the higher of:

- (a) one per cent of assets under management that the adviser holds or has access to, as calculated using the adviser's most recent financial records, or \$25,000,000, whichever is less;
- (b) one per cent of the adviser's total assets, as calculated using the adviser's most recent financial records, or \$25,000,000, whichever is less;
- (c) \$200,000;

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## C. Bonding continued

(d) the amount determined to be appropriate by a resolution of the adviser's board of directors or individuals acting in a similar capacity for the firm.

Section 12.6 of NI 31-103 contains conditions in respect of bonding and insurance that benefits or names another person as insured.

Section 12.7 requires a registered adviser to notify the regulator of any changes in, claim under or cancellation of any insurance policy required by Division 2 of Part 12 of NI 31-103.

## D. Records and Statements

### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

Division 5 of Part 5 of the Rules set out the record keeping and reporting requirements for advisers.

### **Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009**

Subsection 11.5(1) of NI 31-103 provides that a registered adviser must maintain records to

- (a) accurately record its business activities, financial affairs, and client transactions, and
- (b) demonstrate the extent of the firm's compliance with applicable requirements of securities legislation.

Subsection 11.5(2) provides that the records required under Subsection 11.5(1) include, but are not limited to, records that do the following:

- (a) permit timely creation and audit of financial statements and other financial information required to be filed or delivered to the securities regulatory authority;
- (b) permit determination of the registered adviser's capital position;
- (c) demonstrate compliance with the registered adviser's capital and insurance requirements;
- (d) demonstrate compliance with internal control procedures;
- (e) demonstrate compliance with the firm's policies and procedures;
- (f) permit the identification and segregation of client cash, securities, and other property;
- (g) identify all transactions conducted on behalf of the registered adviser and each of its clients, including the parties to the transaction and the terms of the purchase or sale;
- (h) provide an audit trail for
  - (i) client instructions and orders, and
  - (ii) each trade transmitted or executed for a client or by the registered adviser on its own behalf;
- (i) permit the generation of account activity reports for clients;
- (j) provide securities pricing as may be required by securities legislation;
- (k) document the opening of client accounts, including any agreements with clients;
- (l) demonstrate compliance with Sections 13.2 [know your client] and 13.3 [suitability];
- (m) demonstrate compliance with complaint-handling requirements;
- (n) document correspondence with clients;
- (o) document compliance and supervision actions taken by the adviser.

Section 11.6 provides the form, manner and time period that records must be kept. Specifically, a registered adviser must keep a record that it is required to keep under securities legislation

- (a) for 7 years from the date the record is created,
- (b) in a safe location and in a durable form, and
- (c) in a manner that permits it to be provided to the regulator.

A record required to be provided to the regulator or the securities regulatory authority must be provided in a format that is capable of being read by the regulator or the securities regulatory authority.

Subsection 14.14(3) provides that a registered adviser must provide a client with a statement at least once every three months. Subsections 14.14(4) and 14.14(5) set out the information that must be included in a statement.



## E. Compliance and Supervision

### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

Sections 44 of the Rules required advisers to establish and apply written prudent business procedures for dealing with clients in compliance with the Act and the regulations.

Sections 60-63 of the Rules set out proficiency and qualification standards.

### **Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009**

Section 11.1 of NI 31-103 provides that a registered adviser must establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to

- (a) provide reasonable assurance that the adviser and each individual acting on its behalf complies with securities legislation, and
- (b) manage the risks associated with its business in accordance with prudent business practices.

Section 5.1 and 11.2 of NI 31-103 provide that:

- (a) the chief executive officer or sole proprietor of the registered adviser;
- (b) an officer in charge of a division of the registered adviser, if the activity that requires the firm to register occurs only within the division;
- (c) an individual acting in a capacity similar to that of an officer described in paragraph (a) or (b) above

must be designated as an ultimate designated person to do all of the following:

- (a) supervise the activities of the firm that are directed towards ensuring compliance with securities legislation by the firm and each individual acting on the firm's behalf;
- (b) promote compliance by the firm, and individuals acting on its behalf, with securities legislation.

Section 5.2 and 11.3 of NI 31-103 provide that an officer or partner of a registered adviser or the sole proprietor of a registered adviser, must be designated as the registered adviser's chief compliance officer to do all of the following:

- (a) establish and maintain policies and procedures for assessing compliance by the firm, and individuals acting on its behalf, with securities legislation;
- (b) monitor and assess compliance by the firm, and individuals acting on its behalf, with securities legislation;
- (c) report to the ultimate designated person of the firm as soon as possible if the chief compliance officer becomes aware of any circumstances indicating that the firm, or any individual acting on its behalf, may be in non-compliance with securities legislation and any of the following apply:
  - (i) the non-compliance creates, in the opinion of a reasonable person, a risk of harm to a client;
  - (ii) the non-compliance creates, in the opinion of a reasonable person, a risk of harm to the capital markets;
  - (iii) the non-compliance is part of a pattern of non-compliance;
- (d) submit an annual report to the firm's board of directors, or individuals acting in a similar capacity for the firm, for the purpose of assessing compliance by the firm, and individuals acting on its behalf, with securities legislation.

Section 11.4 of NI 31-103 provides that a registered adviser must permit its ultimate designated person and its chief compliance officer to directly access the firm's board of directors, or individuals acting in a similar capacity for the firm, at such times as the ultimate designated person or the chief compliance officer may consider necessary or advisable in view of his or her responsibilities.

Sections 3.4, 3.11, 3.12 and 3.13 of NI 31-103 set out the education, training and experience required for a chief compliance officer, portfolio manager - advising representative and portfolio manager - associate advising representative.

Section 4.1 of NI 31-103 provides that a portfolio manager - advising representative and portfolio manager - associate advising representative of one registered adviser must not act as an officer, partner or director of another registered adviser.

Section 4.2 of NI 31-103 provides that an associate advising representative must not advise on securities until it is pre-approved by a designated advising representative. Section 4.2 requires that no later than 7 days after an advising representative has been designated, the registered adviser must notify the regulator of the names of the associate advising representative and advising representative who are subject to the designation.

Section 14.10 requires a registered adviser to ensure fairness in allocating investment opportunities among its clients.

## F. Financial Reporting and Audits

### Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009

#### *Financial statements*

Section 69 of the Rules required registered advisers to file financial statements annually and at any other time requested.

#### *Audits*

Sections 71 and 72 of the Rules set out the requirements relating to audits requested by the executive director.

### Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009

#### *Financial statements*

Sections 12.10 and 12.13 of NI 31-103 provide that a registered adviser must no later than 90 days after the end of its financial year deliver to the regulator audited annual financial statements that include the following:

- (a) an income statement, a statement of retained earnings and a cash flow statement, each prepared for the most recently completed financial year and the financial year immediately preceding the most recently completed financial year, if any;
- (b) a balance sheet, signed by at least one director of the registered adviser, as at the end of the most recently completed financial year and the financial year immediately preceding the most recently completed financial year, if any;
- (c) notes to the financial statements.

These financial statements must be prepared in accordance with must be prepared in accordance with [National Instrument 52-107 Acceptable Accounting Principles, Auditing Standards and Reporting Currency](#), except that the statements must be prepared on a non-consolidated basis.

#### *Audits*

Section 12.8 of NI 31-103 require a registered adviser to direct its auditor in writing to conduct any audit or review required by the regulator during its registration and to submit a copy of the direction to the regulator

- (a) with its application for registration, and
- (b) no later than the 7th day after the registered adviser changes its auditor.

Section 12.9 of NI 31-103 provides that a registrant must not withhold, destroy or conceal any information or documents or otherwise fail to cooperate with a reasonable request made by an auditor of the registered adviser in the course of an audit.

## G. Know-Your-Client and Suitability

### Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009

Section 48 of the Rules required registrants to make enquiries to learn essential facts about every client (including identity) and to determine general investment needs and objectives of the client, the appropriateness of a recommendation made to the client and the suitability of a proposed purchase or sale for that client.

Section 47 of the Rules required an adviser to designate a compliance officer (and in certain cases a branch manager or administrative officer) to approve the opening of new accounts and supervise transaction made on behalf of clients.

### Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009

Sections 13.2 and 13.3 of NI 31-103 now cover the requirements for knowing a client and determining the suitability of investments.

Section 13.2 provides that a registrant must take reasonable steps to

- (a) establish the identity of a client and, if the registrant has cause for concern, make reasonable inquiries as to the reputation of the client,
- (b) establish whether the client is an insider of a reporting issuer or any other issuer whose securities are publicly traded,
- (c) ensure that it has sufficient information regarding the client's investment needs and objectives, financial circumstances and risk tolerance to enable it to meet its obligations under Section 13.3, and
- (d) establish the creditworthiness of the client if the registered adviser is financing the client's acquisition of a security.

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## G. Know-Your-Client and Suitability continued

For the purpose of establishing the identity of a client that is a corporation, partnership or trust under paragraph (a) above, the registrant must establish the following:

- (a) the nature of the client's business;
- (b) the identity of any individual who,
  - (i) in the case of a corporation, is a beneficial owner of, or exercises direct or indirect control or direction over, more than 10% of the voting rights attached to the outstanding voting securities of the corporation, or
  - (ii) in the case of a partnership or trust, exercises control over the affairs of the partnership or trust.

Section 13.2 requires a registrant to take reasonable steps to keep the information required current.

Section 13.3 requires a registrant to take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a client to buy or sell a security, or makes a purchase or sale of a security for a client's managed account, the purchase or sale is suitable for the client. Section 13.3 also provides that if a client instructs a registrant to buy, sell or hold a security and in the registrant's reasonable opinion following the instruction would not be suitable for the client, the registrant must inform the client of the registrant's opinion and must not buy or sell the security unless the client instructs the registrant to proceed nonetheless.

Note that in addition to the Know-Your-Client requirements contained in NI 31-103, advisers are required to comply with the provisions of [the Proceeds of Crime \(Money Laundering\) and Terrorist Financing Act](#), its regulations and the guidelines of [the Financial Transactions and Reports Analysis Centre of Canada](#) (FINTRAC).

## H. Conflicts

### Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009

Division 11 of Part 5 of the Rules contained the requirements relating to conflict of interest.

Section 16 of the Rules restricted an adviser and its partners, directors, officers and associates from having a direct or indirect interest in any other dealer, underwriter or adviser without the consent of the executive director. Further, Subsection 61(2) prohibited advising employees and advising partners, directors or officers of an adviser from acting as a director or officer of a reporting issuer.

Although NI 31-103 does not contain provisions that are identical to these former provisions, an adviser should consider whether ownership in another registrant or acting as a director or officer of a reporting issuer creates a conflict of interest that requires disclosure under Section 14.2 of NI 31-103. Further, [National Instrument 33-109 Registration Information](#) requires any person holding more than 10% of the voting shares of a registrant to be registered. Finally, [Multilateral Instrument 34-202 Registrants Acting as Corporate Directors](#) provides guidance on the issues relating to representative of an adviser acting as a director of or adviser to a reporting issuer.

### Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009

Sections 13.4–13.6 of NI 31-103 set out the new requirements relating to conflicts of interest.

Section 13.4 requires a registered adviser to take reasonable steps to identify existing material conflicts of interest, and material conflicts of interest that the registered adviser in its reasonable opinion would expect to arise, between the firm, including each individual acting on the firm's behalf, and a client. A registered adviser must respond to an existing or potential conflict of interest identified. If a reasonable investor would expect to be informed of a conflict of interest identified, the registered adviser must disclose, in a timely manner, the nature and extent of the conflict of interest to the client whose interest conflicts with the interest identified.

Section 13.5 restricts a registered adviser from engaging in certain transactions with a responsible person of the registered adviser. The term "responsible person" means, for a registered adviser,

- (a) the adviser,
- (b) a partner, director or officer of the adviser, and
- (c) each of the following who has access to, or participates in formulating, an investment decision made on behalf of a client of the adviser or advice to be given to a client of the adviser:
  - (i) an employee or agent of the adviser;
  - (ii) an affiliate of the adviser;
  - (iii) a partner, director, officer, employee or agent of an affiliate of the adviser.

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## H. Conflicts continued

A registered adviser must not knowingly cause an investment portfolio managed by it, including an investment fund for which it acts as an adviser, to do any of the following:

- (a) purchase a security of an issuer in which a responsible person or an associate of a responsible person is a partner, officer or director unless
  - (i) this fact is disclosed to the client, and
  - (ii) the written consent of the client to the purchase is obtained before the purchase;
- (b) purchase or sell a security from or to the investment portfolio of any of the following:
  - (i) a responsible person;
  - (ii) an associate of a responsible person;
  - (iii) an investment fund for which a responsible person acts as an adviser;
- (c) provide a guarantee or loan to a responsible person or an associate of a responsible person.

Section 13.6 provides that a registered adviser must not make a recommendation in any medium of communication to buy, sell or hold a security issued by the registered adviser, a security of a related issuer or, during the security's distribution, a security of a connected issuer of the registered adviser, unless any of the following apply:

- (a) the firm discloses, in the same medium of communication, the nature and extent of the relationship or connection between the firm and the issuer;
- (b) the recommendation is in respect of a security of a mutual fund, a scholarship plan, an educational plan or an educational trust that is an affiliate of the registered adviser and the names of the registered adviser and the fund, plan or trust, as the case may be, are sufficiently similar to indicate that they are affiliated.

## I. Referral Arrangements, Referral Fees and Contingent Fees

### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

Prior to March 28, 2010, Section 53 of the Rules specified the disclosure required in respect of referral fees and commission splitting.

### **Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009**

Sections 13.7-13.11 of NI 31-103 set out the new requirements relating to referral arrangements and referral fees.

Section 13.8 specifies the requirements imposed on adviser with respect to referral arrangements.

Section 13.9 requires registrants to verify the qualifications of the person or company receiving the referral.

Section 13.10 specifies the disclosure that must be provided to clients (which includes prospective clients).

## J. Loans

### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

No former provision

### **Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009**

Section 13.12 of NI 31-103 provides that a registrant may not loan money, extend credit or provide margin to a client.

Section 13.13 of NI 31-103 requires a registrant to provide a client with the following written statement if it makes a recommendation that a client use borrowed money to finance any part of a purchase of a security:

"Using borrowed money to finance the purchase of securities involves greater risk than a purchase using cash resources only. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same even if the value of the securities purchased declines."

The foregoing disclosure is not required if

- (a) the statement above was provided to the client no earlier than 180 days before the proposed purchase,
- (b) the proposed purchase is on margin and the client's margin account is maintained at a registered adviser that is a member of IIROC or MFDA, or
- (c) the client is a permitted client.



## K. Complaints

### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

Section 44 of the Rules required advisers to establish and apply written prudent business procedures for dealing with clients in compliance with the Act and the regulations.

### **Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009**

Section 13.15 of NI 31-103 now specifies how complaints are to be handled. A registered adviser must document and, in a manner that a reasonable investor would consider fair and effective, respond to each complaint made to the registered adviser about any product or service offered by the firm or a representative of the firm.

Section 13.16 of NI 31-103 contains new dispute resolution provisions. These provisions already apply to any new advisers (advisers that were not registered before September 28, 2009) and will apply to all advisers (including those that were registered before September 28, 2009) on September 28, 2011. The new provisions require a registered adviser to ensure that independent dispute resolution or mediation services are made available, at the firm's expense, to a client to resolve a complaint made by the client about any trading or advising activity of the firm or one of its representatives. If a person or company makes a complaint to a registered adviser about any trading or advising activity of the firm or one of its representatives, the registered adviser must as soon as possible inform the person or company of how to contact and use the dispute resolution or mediation services which are provided to the firm's clients.

## L. Disclosure to Clients

### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

Subsection 44(1) of the Rules required advisers to establish and apply written prudent business procedures for dealing with clients in compliance with the Act and the regulations.

Subsection 44(5) of the Rules required advisers to include as part of their written business procedures, written standards or fairness for the allocation of investment opportunities among its clients and to provide a copy of the standards to each client.

Section 50 of the Rules provides a list of information that an adviser must provide a client or prospective client on request. This provision only applies to advisers that were registered before September 28, 2009 and will be repealed on September 28, 2010.

Subsection 52(2) of the Rules required an adviser that proposed to sell or assign a client's account to provide the client with a written explanation and to advise the client of their right to close the account.

Section 11 of the Rules prohibited any person from using the terms portfolio manager, investment counsel or securities adviser in a manner that would deceive or mislead the public about the proficiency and qualifications of such person or give a false impression that the person was authorized to act as a portfolio manager, investment counsel or securities adviser. Although NI 31-103 does not contain a provision that is identical to this former provision, Section 14 of the Rules (which is still in force) requires an adviser or an advising representative to deal fairly, honestly and in good faith with clients.

### **Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009**

Division 2 of Part 14 of NI 31-103 sets forth certain disclosure that must be provided by advisers to clients.

Section 14.2 of NI 31-103 contains new relationship disclosure provisions. These provisions already apply to any new advisers (advisers that were not registered before September 28, 2009) and will apply to all advisers (including advisers that were registered before September 28, 2009) on September 28, 2010. Section 14.2 requires a registered adviser to deliver to a client all information that a reasonable investor would consider important about the client's relationship with the adviser. The information required to be delivered includes all of the following:

- (a) a description of the nature or type of the client's account;
- (b) a discussion that identifies the products or services the registered adviser offers to a client;
- (c) a description of the types of risks that a client should consider when making an investment decision;
- (d) a description of the risks to a client of using borrowed money to finance a purchase of a security;
- (e) a description of the conflicts of interest that the registered adviser is required to disclose to a client under securities legislation;
- (f) disclosure of all costs to a client for the operation of an account;

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## L. Disclosure to Clients

- (g) a description of the costs a client will pay in making, holding and selling investments;
- (h) a description of the compensation paid to the registered adviser in relation to the different types of products that a client may purchase through the registered adviser;
- (i) a description of the content and frequency of reporting for each account or portfolio of a client;
- (j) disclosure that independent dispute resolution or mediation services are available to a client, at the firm's expense, to mediate any dispute that might arise between the client and the firm about a product or service of the firm;
- (k) a statement that the firm has an obligation to assess whether a purchase or sale of a security is suitable for a client prior to executing the transaction or at any other time;
- (l) the information a registered adviser must collect about the client under Section 13.2 [know your client].

A registered adviser must deliver to a client the information before the firm first

- (a) purchases or sells a security for the client, or
- (b) advises the client to purchase, sell or hold a security.

If there is a significant change to the information delivered to a client the registered adviser must take reasonable steps to notify the client of the change in a timely manner and, if possible, before the firm next

- (a) purchases or sells a security for the client, or
- (b) advises the client to purchase, sell or hold a security.

Section 14.3 requires disclosure to clients about the fair allocation of investment opportunities. A registered adviser must deliver to a client a summary of the policies required under Section 11.1 [compliance system] that provide reasonable assurance that the firm and each individual acting on its behalf complies with Section 14.10 [allocating investment opportunities fairly] and that summary must be delivered

- (a) when the adviser opens an account for the client, and
- (b) if there is a significant change to the summary last delivered to the client, in a timely manner and, if possible, before the firm next
  - (i) purchases or sells a security for the client, or
  - (ii) advises the client to purchase, sell or hold a security.

Section 14.4 requires disclosure when an adviser has a relationship with a financial institution. If a registered adviser opens a client account to trade in securities, in an office or branch of a Canadian financial institution or a Schedule III bank, the registered adviser must give the client a written notice stating that it is a separate legal entity from the Canadian financial institution or Schedule III bank and, unless otherwise advised by the registrant, securities purchased from or through the registrant

- (a) are not insured by a government deposit insurer,
- (b) are not guaranteed by the Canadian financial institution or Schedule III bank, and
- (c) may fluctuate in value.

The registered adviser must receive a written confirmation from the client that the client has read and understood the notice before the registered adviser

- (a) purchases or sells a security for the client, or
- (b) advises the client to purchase, sell or hold a security.

This requirement does not apply to a registered adviser if the client is a permitted client.

Section 14.5 requires a registered adviser whose head office is not located in the local jurisdiction to provide its clients in the local jurisdiction with a statement in writing disclosing the following:

- (a) the non-resident status of the registrant;
- (b) the registrant's jurisdiction of residence;

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## L. Disclosure to Clients continued

- (c) the name and address of the agent for service of process of the registrant in the local jurisdiction;
- (d) the nature of risks to clients that legal rights may not be enforceable in the local jurisdiction.

Section 14.11 requires notice be given to a client if their account is to be sold or assigned. If a registered adviser proposes to sell or assign a client's account in whole or in part to another registrant, the registered adviser must, prior to the sale or assignment, give a written explanation of the proposal to the client and inform the client of the client's right to close the client's account.

## M. Business Transactions

### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

Section 52(1) of the Rules require an adviser that had a material change in ownership or control to provide the client with a written explanation of the change and to advise the client of their right to close the account. This provision only applies to advisers that were registered before September 28, 2009 and will be repealed on September 28, 2010. Although NI 31-103 does not contain a provision that is identical to this former provision, an adviser should consider whether disclosure of the change in ownership or control is something that a reasonable investor would consider important in respect of their relationship with the adviser, which would require disclosure under Section 14.2 of NI 31-103. Further, the adviser should consider whether the change creates a conflict of interest that requires disclosure under Section 14.2 of NI 31-103.

Section 73 required that written notice be given of an acquisition of 10% or more of the outstanding voting securities of a registrant.

National Instrument 33-102 *Regulation of Certain Registrant Activities* prohibited tied settling and selling transactions.

### **Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009**

Sections 11.9 and 11.10 of NI 31-103 now require an adviser who is acquiring a registered firm's securities or assets or an adviser whose securities or assets are being acquired to notify the regulator in writing. The time periods for delivering the notice and the content of the notice are detailed in Section 11.9 and 11.10. Certain acquisitions are exempt.

Sections 11.7 and 11.8 of NI 31-103 prohibit tied settling and selling transactions.

## N. Holding Assets

### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

Sections 55-58 of the Rules set out requirements for handling client assets.

Section 51 of the Rules required an adviser to supervise the account of each client separately and distinctly from the accounts of other clients.

### **Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009**

Sections 14.6-14.9 of NI 31-103 now contain the requirements for handling client assets.

## O. Mobility

### **Description of the former provisions of the Act, the Rules or Policies prior to September 28, 2009**

Multilateral Instrument 11-101 *Principal Regulator System* provided mobility exemptions.

### **Description of the new provisions of the Act, the Rules and NI 31-103 after September 28, 2009**

Section 2.2 of NI 31-103 now contains mobility exemptions.

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Lindy Bremner compiled this comparison between the former provisions of the Act, the Rules and Policies to the new provisions of the Act, the Rules and NI 31-103. Lindy is a Senior Legal Counsel with the Legal Services Branch of the BCSC's Capital Markets Regulation Division. Lindy has been with the BCSC since March 2010.

If you found this comparison useful, [let us know](#) or send us your suggestions for other policy comparisons that will assist you with your firm's compliance.

## Resources for Registrants

- [National Instrument 31-103 Registration Requirements and Exemptions](#)
- [BCSC Compliance Toolkit](#) – a resource for compliance
- [CSA Registration Database](#) – registration type and status of individuals and firms
- [BCSC Disciplined Persons List](#) – individuals that have been sanctioned by the BCSC
- [BCSC Q & A's for Dealers and Advisers](#) – questions and answers for registrants
- [BC Securities Act, Regulations and Rules](#) – the securities legislation
- [Policies and Instruments](#) – policies and instruments in effect in BC
- [Registration Forms](#) – forms specific to dealers and advisers
- [BCSC Weekly Report](#) – weekly updates on new policies, news releases and orders
- [InvestRight](#) – investor education by the BCSC

### Other resources:

- [BC Statutes](#) and [Federal Statutes](#)
- [AIMA Canada](#) – The Alternative Investment Management Association
- [Canadian Securities Administrators](#)
- [Canadian Securities Institute](#)
- [CFA Institute](#)
  - [CFA Professional Conduct](#)
  - [CFA Standards of Practice Handbook](#) (PDF download)
  - [CFA Vancouver](#)
- [FINRA Financial Industry Regulatory Authority](#) - Compliance tools
- [Managed Funds Association](#) – reports on sound practices
- [OSC Compliance resources](#)
- [Society for Corporate Compliance and Ethics](#)
- [US Securities and Exchange Commission](#)
  - [Information for Newly-Registered Investment Advisers](#)

## The Registrant

**Editor:** [Edwin Leong](#)

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