
CANADIAN REGISTRATION REFORM PROVIDES EASIER ACCESS FOR U.S. BROKER-DEALERS AND ADVISERS

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Introduction

After several years of proposals, the Canadian Securities Administrators have published the final version of National Instrument 31-103 *Registration Requirements and Exemptions*. The purpose of NI 31-103 is primarily to modernize, harmonize (although it falls somewhat short of this goal) and streamline the Canadian dealer and adviser registration regime.

For U.S. broker-dealers and investment advisers, NI 31-103 may provide easier access to the Canadian market. U.S. broker-dealers, who have heretofore had to register as an "international dealer" in Ontario, will be able to rely on an exemption to carry on substantially the same activities that such registration permitted. Furthermore, they will be able to deal with certain high net worth individuals unlike in the past.

Similarly, for U.S. investment advisers who currently would have to register to offer their portfolio management services in those provinces of Canada where they have clients, there will be an exemption from the registration requirement for advising certain permitted clients with respect primarily to non-Canadian securities, subject to their Canadian business being no more than 10% of its consolidated portfolio management business. The list of permitted clients is broader than the list that advisers currently registered in the category of "international adviser" may advise.

Finally, if these exemptions do not permit the U.S. entity to carry on its intended activities in Canada, the entity may register by dealing with only one or two of the provincial and territorial securities commissions. Moreover, the registration requirements will be substantially the same across the country.

NI 31-103 also brings into force a requirement of managers of investment funds to register as such. For now, entities without an office in Canada are exempt from the requirement, but this may change in the future.

Broker-Dealers

Currently U.S. broker-dealers who wish to trade with Canadian clients have to register in Ontario and Newfoundland and Labrador as an "international dealer" and to rely on exemptions from the dealer registration requirements elsewhere.

Under NI 31-103 an exemption from the requirement to register is available to a dealer if:

- (a) the head office or principal place of business of the dealer is in a jurisdiction outside Canada;
- (b) the dealer is registered under the securities legislation of such jurisdiction in a category that would permit it to carry on the activities that registration in the Canadian jurisdiction would permit it to carry on;
- (c) the dealer engages in the business of a dealer in such jurisdiction;
- (d) the dealer is acting as principal or as agent for the issuer of the securities, for a permitted client or for a non-resident of Canada;
- (e) the dealer has submitted to each applicable Canadian securities regulatory authority a Submission to Jurisdiction and Appointment of Agent for Service in prescribed form ("Form 31-103F2").

The types of activities which may be undertaken pursuant to this exemption will be limited to the following (substantially the same as the limitations imposed on dealers registered in the current Ontario international dealer registration category):

- (a) an activity (other than a sale of a security) reasonably necessary to facilitate a distribution of securities primarily outside Canada;

- (b) a trade in a debt security with a "permitted client" during the distribution of the security, if the debt security is being offered primarily outside Canada and not pursuant to a prospectus filed in Canada;
- (c) a trade in a debt security that is a foreign security with a permitted client, other than during the distribution of the security (note that the current Ontario provision is not limited to a foreign security);
- (d) a trade in a foreign security with a permitted client, other than during the distribution of the security under a prospectus filed in Canada;
- (e) a trade in a foreign security with a Canadian investment dealer;
- (f) a trade in any security with an investment dealer that is acting as principal.

A "permitted client" is, with minor differences, any institutional accredited investor (which is who currently constitutes permitted clients for Ontario registered international dealers) plus any individual who beneficially owns financial assets having an aggregate realizable value (before taxes but net of related liabilities) that exceeds C\$5 million.

A dealer relying on this exemption must notify each client (other than a dealer or adviser registered in Canada) that it is not registered in Canada, what its jurisdiction of residence is, the name and address of the agent for the service of process and that there may be difficulty enforcing legal rights against the dealer because it is resident outside Canada and all or substantially all of its assets may be situated outside Canada.

Dealers currently registered as an international dealer in Ontario or Newfoundland and Labrador have until October 28, 2009 to file the Form 31-103F2 and comply with the notification requirement described in the previous paragraph. Dealers who wish to continue to rely upon this exemption must notify the regulator 12 months after it first submitted the Form 31-103F2 and each year thereafter (although in

Ontario, the annual payment of fees is sufficient for this purpose).

U.S. broker-dealers who carry on business in Canada will need to determine whether the new international dealer exemption is broad enough to cover their Canadian activities. If so, they should file the Form 31-103F2 in the appropriate jurisdictions and provide the required notification to their clients. If not, they will have to apply for registration as a dealer in the category of investment dealer, mutual fund dealer, scholarship plan dealer, exempt market dealer or restricted dealer, depending on the type of business which they intend to carry on.

Investment Advisers

Currently, U.S. investment advisers who wish to advise Canadian clients have to register in the appropriate province or territory of Canada. There are the specific categories of "international adviser" in Ontario and "portfolio manager and investment counsel (foreign)" in Alberta which are not subject to some of the requirements imposed on domestic advisers but whose activities are limited. In other jurisdictions, a similar result is obtained by imposing terms and conditions on the adviser's registration.

Under NI 31-103, an exemption from the requirements to register is available to an adviser if:

- (a) the adviser's head office or principal place of business is in a jurisdiction outside Canada;
- (b) the adviser is registered, or operates under an exemption from registration under the securities legislation of such jurisdiction in a category of registration that permits it to carry on the activities in that jurisdiction that registration in the Canadian jurisdiction as an adviser would permit it to carry on;
- (c) the adviser engages in the business of an adviser in such jurisdiction;
- (d) during its most recently completed year not more than 10% of the aggregate consolidated gross revenues of the adviser and its affiliates (other than an affiliate that is registered as an adviser in Canada)

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- was derived from portfolio management activities in Canada;
- (e) before advising a client, it notifies the client that it is not registered in Canada, what its jurisdiction of residence is, the name and address of the agent for the service of process and that there may be difficulty enforcing legal rights against the adviser because it is resident outside Canada and all or substantially all of its assets may be situated outside Canada;
 - (f) the adviser has submitted a Form 31-103F2 to each applicable Canadian securities regulatory authority.

This exemption is available for acting as an adviser only to permitted clients (described above) other than a person registered in Canada as a dealer or adviser and only in connection with non-Canadian securities, unless providing such advice is incidental to advising with respect to foreign securities. The new list of permitted clients includes more entities than the current list of permitted clients for Ontario-registered international advisers. For example, the current definition includes Canadian regulated pension funds having net assets of at least \$100 million. The minimum net asset threshold will no longer apply.

Those advisers registered as an international adviser in Ontario or as a portfolio manager and investment counsel (foreign) in Alberta will remain registered until September 28, 2010 and therefore will not be subject to the requirements of (e) and (f) described above until then. Thereafter their registration will be revoked unless they apply for registration.

The requirements to notify the applicable regulator on an annual basis applies as it does for the international dealer exemption.

The "sub-adviser" exemption, i.e. the exemption to act as a sub-adviser for an Ontario registered adviser who assumes responsibility for such advice will remain, but unexpectedly will not apply across the country. Securities regulatory authorities elsewhere have indicated that they will still grant discretionary relief on a similar basis. This situation is said to be temporary to give the regulators an opportunity to review the exemption taking into account the regulatory responses to cross-border activity.

The Quebec regulator has decided to eliminate, effective when NI 31-103 comes into force, the adviser registration exemption currently available in Quebec that permits an adviser to provide advice to accredited investors without registration.

U.S. advisers who have Canadian clients will need to determine whether the new international adviser exemption is broad enough to cover their Canadian activities. If so, they should file the Form 31-103F2 in the appropriate jurisdictions and provide the required notification to their clients, in each case within the appropriate time period. If not, they will have to apply for registration as an adviser in the category of portfolio manager or restricted portfolio manager. In making these determinations, they should be aware that it is now clear that providing advice outside Canada to a non-Canadian investment fund that offers its securities in Canada is not considered providing advice in Canada. The Ontario Securities Commission previously took a different view.

Investment Fund Managers

One of the concepts being introduced by NI 31-103 is the requirement of the managers of investment funds to register as such, even if they do not act as the investment adviser to the fund. For now, entities that do not have an office in Canada do not have to be registered as such even if the investment fund offers its securities in Canada. The Canadian Securities Administrators indicate that they intend to publish for comment a proposal which may require such registration. In the meantime the OSC maintains that such fund managers are required to pay an annual fee.

Registration

As a result of the harmonization provisions and the so-called "passport system" that applies outside Ontario, an applicant for registration can deal with only one (if the "principal regulator" is the Ontario Securities Commission) or two (otherwise) securities regulatory authorities and the registration requirements are now substantially the same among all the jurisdictions. The principal regulator is the securities regulator in the province or territory in which the entity has (or expects to have) the most clients. Accordingly, registration in multiple jurisdictions will be much easier than at present.