# Appendix A

## Summary of comments and responses on the 2008 Proposal

This appendix summarizes the written public comments we received on proposed National Instrument 31-103 *Registration Requirements* (the Rule), Companion Policy 31-103CP (the Companion Policy) and the proposed forms under National Instrument 33-109 *Registration Information* (the NRD Forms) as published on February 29, 2008 (the 2008 Proposal). It also sets out our responses to those comments.

**Drafting suggestions**
We received a number of drafting comments on the Rule, the Companion Policy and related forms. While we incorporated many of the suggestions, this document does not include a summary of the drafting changes we made.

**Topics outside the scope of the registration reform project**
We have not provided responses to the comments we received on topics that are outside the scope of the registration reform project, including:

- developing a documented process or structure to facilitate regulatory harmonization between provinces, securities administrators and self-regulatory organizations (SROs)
- registering financial planners
- allowing salespersons to direct commissions to personal corporations
- adopting a uniform definition of the term "security"
- registration fees
- delegation of the registration function to SROs
- resale restrictions on exempt securities
- harmonizing the regulatory treatment of securities and insurance products, such as segregated funds
- creating a registration category for small firms, with reduced requirements
- the regulatory framework for registration with regard to principal protected notes
- mutual recognition or special exemption regimes for foreign-based entities

**Categories of comments and single response**
In this document, we have consolidated and summarized the comments and our responses by theme. In general, we have not included comments already addressed in our summary of the comments on the proposal published on February 23, 2007 (the 2007 Proposal).

### Responses to comments received on the Rule

**General comments**

***Harmonization issues***
All jurisdictions are adopting the Rule, which harmonizes the registration requirements. However, several commenters expressed concern about a fractured regulatory environment for registration across Canada, including:

- the business trigger for dealer registration
- the regulation of trading in exempt securities
- the proposed amendments to the *Securities Act* (Ontario)
- the treatment of federally regulated financial institutions

***Business trigger for dealer registration***
The jurisdictions have consulted each other on any legislative amendments needed to support the Rule to ensure that it operates the same way in all jurisdictions. The CSA believes that functional harmonization has been reached since anyone who is in the business of trading in securities must register. However, members of the CSA have used different techniques to implement the business trigger for dealer registration, which do not result in any difference in the trigger itself:

- Most jurisdictions are implementing the business trigger for registration by way of legislative amendments. The legislation in those jurisdictions will require a person or company who is in the business of trading in securities to register as a dealer.

- Manitoba, British Columbia and New Brunswick are exempting from registration anyone who is not in the business of trading in securities.

- In Alberta, the legislation will require a person or company that is in the business of dealing in securities to register as a dealer. However, the Alberta Securities Commission (ASC) will implement, concurrently with the Rule, ASC Rule 31-504 *Dealer Registration Requirement - Scope of Application* to specify the scope of application of the dealer registration requirement in the *Securities Act* (Alberta) and to harmonize the registration requirement with the other jurisdictions.

***Regulation of trading in exempt securities***
The requirements applicable to registered exempt market dealers (EMDs) are the same in all jurisdictions. However, Alberta, British Columbia, Manitoba, Nunavut, Northwest Territories and Yukon (Northwestern Jurisdictions) are providing an exemption from EMD registration that imposes a targeted obligations regime on a person or company who is in the business of trading in the exempt market and is not otherwise registered with any securities regulatory authority.

A more detailed discussion of this exemption is set out in Appendix D of this Notice. The text of the order setting out the terms and conditions of this exemption is available in a separate notice on the following websites:

www.albertasecurities.com
www.bcsc.bc.ca

Saskatchewan is considering whether it will adopt this exemption and will release a separate notice when it has made its decision.

***Securities Act (Ontario)***
Commenters expressed concern that moving some of the provisions in the Rule to the *Securities Act* (Ontario) will detract from the harmonization of the Canadian securities regulatory regime. The Ontario government has decided to insert a number of provisions from the Rule into the *Securities Act* (Ontario). As a result, certain provisions of the Rule are stated not to apply in Ontario and explanatory notes have been inserted in the Rule. However, the provisions that will be adopted in the *Securities Act* (Ontario) are not materially different from those that appear in the Rule.

***Federally regulated financial institutions***
It has been suggested that a federally regulated financial institution should be exempted from dealer, adviser, and investment fund manager registration. The securities-related activities of federally regulated financial institutions are not separately addressed in the Rule. The CSA is maintaining the status quo on the requirements applicable to these institutions.

***Definition of "permitted client"***
We received several comments on the proposed definition of "permitted client." The commenters asked us to expand the definition of "permitted clients" by including certain entities. We also received comments on the monetary thresholds for shareholders' equity of corporations and for financial assets of individuals.

We agree with the commenters on some but not all of their comments and have amended the definition of "permitted client" to include:

- investment funds that are managed by a person or company registered as an investment fund manager under the securities legislation of a jurisdiction of Canada

- wholly-owned subsidiary companies of Canadian pension plans

- corporations having net assets of least $25 million (from $100 million of shareholders' equity in the 2008 Proposal)

- non-incorporated companies, partnerships and trusts

Further, we have designated as permitted clients other types of vehicles that other permitted clients may use for their investing, as long as no non-permitted client also uses that vehicle for investing.

We believe that registered charities that do not have an "eligibility adviser", family trusts and individuals with less than $5 million in financial assets should have the benefit of a suitability determination. They have therefore not been included in the "permitted clients" definition.

We have also made selected conforming changes to elements of the definition of "permitted client" that derive from the definition of "accredited investor" in NI 45-106 *Prospectus and Registration Exemptions.*

**Categories of registration - firms**

***Investment fund manager***
We were asked to provide clarification on some of the circumstances in which registration in the investment fund manager (IFM) category is required:

- Registered portfolio managers using their own pooled funds (which we now refer to as *non-prospectus qualified investment funds*) as portfolio management tools are required to register in the IFM category since the regulatory concerns relevant to IFM registration apply to these activities. Portfolio managers are therefore not exempt from IFM registration. However, we have eliminated the cumulative capital requirement if the firm is registered as both a portfolio manager and IFM.

- A general partner of a limited partnership investment vehicle acting in the capacity of investment fund manager of a pooled investment vehicle may be required to register in the IFM category, but only if the pooled investment vehicle is organized and invests in a manner that falls within the definition of investment fund in securities legislation. We have added in the Companion Policy discussion of IFMs of limited partnerships.

- We have provided a temporary two-year exemption in the Rule for IFMs whose head office is located outside Canada. See the Notice for a discussion of the CSA's ongoing policy development for foreign IFMs.

- For IFMs with a head office in Canada, we have provided a temporary two-year exemption in the Rule from registering in other Canadian jurisdictions as long as they are registered in the jurisdiction where their head office is located.

- We have provided a specific exemption from IFM registration for capital accumulation plans in the Rule. It will be available to the extent the plan is only required to be registered as an IFM because the investment fund is an investment option in a capital accumulation plan. The CSA is reviewing its policy approach with regard to IFM registration for capital accumulation plans. The CSA may therefore amend or revoke this exemption.

***Exempt market dealer***

*KYC and suitability requirements*
We received several comment letters stating that EMDs should be exempt from the know your client (KYC) and suitability requirements, and that clients should be permitted to waive KYC and suitability.

The CSA believes that KYC and suitability are fundamental requirements of the registration regime. However, the extent of KYC information that will be sufficient for a registrant to determine suitability will depend on the circumstances of the client, the transaction, the client's relationship with the registrant and the registrant's business model. We have amended the Companion Policy to include more detailed guidance on this issue.

Permitted clients can waive suitability determinations where the registrant is not providing discretionary portfolio management.

We received numerous letters from individuals indicating that investors purchasing under the offering memorandum exemption would resist providing EMDs with information that is necessary to assess suitability. The commenters perceived this as an invasion of privacy. As noted above, an exemption from the EMD registration requirement is available on certain terms and conditions in the Northwestern Jurisdictions.

*Proprietary pooled funds and location of client assets*
One commenter expressed the view that fund issuers who are not portfolio managers that sell their own proprietary pooled funds pursuant to a prospectus exemption should not have to register as an EMD, provided that client assets are held by an independent custodian. Our view is that the location of client assets is not a valid policy rationale for requiring or not requiring registration.

*Foreign EMDs*
One commenter expressed the opinion that foreign EMDs that are subject to regulation in their home jurisdiction should be exempt from the capital, insurance, chief compliance officer (CCO), ultimate designated person (UDP), relationship disclosure, suitability, margin, and borrowed money disclosure provisions in the Rule, and that the CSA should not impose "redundant" requirements on exempt market firms that are registered in foreign jurisdictions. The commenter also stated that the CSA should consider a mutual recognition system for these firms.

We believe that the location of the EMD is not in itself a valid policy rationale for requiring or not requiring registration. A mutual recognition system is beyond the scope of this project.

***Sale of mutual fund securities***
We received comments that EMDs should not be permitted to sell prospectus qualified mutual funds without mutual fund dealer registration. The EMD category contemplates sales of a wide range of securities to qualified purchasers and we can see no investor protection reason why this should not include sales of prospectus qualified mutual funds. We will nonetheless monitor the situation in case regulatory concerns arise.

***Mutual fund dealer***
We received comments to the effect that the CSA should permit mutual fund dealers that are members of the Mutual Fund Dealers Association of Canada (MFDA) to sell exempt securities, including non-prospectus qualified mutual funds, without requiring registration as an EMD.

The definition of mutual fund does include prospectus-exempt mutual funds and as such, mutual fund dealers are already permitted to trade in these pooled funds without the requirement to register as an EMD. There are also certain exempt securities that do not trigger the dealer registration requirement (e.g., specified debt) and can therefore be sold by mutual fund dealers that are not also registered as EMDs.

Some commenters suggested that mutual fund dealers should be permitted to sell exchange traded funds (ETFs) that do not fit within the definition of "mutual fund". We disagree. Such ETFs are fundamentally different from conventional mutual funds. There are specific market regulation issues pertaining to ETFs that are distinct from those pertaining to retail mutual fund distribution activity.

***Advisers and investment funds***
Some CSA members previously took the view that advice to an investment fund "flows through" to the investors in the fund. The effect of this interpretation was that the adviser to a fund must register, or be exempted, in that jurisdiction, if any units of the fund are sold there. This applies even if the adviser is located outside the jurisdiction and the fund is established outside the jurisdiction. We have not continued with this interpretation.

Under the Rule, the adviser to a fund that is constituted in a jurisdiction must be a registered portfolio manager in that jurisdiction, regardless of where the fund's investors are located. This is because the fund is the client receiving the advice, so advice is given in the jurisdiction where the advice is received and where the adviser is located.

If the fund is established outside a jurisdiction where units are sold and the adviser is also located outside the jurisdiction, the advice to the fund is not given in the jurisdiction. In this case, the adviser does not have to register in that jurisdiction.

**Categories of registration - individuals**

***Ultimate designated person***
We received comments that role of UDP is overly broad as stated in the Rule and Companion Policy, and should be made consistent with IIROC Rule 38, which provides that that the UDP is responsible for the conduct of the firm and the supervision of its employees. Further, it was suggested that the definition of UDP should be expanded to allow firms to designate this function to any of the senior officers permitted under IIROC By-law 1 (CEO, President, COO, CFO, or such other officer that has been approved by IIROC).

We have not changed the definition of UDP or the description of the role of the UDP. We remain convinced that the importance of the registered firm's compliance system and the UDP's role within it is such that only the most senior officer is appropriate to fill that role. We have clarified the UDP-CCO distinction in the Companion Policy discussion. IIROC Rule 38 will be amended to conform to the Rule.

Another commenter suggested that the firm should have the ability to designate more than one UDP. We disagree. The status and the role of the UDP preclude that position being filled by more than one individual.

***Chief compliance officer***
We received comments stating that certain circumstances could warrant the designation of several CCOs, such as for large registrants that have registerable activities carried out through various operating divisions. We will consider applications for exemptions on a case-by-case basis for these types of arrangements, but we have not changed the Rule. These arrangements may be appropriate only in limited circumstances.

***Associate advising representative***
We disagree with the comment stating that advisers should not be required to notify the regulator when the adviser designates an associate advising representative. The regulators need to be in a position to determine that the conditions that apply to the activities of the associate advising representative are met. An adviser must always pre-approve the advice given by an associate advising representative. The form of the pre-approval will depend on the circumstances, such as the associate advising representative's level of experience.

**Exceptions for members of self regulatory organizations (SROs)**
In response to comments requesting that the Rule comprise a broader list of requirements that would not apply to SRO members, we have made changes to include in the exemption the subordination agreement notice requirement, global financial institution bonds and the detailed requirements of relationship disclosure information.

However, we have not included an exemption from the following requirements:

- complaint handling and referral arrangements because there is substantial ongoing harmonization of the SRO Rules and the Rule

- the conflicts of interest provisions because these are outcome-based requirements that apply to registrants in all categories, whether or not they are SRO members

- the requirements relating to statements of account and portfolio because these set out the frequency of statement delivery and apply to registrants in all categories, including SRO members

We have deleted the reference to the dispute resolution service (sub-paragraph (p) of section 3.3(1) of the 2008 Proposal) since this was only intended as a technical exception for Québec registrants.

## Solvency and financial reporting requirements

### *General comments on calculation of excess working capital*

*Where assets are held*
We received a comment that where a third-party custodian holds client assets, there should be no working capital or insurance requirements. We disagree. Where the client assets are held, whether or not at a third-party custodian, is not a sufficient policy rationale for exempting a firm from the capital or insurance requirement. The solvency requirements are designed not only to protect client assets, but also to ensure a firm has the financial capacity to meet its day-to-day operations.

*Margin rules and market risk*
One commenter believed that using the margin rules of the Investment Industry Regulatory Organization of Canada (IIROC) does not necessarily provide an accurate assessment of market risk and that the proposed 50% margin rate for mutual funds is too high in respect of mutual funds that only invest in bonds.

We disagree. The calculation of market risk is based on the nature of the underlying security using the margin rates that are common to the investment industry today. We have updated the margin rates in schedule 1 to Form 31-103F1 *Calculation of excess working capital*.

A commenter stated that registrants that prepare financial statements in accordance with GAAP should not have to calculate market risk (line 9) in accordance with the principles set out in Schedule 1. We disagree. Market risk is designed to capture any adverse movement in securities prices, and the fact that a financial statement is prepared in accordance with Canadian GAAP may not necessarily reflect market risk.

*Long-term related party debt*
We received a suggestion that registrants should not have to add back 100% of long-term debt owed to a related party (line 5) of Form 31-103F1 if the related party debt is not due in the next 12 months. We disagree. The calculation of excess working capital is done on a conservative basis.

Long-term related party debt is treated as a current liability because it is easier for a related party to change the terms of repayment if the registrant is experiencing financial difficulty. If a registrant executes a subordination agreement, the treatment of the related party debt changes.

*Guarantees*
A commenter expressed the view that where a registrant guarantees the debt of an affiliated registrant, the calculation should not include both the debt for one registrant and the guarantee of that debt by the other registrant. Our response is that the calculation of excess working capital is done on a conservative basis. This is a conservative adjustment

in the capital formula, as a registrant may be called at any time to make a payment related to a guarantee.

The capital formula does not differentiate between short-term or long-term guarantees. If the amount of the guarantee has been included in the balance sheet as a current liability, it does not need to be included again on line 11 of Form 31-103F1.

We have simplified the form of the subordination agreement in Appendix B to the Rule.

***Application of solvency and financial reporting requirements to IFMs***

*NAV corrections and adjustments*
It was suggested that a materiality threshold should be in place for net asset value (NAV) corrections and adjustments, which is currently 50 basis points or $50. Otherwise, the reporting could become an administrative burden and the costs of reporting may be onerous.

Our response is that a firm is required to have policies and procedures in place to cover all the major functional areas of its business. This includes dealing with NAV adjustments, should they occur.

A firm may use the IFIC Bulletin 22 – *Correcting Portfolio NAV Errors* or establish a more stringent policy which would include a materiality threshold.

One commenter considered the requirement to report NAV adjustments on a quarterly basis to be unnecessary and unduly onerous. We disagree and have added additional guidance in the Companion policy on how to comply with the NAV reporting requirements.

*Capital requirement for IFMs*
A commenter suggested that IFMs, particularly those in investment fund complexes with various fund families, should be permitted to either take on additional insurance to satisfy regulatory concerns or use a graduated capital requirement based on the amount of assets invested. Alternatively, the CSA should require IFMs to hold a minimum $500,000 investment in their funds until they reach a threshold of assets under management.

Our response is that it is a basic requirement in Canada and in similar jurisdictions that registrants should be able to demonstrate that they are adequately capitalized and financially solvent. The prescribed amounts in the proposed Rule are minimums and fund managers may determine that their business model requires a greater amount to adequately manage their business.

*Insurance requirements for IFMs*
One commenter advocated that the insurance requirement should be limited to 1% of assets under management and that small fund managers who use independent custodians should be exempt from the insurance requirement.

We disagree. Insurance requirements are meant to protect the firm against property loss. The amount of insurance required for fund managers is formula-based and is linked to assets under management. We believe these requirements are appropriate in view of the activities undertaken by IFMs. Further, we believe there are other activities carried on by the fund manager that require insurance coverage. The Financial Institution Bond (FIB) Clauses A to E provide coverage for various types of losses.

*Financial reporting requirement for IFMs*
A commenter stated that IFMs that do not handle, hold or have access to client assets should be exempt from the requirement to file quarterly financial statements. However, the CSA believes that a fund manager, as trustee, has access to client assets. Client funds are continually "in transit" to and from the custodian as new investments are made or existing investments are redeemed. We therefore do not agree with the comment.

A commenter considered that the quarterly reporting requirements for IFMs, which do not apply to advisers, are excessive. We disagree. The operations of IFMs and advisers are different. An IFM has the responsibilities associated with fund accounting, transfer agency and trust accounting and must ensure that these functions are being properly performed (including when they have outsourced these duties).

*Trade confirmations*
It was suggested that in cases where securities in client name are maintained by the client with the IFM, the client may communicate directly with the IFM in order to redeem the securities. In such cases, the client would not receive a trade confirmation since that requirement would not apply to the IFM, which does not seem appropriate. We agree and have amended the Rule to provide that the IFM will be required to send trade confirmations in such cases.

***Application of solvency and financial reporting requirements to advisers***

*Capital requirement*
It was suggested that investments in an adviser's pooled funds should not be subject to a reduction for market risk. Alternatively, they should be subject to a 50% reduction provided the investment is in a fund managed by an IFM, there are no restrictions on the ability of the IFM to redeem its investment, and the investment can be redeemed or sold within two months of the date of the redemption notice. This would be consistent with mutual funds offered by prospectus. Alternatively, advisers who use independent custodians and whose investment fund assets comprise less than 25% of assets under management should have a $25,000 minimum capital requirement.

We disagree. We believe the proposed capital requirement for advisers is appropriate. The calculation of market risk is based on the nature of the underlying security using the margin rates that are common to the investment industry today. Mutual funds offered by prospectus have a lower market risk than pooled funds because they are regulated by NI 81-102 *Mutual Funds*.

*Insurance requirement*
One commenter believed that the new insurance requirement for advisers will diminish investment returns for investors. We disagree. Insurance requirements are meant to protect firm assets. The amount of insurance required is formula based. If an adviser does not hold or have access to client assets, the amount of insurance required is a single loss limit of $50,000, which is not an increase in some jurisdictions.

***Application of solvency and financial reporting requirements to EMDs***
According to some commenters, EMDs that do not hold or have access to client assets should be exempt from the solvency and insurance requirements in the Rule. We revised many of the requirements applicable to EMDs to eliminate the distinction between dealers that handle, hold, or have access to client assets and those that do not, which was introduced in the 2008 Proposal.

On reconsideration, we are not persuaded that this distinction is meaningful. The requirements applicable to EMDs will apply equally to all registrants in that category, consistent with the 2007 Proposal.

**Proficiency requirements**

***Proficiency principle***
We were asked to further explain the proficiency principle. The CSA views the proficiencies specified in the Rule as baseline requirements for registration, which apply to all registrants. Education and experience are ongoing requirements. We have provided clarification on the proficiency principle in the Companion Policy, in which we state that registered firms should ensure that registered individuals acting on their behalf meet the proficiency requirement at all times.

We also note in the Companion Policy that firms should perform their own analysis of all products they recommend to clients and provide product training to ensure their registered representatives have a sufficient understanding of the products and their risks to meet their suitability obligations. Similarly, registered individuals should have a thorough understanding of a product before they recommend it to a client.

***Examination-based model***
The CSA has maintained its decision to use an examination-based model to establish the baseline level of knowledge necessary to register as a representative. The CSA believes that passing examinations is sufficient to demonstrate knowledge, and that representatives should be free to follow the courses or other educational options to assist them in passing the examinations.

***General comments on required examinations***
The CSA will assess new examinations that are submitted for approval. We will review the Rule on a periodic basis and codify the recognition of additional examinations as they are approved by the CSA.

***Time limits for applying for registration after completing examinations***
We received several comments to the effect that the 36-month deadline to apply for registration after completing examinations should be removed entirely in situations where the individual has been continuously employed in the securities industry.

The Rule now provides that the 36-month deadline does not apply if the individual was registered in the same category in a jurisdiction of Canada or if the individual gained 12 months of relevant securities industry experience during the 36-month period before the date the individual applied for registration.

***Proficiency exemptions***
We received comments on what constitutes adequate experience and whether we should codify relief in this regard. In our view, it is not possible to determine and codify all of the possibilities relative to relevant experience in the Rule. This forms part of the review of each individual's fitness for registration.

As stated in the Companion Policy, we will consider granting an exemption from any of the prescribed proficiency requirements if we are satisfied that an individual has qualifications or relevant experience that are equivalent to, or more appropriate in the circumstances than, those proficiency requirements. We will make every effort to ensure consistency and transparency in granting or denying exemptions.

***Representatives of EMDs***
We received several comments on the requirement that EMD representatives pass the Canadian Securities Course (CSC) examination. We have added the IFSE Institute *Exempt Market Products Exam* as an alternative to the CSC examination for these representatives, with an extended transition period of 24 months for passing either of these examinations. We will assess new examinations submitted to us for approval and will amend the Rule if and when we approve new examinations.

***Representatives of mutual fund dealers***
We have been asked to further explain the inclusion in the Rule of the proficiency requirements for representatives of mutual fund dealers. The proficiency requirements in the Rule and those of the MFDA are identical for mutual fund dealer representatives. We have included them in the Rule because the registration of these representatives has not been delegated to the MFDA, and the MFDA does not review proficiency for dealing representatives of mutual fund dealers.

Delegation of registration duties by the CSA to the SROs is outside the scope of this project. Further, the MFDA is not recognized in Québec and some mutual fund dealers in other Canadian jurisdictions have been exempted from MFDA membership.

***IFM CCO***
The 2008 Proposal provided that the IFM CCO must have worked for a registered IFM for a number of consecutive years (either three or five). We have removed the qualifier

“consecutive” with regard to work experience of IFM CCOs, since this is not included in the requirement for portfolio managers. We have also deleted the word “registered” in the requirement that the CCO have prior experience at an IFM, since IFMs are not currently required to be registered.

We were asked to make the proficiency requirements identical for both the portfolio manager CCO and the investment fund manager CCO. The functions of the portfolio manager CCO and the IFM CCO are different, and the proficiency requirements, including where the CCO has acquired experience, are therefore different. We have, however, harmonized the requirements to the fullest extent possible.

**KYC and suitability**

It was suggested that the CSA should prescribe a standard KYC form, drafted in consultation with market participants. However, the Rule does not prescribe any forms that registrants must use in order to satisfy the KYC and suitability provisions. The requirements are outcome-based and intended to be flexible. The amount of information collected and the manner in which the information is collected will vary depending on the circumstances of each case.

The proposed KYC provision requires registrants to ascertain if the client is an insider of an issuer (and not only “reporting issuers”). One commenter stated that it was not clear what a registrant is to do with “non-reporting” insider information. We have revised the Rule to provide that a registrant must take reasonable steps to ascertain whether a client is an insider of a reporting issuer or any other issuer whose securities are publicly traded, and we have added guidance in the Companion Policy regarding this aspect of the KYC obligation.

One commenter asked us to explain to what extent a registrant must determine a client’s reputation. In this context, the word “reputation” should be interpreted according to the normal sense of the word. The registrant must make all reasonable inquiries necessary to resolve concerns about a client, including making a reasonable effort to determine, for example, the nature of the client’s business.

**Relationship disclosure information**

We received several comments on the relationship disclosure information provisions and confirm that they will not apply to managed accounts of permitted clients who waive the relationship disclosure requirement, regardless of the firm’s registration category.

We are working with the SROs to harmonize the Rule with the SROs’ client relationship model (CRM). At this stage of the registration reform project, the CSA will retain an outcome-based framework in the Rule to accommodate the adoption of CRM by the SROs.

**Complaint handling**

***Complaint handling provisions and guidance***
We received several comments on the complaint handling provisions in the Rule. We are working with the SROs to harmonize the complaint handling regime with a view to implementing substantially identical provisions, both in the Rule and in the SRO rules and policies.

At this stage of the registration reform project, the CSA has retained an outcome-based complaint handling requirement in the Rule but we provide no detailed guidance in the Companion Policy. When this harmonization work is completed, the CSA will prepare amendments to the Rule and the Companion Policy giving effect to the harmonized framework for handling complaints for non-SRO members. We have deleted the portions of the 2008 Proposal that are not harmonized with the complaint handling framework.

We also received comments asking us to clarify whether clients must exhaust all internal complaint handling mechanisms before pursuing independent dispute resolution. The CSA will address this issue in its development of the harmonized framework for complaint handling.

In response to a request to clarify the complaint handling requirement for firms registered in Québec, we note that these firms are subject to the same complaint handling regime, and are not exempt from the requirements provided in the *Securities Act* (Québec). The fact that they remain subject to the provisions of the Act is reflected in the Rule.

***Dispute resolution service***

A commenter suggested that registrants and their clients should be permitted to choose whether or not to participate in a dispute resolution service. We have redrafted the provision to clarify our intention that registrants can use the dispute resolution service provider of their choice. They are not required to "participate" in a specific dispute resolution program. However, a registrant must provide clients with independent dispute resolution or mediation services at the registrant's expense.

**Record-keeping**
A commenter was of the opinion that the records that firms are expected to retain should be based on a prescriptive list. We have moved away from prescriptive lists to an outcome-based approach. We expect registrants to maintain accurate records of any element of communication with the client that may have an impact on the client's account, including suitability and relationship information, which may evolve and change over time.

We have not prescribed specific records or methods of record-keeping because we recognize that records and methods that are relevant for one firm may not be relevant for another. However, we have provided guidance in the Companion Policy.

It was suggested that we should eliminate the distinction between activity and relationship records. We agree and have eliminated that distinction.

A commenter stated that maintaining relationship records for seven years from the date the client ceases to be a client could be onerous and costly to firms. As stated above, we have eliminated the distinction between activity and relationship records and as a result, we believe the technological costs for maintaining the records prescribed in the Rule are not excessive.

As requested by commenters, we have provided additional guidance in the Companion Policy on record keeping in respect of e-mail, electronic and other forms of communication.

**Client account reporting**

***Trade confirmations***
A commenter recommended that the Rule be amended to create an exemption for confirmations of trades for or on behalf of another foreign or domestic registrant and institutional clients, when the participant and client are using an automated trade matching system that complies with NI 24-101. We agree and have made the change.

***Quarterly (interim) statements of account***
A commenter believed that the requirement for quarterly statements of account (and monthly statements on the client's request) is a new requirement that will impose significant additional burdens on dealers, primarily mutual fund dealers and scholarship plan dealers that currently have an annual reporting requirement and have provided their clients with electronic, password protected access to their accounts on a real-time basis. It was suggested that the additional costs to dealers outweigh the benefits to clients and that statements of account should be sent annually, not quarterly.

We agree as far as scholarship plan dealers are concerned, given their business model. They may send annual statements of accounts only. Mutual fund dealers must send quarterly (interim) statements of account, but we have provided a 24-month transition period to meet the new requirement.

A commenter expressed the view that it is unnecessary to require an adviser to provide monthly statements of portfolio in instances where clients have consented to having their dealer send written trade confirmations to the adviser. However, we believe that where a client does not receive a trade confirmation, it is even more important for that client to receive a statement of portfolio. This position is consistent with multijurisdictional relief that is granted on a standard basis.

**Conflicts of interest**
We received several comments on the conflicts of interest provisions of the Rule. We have made changes to the 2008 Proposal on conflicts in response to comments, in some cases to return to proposals in the 2007 Proposal, and in some cases for clarification.

The objectives of the changes are to ensure that:

- clients receive meaningful disclosure about conflicts of interest
- unnecessary regulatory burdens are not imposed on registrants

More specifically, our responses to the comments are as follows:

- The definition of conflicts of interest should be included in the Rule and should be consistent with that of the IDA. We disagree, since this provision of the Rule is outcome-based and is not inconsistent with IIROC's requirements.

- The CSA should add a materiality threshold to the conflicts of interest provisions. We agree and have amended the Rule.

- The CSA should adopt a more prescriptive approach to conflicts of interest. The CSA believes that the blended approach of both principles and specific requirements is appropriate and will therefore remain. An outcome-based approach allows firms to determine how they will handle conflicts of interest according to their business model, size and types of clients. Prescriptive requirements are also necessary to indicate how certain conflicts situations must be dealt with.

- The CSA should expand the definition of "affiliate" to include trusts and limited partnerships, or add a reference to "associate" to ensure the Rule applies to all types of investment funds. We agree and have made the change within the confines of this section. "Affiliate" is not defined in all jurisdictions, and changing its meaning is beyond the scope of this project.

- The CSA should revise the provisions relating to prohibitions on managed account transactions, the prohibition on cross-trades and inter-fund trades, and the issuer disclosure statement provision. We have revised these provisions. See Appendix B of this Notice for a full description of the changes made.

- The 10% threshold for change of control pre-approval is too restrictive and should be raised to 25%. We disagree. Based on our experience with the existing notice provisions and the structure of most registrants, we believe the threshold is appropriate.

**Referral arrangements**

In response to a comment that the definition of referral arrangements is too broad, we note that this definition is intended by the CSA to be broad. We have added guidance in the Companion Policy on the purpose of the referral arrangement provisions, which is to deal with the abuse, misuse or misinterpretation of referral arrangement relationships involving registrants. We also describe in the Companion Policy the main areas that have been problematic.

One commenter believed that the requirements relating to referral arrangements among affiliates should be removed. Another commenter stated that the CSA should provide a

simplified regime for referral arrangements within large financial groups and that only the method of determining the commission should be included. We disagree. Referral arrangements between affiliates must also be disclosed to clients. However, referrals within the same firm are not subject to these provisions because the firm would need to consider their conflicts of interest obligations.

One commenter expressed the view that referral arrangements should only be allowed between firms or individuals who are regulated by the CSA or the SROs. Our response is that situations where only one of the parties to a referral is a registrant have raised regulatory concerns, and we intend for all referral arrangements that involve a registrant be regulated.

It was suggested that the Rule should outline how the CSA will take steps to ensure that investment products are appropriately vetted to prevent unsuitable and fraudulent products from entering the market before they are inadvertently sold or referred by financial advisors. Our response is that as part of a registrant's KYC and suitability obligations, a registrant should fully understand the product recommended to clients prior to performing an assessment of suitability.

We received a recommendation that only material changes to referral arrangements be communicated to affected clients. However, we believe that all of the items that must be disclosed to clients are sufficiently important that any change in this information warrants disclosure to clients.

**Exemptions**

***Location of exemptions***
We agree with the comment that all registration exemptions should be located in one instrument and have moved most registration exemptions into the Rule.

***New exemption for banks, hedge funds, and pension funds***
A commenter suggested that those who conduct their securities trading business through a registered dealer should not be required to themselves register as a dealer consistent with current securities laws. We have restored this exemption in the Rule.

***Private investment clubs***
One commenter suggested that the current dealer registration exemption for investment funds operating as private investment clubs should be added to the Rule. We agree and have done so.

***Dealer registration exemption for portfolio managers of pooled funds***
We have not extended the dealer registration exemption for portfolio managers of non-prospectus qualified funds to funds of affiliates or sales outside of fully managed accounts. This exemption is intentionally narrow, as we believe dealer registration is appropriate in most other situations. Discretionary relief will be considered on a case-by-case basis for cases that fall outside this exemption. This might include the integrated operations of certain affiliated groups.

***Registration exemption for registered mortgage brokers who trade in syndicated mortgages (Alberta)***
A commenter stated that Alberta should not have removed the registration exemption for registered mortgage brokers who trade in syndicated mortgages and that the Real Estate Council of Alberta (RECA) should regulate arm's length syndicated mortgages.

Our response is that Alberta Securities Commission (ASC) staff became aware that the use of the mortgages exemption had expanded beyond the scope of the original policy rationale underlying this exemption. As a result, ASC staff were concerned that the distribution of securities in connection with syndicated mortgages was, essentially, unregulated.

Mortgage brokers who trade in syndicated mortgages currently have, and will continue to have, access to a variety of prospectus exemptions, such as the accredited investor, offering memorandum, and minimum amount exemptions, under which they may distribute debt obligations that are associated with syndicated mortgages.

***Mobility exemption***
One commenter asserted that the mobility exemption is too onerous and does not reflect the realities of a more mobile Canadian population. Specifically, limiting the number of eligible clients to 10 (for firms) and five (for individuals) is unreasonable. We disagree. Once a person or company has more than a minimal presence in a local jurisdiction, the person or company should register in that jurisdiction.

**International dealers and advisers**
One commenter indicated that the definition of international dealer set out in the Rule should include international dealers that are exempt from registration in their home jurisdiction. We disagree. For dealer activities, the CSA believes that registration in the home jurisdiction is an important feature of investor protection.

We received a comment to the effect that an international dealer should be permitted to trade in any security with an investment dealer without further restriction. We disagree. International dealers remain restricted from trading in securities of Canadian issuers. We have not, as suggested by the commenter, limited the international dealer restrictions to trades on Canadian marketplaces.

We also disagree with comments to the effect that the CSA should permit international dealers to trade in interlisted securities on non-Canadian markets. We disagree with these suggestions because they are not consistent with the policy of restricting international dealers from trading in securities of Canadian issuers.

Another commenter suggested that international advisers should be permitted to provide investment management services to a *de minimus* number of clients who would not fall within the definition of "permitted client", analogous to the mobility exemption. We

disagree. The sophistication and financial resources of permitted clients is an important basis for the exemption for international advisers.

**Automatic transfers**
In response to a comment we received, we confirm that the automatic transfer process is only available where a registrant transfers in the same category, the new sponsoring firm is registered in the same category and in the same jurisdiction as the previous firm.

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

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

This allows an individual to engage in activities requiring registration from their first day with the new sponsoring firm. There are some restrictions on automatic transfers where an individual's conduct might cause regulatory concerns.

**Transition**
See CSA Staff Notice 31-311 Proposed National Instrument 31-103 *Registration Requirements and Exemptions: Transition into the new registration regime* for a detailed description of transition periods. We have generally lengthened the transition periods and have included in the Rule a provision on the protection of existing relief.

## Responses to comments received on 31-103 CP

**Business trigger factors**
We received comments to the effect that the business trigger guidance in the Companion Policy is inconsistent with the *Securities Act* (Ontario) amendments that were proposed in April 2008. The business trigger factors have been removed from the amendments to the *Securities Act* (Ontario).

We have amended the guidance on the business trigger factors, as follows:

**Acting as an "intermediary" and acting as a "market maker"**
We have clarified the guidance, which now indicates that we will not automatically assume that a person or company acting in either of those capacities is necessarily in the business of trading in securities. The totality of a person's activities will be considered in each case. We have not expanded on the "market maker" concept since this is a generally understood term in the securities industry.

**Venture capital and private equity**
We were asked to provide more guidance concerning venture capital and private equity in the Companion Policy. We have substantially revised the discussion of venture capital in the business trigger part of the Companion Policy. There are, however, a wide variety of venture capital and private equity business models, so we anticipate providing supplemental guidance at a later date.

**Asset allocation activities**
We were asked to re-insert the original asset allocation discussion in section 2.5 of the first draft of the Companion Policy, in order to provide clarity to the industry on whether pure asset allocation is considered generic advice. That discussion was removed in the 2008 Proposal following a review by CSA, which had concluded that financial planning activities are outside the scope of the registration reform project.

We maintain that position. Whether pure asset allocation activities are to be considered generic, non- specific advice, will have to be considered on a case-by-case basis by the person or company performing the asset allocation activity.

**IFM marketing and wholesaling activities**
We were asked to confirm whether dealer registration should be required where marketing and wholesaling activities are limited to funds that are distributed through a third-party dealer, or funds that are managed by an affiliate of the IFM. We have clarified the guidance in the Companion Policy.

**Guidance on risk management**
One commenter indicated that the Companion Policy contains guidance on assuring compliance with securities law but contains no guidance on managing business risks, and believes that we should add more guidance, including a description of the types of risks that a firm should consider and a discussion of "prudent business practices."

We have added some guidance in the Companion Policy but caution each registrant that it must identify its own specific risks and put in place monitoring and reporting procedures to address those risks.

**Outsourcing**
A commenter believed that the statement that registered firms are "fully liable and accountable for all functions that they outsource to a service provider" is inappropriate and imposes a standard of liability that does not exist in the marketplace today. We disagree. A registrant that chooses to outsource to a service provider should take appropriate measures to ensure that the quality of service provided meets the requirements with which the registrant must comply.

## Responses to comments received on NRD FORMS

**Form 33-109F1 – Notice of termination**
Some commenters asked us to clarify the two-step filing procedure for firms filing this form, to remove subjective elements from the questions in Part E and to confirm answering those questions will not contravene Canadian privacy legislation. Our response is as follows:

- The first four parts of the form must be answered within seven days of the effective date of termination, and the questions in Part E (now item 5), if applicable, must be answered within 40 days.

- A single submission on NRD can be made to complete the entire form if all details are available within the initial seven-day period.

- Alternatively, to answer the questions in Part E at a later date, a filer will update the initial filing by making an NRD submission to be renamed "Update / Correct Termination Information."

- In jurisdictions that charge late filing fees, those fees could apply to late filings for both seven-day and 40-day deadlines.

- In Part E, we agreed with some comments by revising questions 3 and 8 to make them less subjective and we deleted proposed question 10.

When individuals apply for registration, they provide consent to the collection by the regulator of personal information, including "employment records" (see item 20 of Form 33-109F4). Accordingly, the provision and collection of this information does not contravene Canadian privacy legislation.

**Form 33-109F2 – Change or surrender of individual category**
A commenter suggested that the form should include a field for the effective date of the change or surrender. We disagree. The effective date is the date the regulator approves the application for change or surrender of categories and, therefore, we do not require an effective date field for this form.

**Form 33-109F3 – Business locations other than head office**
In response to a comment, we have added a Branch Transit/Cost Centre or Unique Identification Number field to this form. We do not agree that the term "sub-branch" should be deleted from this form, as the MFDA will continue to use branches and sub-branches as descriptions of business locations.

**Form 33-109F4 – Application for registration of individuals and review of permitted individuals**
We were asked to make the following changes to Form 33-109F4:

- Business names should be dealt with outside NRD as a function of the firm's internal compliance and, therefore, the question regarding business names should be deleted from this form. We disagree. There are business names associated with individuals and not the firm, and requesting this information ensures the information can be searched for the individual's associations, as Item 1 is a "searchable field" on NRD.

- Remove the requirement to disclose eye colour, hair colour, height, and weight. Since photographs are not required to be submitted for individual applicants, the CSA will continue to request this information for identification purposes.

- Revise the proficiency section to limit disclosure to post-secondary education, degrees and diplomas that are relevant to, or required for, the application. We will continue to require full details of all post-secondary education, since this information is a matter of record at the post-secondary institutions attended by the applicant and is not difficult to obtain.

- Include a separate reference guide for this form. We may provide in future a reference guide for this form.

**Form 33-109F6 – Application for registration as dealer, adviser or investment manager**

We have reorganized and revised the Form 33-109F6 (F6) in a manner that we believe addresses the comments received. The revised F6 provides clarity and guidance within a logically structured framework. These changes are intended to create a more user friendly registration form that provides the regulator with the information necessary to determine whether a firm is suitable for registration.

In response to comments, we have provided extensive instructions for completing the F6 and added a "definition" section of terms used throughout the form. Collectively, these defined terms provide clarity to the filers. The form permits firms that are already registered in at least one jurisdiction of Canada to file an abbreviated F6. We have also revised the list of documents required to be submitted to the regulator, along with the F6.

**Form 33-109F7 – Notice of reinstatement of registered individuals and transfer of permitted individuals**

A condition for using the Form 33-109F7 is that, since the individual leaving their former sponsoring firm, there have been no changes to the information previously provided in respect of Items13 (Regulatory Disclosure), 14 (Criminal Disclosure), 15 (Civil Disclosure) and 16 (Financial Disclosure) of Form 33-109F4.

A commenter pointed out that there will always be a change in Item 13 – Regulatory Disclosure, as firms will end-date an individual's registration history with the previous sponsoring firm. In response to this comment, we have reworded Item 13.1(a) and 13.2(a) to address this concern.

## List of commenters

Private individuals are not included in this list.

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| Advocis | Independent Planning Group Inc. |
| Agri-Growth International Inc. | Investment Adviser Association |
| Alberta Land & Investment Brokers Inc. | Investment Counsel Association of Canada |
| Alberta Providence Financial Inc. | Investment Dealers Association of Canada |
| Alta Gas Ltd. | Investment Industry Association of Canada |
| Alternative Investment Management Association | Investment Technology Group |
| Arrow Hedge Partners Inc. | Irwin, White & Jennings |
| Assante Wealth Management | Jarislowsky Fraser Limited |
| Barometer Capital Management Inc. | Keystone Real Estate Investments |
| Becher McMahon Capital Markets Inc. | KMC Capital Inc. |
| Bick Financial Security Corporation | La Banque Nationale du Canada |
| Blaney McMurtry LLP | Limited Market Dealers Association |
| BMO Mutual Funds | Managed Funds Association |
| BMO Nesbitt Burns Inc. | MC2 Consulting Inc. |
| Borden Ladner Gervais LLP | McLean Budden Limited |
| Borden Ladner Gervais LLP on behalf of Orbis | McMillan |
| Investment Management Limited | MD Funds Management Inc. |
| Brandes Investment Partners & Co. | MGI Securities |
| CAL-GAS Inc. | Nexus Investment Management Inc. |
| Canada's Venture Capital & Private Equity Association | Olympia Trust Company |
| Canadian Advocacy Council | Ontario Bar Association |
| Canadian Bankers Association | Ontario Teachers' Pension Plan |
| Canadian Life and Health Insurance Association Inc. | Osler, Hoskin & Harcourt LLP |
| Capital Street Group | Osler, Hoskin & Harcourt LLP on behalf of The |
| Cardinal Capital Management, Inc. | Goldman Sachs Group, Inc. |
| CareVest Capital Inc. | Paragon Capital Corporation Ltd. |
| Chambre de la sécurité financière | PFSL Investments Canada Ltd. |
| CIBC | Prestigious Properties Group |
| Citrine Investment Services | Proforma Capital Inc. |
| Clearview School Division No. 71 | R.A. Floyd Capital Management Inc. |
| Cornerstone Group of Companies | Royal Bank Financial Group |
| Cornerstone Investment Strategies Inc. | Resolute Funds Limited |
| Crosbie & Company Inc. | RESP Dealers Association of Canada |
| Crown Properties International Corporation | Schinnour Matkin & Baxter |
| CSI Global Education Inc. | Scotia Cassels |
| Desjardins Fédération des caisses du Québec | Securities Industry and Financial Markets Association |
| Edward Jones | Shire International Real Estate Investments Ltd |
| Fasken Martineau DuMoulin LLP | SHSC Financial Inc. |
| Federation of Mutual Fund Dealers | Signature Capital Inc. |
| Fleming LLP | Société Générale Corporate & Investment Banking |
| Focused Money Solutions Inc. | Stikeman Elliott LLP |
| Foundation Capital Corporation | TD Bank Financial Group |
| Franklin Templeton Investments Corp. | TD Securities (USA) LLC |
| Goodmans LLP | The Canadian Institute of Chartered Accountants |
| Greystone Managed Investments Inc. | The Investment Funds Institute of Canada |
| Hanbury Management Ltd | The Lucid Group of Companies |
| Healthbridge Capital Management Ltd. | Tikka Financial |
| Highstreet Asset Management | Torys LLP |
| IFSE Institute | Tradex Management Inc. |
| IGM Financial Inc. | VenGrowth Asset Management Inc. |
| Independent Financial Brokers of Canada | Worldsource Financial Management Inc. |