

Registration Reform

IN CANADA
The Finish Line is Here

Section E of Stikeman Elliott's Report on Canada's New Registration Regime
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**Impact on International Dealers
and Non-Canadian Dealers Trading
in the Exempt Market**



Impact on International Dealers and Non-Canadian Dealers Trading in the Exempt Market

On July 17, 2009, the Canadian Securities Administrators (the CSA) published their final proposal for National Instrument 31-103 - *Registration Requirements and Exemptions* (31-103). Subject to government and other local approval requirements, 31-103 will come into force on September 28, 2009 (the Implementation Date).

31-103 is intended to harmonize, streamline and modernize registration requirements and exemptions across all Canadian provinces and territories (jurisdictions) and represents a major overhaul of the current registration regime. The new registration regime has significant implications for Canadian and non-Canadian dealers, advisers and investment fund managers currently doing business on a registered or exempt basis in any jurisdiction of Canada, including non-Canadian dealers registered in Ontario and Newfoundland and Labrador in the category of international dealer and persons relying on the "accredited investor" exemption and other exemptions from the dealer registration requirement in other Canadian jurisdictions. The new rules will also have significant implications for private placements and other capital market activities in Canada.

Key Changes to the Current Dealer Registration and Exemption Regimes

Material changes introduced by 31-103 for international dealer registrants and persons relying on the current dealer registration exemptions include:

- the elimination of the international dealer registration category in Ontario and Newfoundland and Labrador;
- the repeal of the dealer registration exemptions contained in National Instrument 45-106 - *Prospectus and Registration*

Exemptions (45-106), including the exemption for trades with accredited investors;

- the introduction of a new international dealer exemption that narrows the list of clients with whom a non-Canadian dealer may trade on an exempt basis;
- for persons relying on the dealer registration exemptions under the current version of 45-106 and who would be relying in future on the international dealer exemption, the introduction of a new restriction that trading activities under the international dealer exemption relate to "foreign securities" (which excludes inter-listed securities of Canadian issuers) and certain Canadian debt securities only;
- the introduction of a "business trigger" requiring registration of all persons who are in the business of trading in securities unless an exemption is available; and
- the introduction of an exempt market dealer (EMD) registration category that will permit Canadian and non-Canadian dealers to trade (1) in securities being distributed under a prospectus exemption or (2) with persons or companies to whom a security may be distributed under a prospectus exemption (for example, trading with an accredited investor).

Introduction of "Business Trigger" for Dealer Registration

Currently, the dealer registration requirement is generally triggered by the act of trading in a security. With the implementation of 31-103 and related legislative amendments in most Canadian jurisdictions, the dealer registration requirement will be triggered by being "in the business of" trading in securities as principal or agent. The introduction of the business trigger for the dealer registration requirement may eliminate the need for certain persons to register as a dealer if they carry out limited trades and are not otherwise in the business of trading in securities. For a discussion of the types of factors that the CSA view as indicative of a business purpose and that may trigger the dealer registration requirement, see the discussion under the heading Business Trigger for Registration under the topic Overview of Canada's New Registration Regime.

Blanket Registration Exemptions for Certain Trades in Selected Canadian Jurisdictions

Alberta, British Columbia, Manitoba and the three Canadian territories (the Northwest Territories, Nunavut and the Yukon Territory) will introduce standard blanket orders exempting individuals and firms from the dealer registration requirement when they trade in securities distributed under the accredited investor and other specified exemptions from the prospectus requirement under NI 45-106 (the Blanket Registration Exemptions). The Blanket Registration Exemptions will be unavailable to non-Canadian dealers that are registered in their home jurisdictions or in any Canadian jurisdiction. To rely on the Blanket Registration Exemptions, a non-resident person must: (1) not be registered in any jurisdiction; (2) not provide suitability advice leading to the trade; (3) not otherwise provide financial services to the purchaser; (4) not hold or have access

to the purchaser's assets; (5) provide a risk disclosure in prescribed form to the purchaser; and (6) file an information report with the local regulator.

Current Dealer Registration and Exemption Regime

In Ontario and Newfoundland and Labrador, registration as an international dealer has permitted a non-Canadian dealer to trade with local "designated institutions" in non-Canadian equity securities and certain Canadian debt securities. The practical effect of the international dealer registration regime in these jurisdictions has been to permit a non-Canadian dealer to trade in permitted securities with any person or entity, other than an individual, that qualifies as an accredited investor. In all other Canadian jurisdictions, securities laws currently permit a non-Canadian dealer to trade in both Canadian and non-Canadian securities with an accredited investor on a basis that is exempt from the dealer registration requirement.

International Dealer Exemption – Restrictions and Conditions

Under 31-103, a non-Canadian dealer that is an "international dealer" may rely on the international dealer exemption to trade with "permitted clients" (a subset of accredited investors under 45-106) when trading in foreign securities and certain Canadian debt securities.

In order to qualify as an international dealer, the non-Canadian dealer must be registered under the securities legislation of the foreign jurisdiction in which its head office or principal place of business is located in a category of registration that permits the dealer to carry on the activities which the non-Canadian dealer is proposing to carry on in the local Canadian jurisdiction. The non-Canadian dealer must also be engaged in the business of a dealer in that foreign jurisdiction.

In order to rely on the exemption, the international dealer must have previously:

- submitted to the relevant securities regulatory authorities an executed Form 31-103F2 *Submission to Jurisdiction and Appointment of Agent for Service* (Form 31-103F2); and
- notified the permitted client (1) that it is not registered in Canada, (2) of its jurisdiction of residence, (3) of the name and address of the agent for service of process appointed by the international dealer in the local jurisdiction, and (4) that there may be difficulty enforcing legal rights against the international dealer because it is resident outside Canada and all or substantially all of its assets are situated outside of Canada.

A person relying on the international dealer exemption will be required to pay capital market participation fees and submit a prescribed form to the Ontario Securities Commission on an annual basis. Other fee requirements may apply in other Canadian jurisdictions. In those other jurisdictions, the non-Canadian dealer must notify the local regulator 12 months after it first submits a Form 31-103F2 and each year thereafter if it continues to rely on the exemption.

International Dealer Exemption – Narrower List of Permitted Clients

The practical effect of the international dealer registration exemption is to narrow somewhat the list of clients with whom a non-Canadian dealer is permitted to trade on an exempt basis and to require registration as an exempt market dealer as a condition to trading with the full range of accredited investors without restriction as to the type of security. For example, non-Canadian dealers currently registered as international dealers in Ontario and Newfoundland and Labrador will no longer be permitted to trade with the following categories of clients under the international dealer exemption:

- a corporate entity with net assets of C\$5,000,000 (the applicable threshold under the exemption is increased to C\$25,000,000); or
- an investment fund that is not advised by a person registered as a portfolio manager or managed by an investment fund manager registered in a jurisdiction in Canada.

Non-Canadian dealers relying on the international dealer exemption, however, will be permitted to trade with individuals with net financial assets before taxes in excess of C\$5,000,000. Registered international dealers are not currently permitted to trade with individuals. The CSA have also expanded the regulated pension fund category to include a wholly-owned subsidiary of a registered pension fund in recognition of the fact that large Canadian pension plans now often invest through special purpose vehicles.

In the Canadian jurisdictions that currently permit non-Canadian dealers to trade with any category of accredited investor in any type of security on an unregistered basis, 31-103 will require such dealers to register or to rely on the more restricted international dealer exemption, as a consequence of which, the unregistered non-Canadian dealer will only be permitted to trade with the narrower list of permitted clients and then only in foreign securities and certain Canadian debt securities.

Alternatively, a non-Canadian dealer will be required to register as an exempt market dealer to gain access to the full list of accredited investors with whom it is currently permitted to trade without restriction as to the type of security.

International Dealer Exemptions – Subject to Foreign and Debt Securities Restriction

A non-Canadian dealer may currently trade on an exempt basis in both Canadian and non-Canadian securities with accredited investors resident in most provinces and territories, other than Ontario and Newfoundland and Labrador where registered international dealers are already subject to a restriction as to the type of securities they can trade.

Under the international dealer exemption, non-Canadian dealers will be restricted to trading in "foreign securities" and in certain Canadian debt securities only. The term "foreign security" is defined as a security of an issuer formed under the laws of a foreign jurisdiction or a security issued by a foreign government.

Inter-listed Securities

The CSA have confirmed in the Notice to 31-103 that the definition of foreign security is intended to exclude securities of Canadian issuers inter-listed on non-Canadian markets. This restriction would appear to require non-Canadian dealers to register as dealers in Canada in order to trade the securities of inter-listed Canadian issuers with Canadian clients even if the trade is effected on a non-Canadian market, unless a dealer registration exemption other than the international dealer exemption is available.

Exempt Market Dealer Registration Requirement

Under 31-103, a non-Canadian dealer will be required to register as an exempt market dealer (EMD) to trade in Canadian and non-Canadian securities with the full list of accredited investors and without restriction as to the type of security. A non-Canadian dealer that wishes to register as an EMD will be required to:

- make informational filings for each of its directors and senior executive officers;
- register each of its individual dealing representatives that will trade in Canada, who will be subject to Canadian proficiency requirements; and
- register an ultimate designated person (the senior person responsible for supervising and promoting compliance by the firm and individuals acting on its behalf) and a chief compliance officer (the person responsible for the day-to-day monitoring of the firm's adherence to its compliance policies and procedures).

The U.S. Series 7 exam together with the New Entrants Course Exam of CSI Global Education Inc. (CSI) is considered the equivalent of CSI's Canadian Securities Course Exam, which is required for registration as a dealing representative of an EMD. Discretionary exemptions from proficiency requirements may be available in certain cases.

In addition to registration requirements, EMDs will be subject to requirements applicable to the business operations of non-SRO registered dealers (including mandated compliance systems, books and records requirements, capital, bonding and insurance requirements, annual (audited) financial statement reporting requirements, capital adequacy calculation and reporting requirements, and other notice filing requirements). EMDs will also be subject to client information and reporting requirements, requirements governing client relationships (including know your client and product suitability requirements, mandated conflict of interest procedures and disclosure requirements), complaint handling procedures, and specific safekeeping and custody rules for client assets. For a discussion of requirements for exempt market dealers refer to the topic Impact on Limited Market Dealers and Unregistered Dealers Trading in the Exempt Market.

Non-Resident Status

31-103 does not require registered firms to be incorporated or maintain a place of business in Canada, although firms applying in a category of dealer registration (for example, investment dealer or mutual fund dealer), which is subject to membership with a recognized Canadian self regulatory organization (SRO) may be subject to residency requirements imposed by the SRO. All non-resident applicants for registration will be required to provide disclosure to clients as to their non-resident status and designate an agent for service of process in the local jurisdiction.

Margin and Prohibition on Lending to Clients

31-103 prohibits the provision of loans, credit or margin to clients by any registrant that is not a member of the Investment Industry Regulatory Organization of Canada (IIROC), the SRO for fully registered investment dealers.

Underwriting

Non-Canadian dealers registered in the category of exempt market dealer may act as an underwriter in respect of a distribution of securities that is made under an exemption from the prospectus requirements. The international dealer exemption is also an exemption from the requirement to be registered to be an underwriter, subject to the same conditions.

Custody Requirements

Non-Canadian dealers registered as EMDs will be subject to specific custody requirements.

Commodity Futures

The regulation of exchange-traded and other derivatives varies considerably across all Canadian jurisdictions. See the discussion under the topics Quebec's Derivatives Act and Trading or Advising in Commodity Futures.

Continuation of Existing Discretionary Relief

A non-Canadian dealer relying on a discretionary exemption, waiver or approval granted by a local regulator prior to the Implementation Date is exempt from any substantially similar provision of 31-103.

Transition Requirements for Registered International Dealers – Exemption Filing Deadline October 27, 2009

The registration of international dealers in Ontario and Newfoundland and Labrador will be revoked on the Implementation Date.

To rely on the international dealer exemption in these jurisdictions, non-Canadian dealers previously registered in this category must submit a completed Form 31-103F2 in the jurisdiction of registration within one month following the Implementation Date (that is, on or before October 27, 2009).

Transition Requirements for Registered Limited Market Dealers

The registration of non-Canadian dealers currently registered as limited market dealers in Ontario (and the registrations of their representatives) will be transitioned to EMD registration in that jurisdiction on the Implementation Date. See the discussion under the topic Limited Market Dealers and Unregistered Dealers Trading in the Exempt Market for more information on this category of registration.

Transition for Dealers Active in Exempt Market

All non-Canadian dealers who have previously been active in the exempt market in a Canadian jurisdiction prior to the Implementation Date will have 12 months to apply for registration in that jurisdiction and comply with applicable requirements.

New entrants, not previously active in the jurisdiction, will have no transitional relief and will have to comply with the conditions of the international dealer exemption or apply for registration as an EMD.

Registration Reform in Canada:

The Finish Line is Here

Canada's new registration rule was published by the Canadian securities administrators in final form on July 17, 2009.

The new regime is expected to be in force September 28, 2009 with transition periods for implementation of aspects varying. The new regime, which has been several years in the making, is intended to harmonize and streamline registration requirements and exemptions across all Canadian jurisdictions. It regulates dealers and advisers, effectively eliminating the dealer registration exemption for trading in the exempt market in Canada, and imposes a new registration requirement for investment fund managers.

The new regime has significant implications for Canadian and non-Canadian market participants, particularly those now doing business on an unregistered or exempt basis.

This document is one part in a series that details the regime and its impact on particular types of market participants and their business activities. The complete document includes the following sections:

- A** Overview of Canada's New Registration Regime
- B** Impact on a Limited Market Dealers and Unregistered Dealers Trading in the Exempt Market
- C** Impact on Investment Fund Managers
- D** Impact on Portfolio Managers and Investment Counsel
- E** Impact on International Dealers and Non-Canadian Dealers Trading in the Exempt Market
- F** Impact on International Advisers
- G** Impact on Investment Dealers and Mutual Fund Dealers
- H** Impact on Issuers Generally
- I** Impact on Investment Funds
- J** Impact on Private Equity and Venture Capital Funds
- K** Impact on Non-Canadian Investment Funds Privately Placing Securities in Canada
- L** New Compliance Requirements for Registrants
- M** Registering in Multiple Jurisdictions
- N** Quebec's *Derivatives Act*
- O** Trading or Advising in Commodity Futures
- P** Useful Links

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