

Registration Reform

IN CANADA
The Finish Line is Here

Section C of Stikeman Elliott's Report on Canada's New Registration Regime
JULY 2009

Impact on Investment Fund Managers



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The final proposal for National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) and the recent amendments to the provinces and territories' Securities Acts impose a new requirement that investment fund managers register as such. This new category of registration is provided for in 31-103 and imposes requirements for capital, insurance, proficiency for the chief compliance officer, as well as ongoing compliance and conduct.

Who is an Investment Fund Manager

The term "investment fund manager" is defined in the securities legislation of the various jurisdictions and refers to a person or company that directs the business, operations or affairs of an investment fund. This role is distinguishable from a person who provides portfolio management services or investment advice to the investment fund. A person providing such services or advice would be acting as an adviser and subject to the adviser registration requirements.

There are no material exemptions from the requirement to register as an investment fund manager and existing managers of mutual funds, for example, who often act as an investment adviser for the mutual fund (and would be registered as an adviser), would need to also register in the investment fund manager category. An investment fund manager that engages in the business of trading in securities of the investment fund it manages may also be required to register as a dealer.

In commentary to National Instrument 81-107 *Independent Review Committee for Investment Funds* (81-107), which includes a definition of "manager" that is the same as the definition of investment fund manager in other parts of the securities laws, the CSA have commented that they are of the view that the term "manager" should be interpreted broadly and is intended to include a group of members on the board of an investment fund or the general partner of an investment

fund organized as a limited partnership, where it acts in the capacity of ‘manager’/ ‘decision maker’. As such, the substance of how investment funds are organized and governed, as well as the question whether the fund is an investment fund, will need to be considered in determining which person or persons may be subject to the investment fund manager registration requirement. In Companion Policy 31-103CP *Registration Requirements and Exemptions* (31-103CP) it is noted that where investment funds are organized as limited partnerships, multiple registrations may not be necessary if each general partner in an affiliated group enters into a management contract with a single registered investment fund manager in the group. See the topic Impact on Private Equity and Venture Capital Funds for a discussion of the meaning of “investment fund”.

Application of Registration Requirement to Non-Canadian Investment Fund Managers

The CSA plan to publish a proposal for comment during the next year to explain under what circumstances an investment fund manager that has a head office outside Canada would need to register and in what circumstances an investment fund manager with a head office in one jurisdiction in Canada would need to register in other jurisdictions.

Registration of Individuals

A firm registered as an investment fund manager is required to have an individual registered as its ultimate designated person (UDP) and an individual registered as its chief compliance officer (CCO). No other individuals at firms that are registered as investment fund managers are required to be registered, although directors and certain officers would be required, as “permitted persons” under National Instrument 33-109 *Registration Information*, to submit Form 33-109F4 in connection with the firm’s registration.

The UDP is required to supervise the activities of the firm that are directed towards ensuring compliance with securities legislation by the firm and each individual acting on its behalf and to promote compliance with securities legislation within the firm.

The CCO is required to establish and maintain policies and procedures for assessing compliance by the firm, and individuals acting on its behalf, with securities legislation; monitor and assess compliance by the firm, and individuals acting on its behalf, with securities legislation; report to the UDP as soon as practicable if the CCO becomes aware of any circumstances indicating that the firm, or any individual acting on behalf of the firm, is in substantial non-compliance with securities legislation; and submit an annual report to the board of directors or partnership for the purpose of assessing compliance by the firm, and individuals acting on its behalf, with securities legislation.

The proficiency requirements for the CCO of an investment fund manager are one of three standards:

FIRST STANDARD:

- has a CFA Charter or professional designation as a lawyer, Chartered Accountant, Certified General Accountant or Certified Management Accountant in a jurisdiction in Canada, a notary in Quebec, or the equivalent in a foreign jurisdiction;
- has both the Canadian Securities Course Exam of CSI Global Education Inc. (CSI) and either the Investment Funds Institute of Canada (IFIC) Officers', Partners' and Directors' Exam or CSI's Partners, Directors and Senior Officers Exam (each the PDO Exam); and
- has either (1) gained 36 months of relevant securities experience while working at a registered dealer, a registered adviser or an investment fund manager or (2) provided professional services in the securities industry for 36 months and worked for an investment fund manager for 12 months.

SECOND STANDARD:

- has IFIC's Canadian Investment Funds Exam, the Canadian Securities Course Exam or the CSI's Investment Funds in Canada Course Exam;
- has the PDO Exam; and
- has gained five years of relevant securities experience while working at a registered dealer, registered adviser or an investment fund manager, including 36 months in a compliance capacity.

THIRD STANDARD:

- has met the proficiency requirements for a CCO of a portfolio manager.

There are no proficiency requirements for the UDP, but the UDP must be the chief executive officer, an officer in charge of a division of the firm, if the activity that requires registration occurs only in the division, or an individual acting in a similar capacity.

Financial Condition Requirements

An investment fund manager is subject to capital and insurance requirements as follows:

- minimum capital of \$100,000;
- requirement that excess working capital be not less than zero;
- bonding or insurance in respect of each prescribed clause and for each clause the highest of the following amounts:
 - one percent of assets under management or \$25,000,000, whichever is less,
 - one percent of the investment fund manager's total assets or \$25,000,000, whichever is less,
 - \$200,000, and
 - the amount determined to be appropriate by a resolution of the directors of the investment fund manager.

Financial and Other Reporting to Regulator

An investment fund manager will be required to deliver to the regulator quarterly and audited annual financial statements, prepared in accordance with generally accepted accounting principles but on an unconsolidated basis, and calculations of excess working capital. The CSA have indicated that they intend to require registrants to adopt international financial reporting standards for financial years beginning on or after January 1, 2011.

An investment fund manager's financial statements delivered to the regulator must include a description of any net asset value adjustment made during the period.

Business Operations and Client Relationship Rules for Investment Fund Managers

An investment fund manager is not subject to the know your client or suitability, client complaint handling or most client account handling requirements for registered firms, but otherwise is subject to the same business operations and client relationship rules as other registered firms. These include: segregation and other requirements pertaining to holding client assets, record keeping requirements, and requirements for its controls and compliance systems. See the discussion under the topic New Compliance Requirements for Registrants.

Conflicts of Interest

An investment fund manager is subject to the conflict of interest provisions of 31-103 that apply generally to registered firms. The obligation to identify conflicts of interest with clients and to resolve them and, in some cases, to disclose them to clients does not apply to an investment fund manager in respect of an investment fund that is subject to 81-107. This rule, which among other things contemplates the appointment of an independent review committee for an investment fund, applies to investment funds that are reporting issuers.

Registrations in Multiple Categories May Be Required and Some Exemptions

As noted, an investment fund manager that is also managing the portfolio for the investment fund or otherwise providing investment advice to the investment fund it is managing will be subject to the adviser registration requirement as well as the investment fund manager registration requirement. Its activities in connection with the selling of securities of the investment fund may also require it to register as a dealer. There is a dealer registration exemption for a person or company in respect of a trade by the person or company if the trade is made solely through an agent that is a registered dealer. In 31-103CP, the CSA note that an investment fund manager does not have to register as a dealer to promote the fund to registered dealers. An investment fund manager is also exempt from the dealer registration requirements for trades in securities of the non-prospectus qualified funds it manages and advises to client accounts it manages. There are further exemptions from the dealer registration requirement for investment fund managers in respect of dividend or distribution reinvestment plans or optional

investment plans of the investment funds or certain additional investments by fund security holders.

If a firm is registered in more than one category it must meet the highest capital requirement and comply with all applicable requirements for registrants in each category. The capital requirements are not cumulative.

Fees Payable in Respect of Registration and the Unregistered Investment Fund Manager Capital Markets Participation Fee in Ontario

In Ontario firms registered as investment fund managers will be required to pay participation fees under OSC Rule 13-502 *Fees* (Ontario Fee Rule). Participation fees must also be paid under the Ontario Fee Rule by any investment fund manager who continues to operate on an unregistered basis in accordance with an exemption from the investment fund manager registration requirement. Fees may also be applicable in other jurisdictions.

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, streamline and modernize 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 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

If you would like a copy of any of the other sections, in electronic or print format, please contact your Stikeman Elliott representative, email us at info@stikeman.com or visit our website at www.stikeman.com

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