

Registration Reform

IN CANADA
The Finish Line is Here

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

**Impact on Portfolio Managers
and Investment Counsel**



Impact on Portfolio Managers and Investment Counsel

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 modify the adviser registration categories and change some of the requirements associated with registration as a "full adviser".

Categories of Registration for Firm and Individuals and Transition Matters

Advisers have typically been registered as both "investment counsel" and "portfolio managers", although these are separate categories of adviser registration in most jurisdictions. Under the new regime, advisers are required to be registered in one of two categories, either:

- portfolio manager, being an adviser that is permitted to advise in any securities; or
- restricted portfolio manager, being an adviser that is limited by conditions on its registration to advising in specified securities, classes of securities or the securities of a class of issuers.

As such, there will be one general category of adviser registration, for both residents and non-residents, that of portfolio manager.

Under the transition provisions of the new regime, persons that are registered as an investment counsel, portfolio manager or portfolio manager/investment counsel (or, in Ontario, non-Canadian investment counsel & portfolio manager or extra-provincial investment counsel & portfolio manager) will be automatically registered in the new category of "portfolio manager". Generally, the only persons who will be reregistered as "restricted portfolio managers" are those persons presently registered in Quebec as "restricted practice advisers".

Individuals at firms registered as portfolio managers will be registered as:

- advising representatives; or
- associate advising representatives.

Portfolio managers will also be required to have individuals who are designated and registered as their ultimate designated person (UDP) and their chief compliance officer (CCO), as is generally currently the case.

Directors and certain officers would still be required, as “permitted persons” under National Instrument 33-109 *Registration Information*, to submit Form 33-109F4 in connection with the firm’s registration.

Matters Materially Different for Portfolio Managers under 31-103

The matters that are materially different portfolio managers under the new registration regime include:

- the requirement to provide a client with relationship disclosure information before advising the client;
- the capital and insurance requirements; and
- the requirement to make available an independent dispute resolution or mediation service, at the firm’s expense, to clients to resolve clients’ complaints.

Adviser Registration Exemptions

31-103 retains the existing adviser registration exemption for members of the Investment Industry Regulatory Organization of Canada (IIROC) that manage clients’ investment portfolios through discretionary authority granted by the client and who are approved to perform that function by IIROC. It also retains in concept the “incidental activities” exemption from the adviser registration requirement for registered dealers that advise a client in connection with a trade in security.

31-103 also adds a new adviser registration exemption for persons who act as advisers if the advice does not purport to be tailored to the needs of the person or company receiving the advice. As a result, for example, newsletter writers who provide general investment recommendations will often no longer be required to be registered as advisers. 31-103 requires a person relying on the general advice exemption that has, or has certain specified relationships with a person that has, a financial or other interest in any recommended securities, to disclose the interest when making the recommendation. In addition, international advisers are exempted from the requirement to register as an adviser where their activities are limited as set out in 31-103 and they are providing the advice from outside of Canada. For further information on the international adviser registration exemption see the discussion under the topic Impact on International Advisers.

31-103 does not extend the sub-adviser exemption to the adviser registration requirement to jurisdictions beyond Ontario at this time. For now, the adviser

registration exemption for sub-advisers in OSC Rule 35-502 – *Non Resident Advisers* (35-502) will be retained in Ontario and exemptive relief where necessary will be considered on a case by case basis in other jurisdictions, as is the current situation.

With the elimination in Ontario of the “look-through” analysis on the adviser registration requirement, which has been confirmed by the CSA in the Notice to 31-103, related adviser registration exemptions that are currently available under 35-502, such as that for non-Canadian advisers in connection with the private placement of the securities of non-Canadian investment funds, are considered unnecessary and are not being carried forward in 31-103 or 35-502.

Dealer Registration Exemptions for Advisers with respect to their Non-Prospectus Qualified Funds

31-103 exempts a registered adviser from the dealer registration requirement in respect of a trade in a security of a non-prospectus qualified investment fund (pooled fund) if (1) the adviser acts as the fund’s adviser and investment fund manager, and (2) the trade is to a managed account of a client of the adviser. This exemption is not available however if the managed account or non-prospectus qualified investment fund was created or is used primarily for the purpose of qualifying for the exemption. Notice to the regulator is required for an adviser to rely on this exemption.

Registration of Individuals and Fit and Proper Requirements for Registration

Individuals registered as advising representatives of a portfolio manager are required:

- to have a CFA charter and 12 months of relevant investment management experience in the 36 month period before applying for registration; or
- to have a Canadian Investment Manager designation (being the designation earned through the Canadian investment manager program of CSI Global Education Inc. (CSI)) and 48 months of relevant investment management experience, 12 months of which was in the 36 month period before applying for registration.

Less experience is required for registration as an associate portfolio manager. Any advice given by an associate portfolio manager must be approved by an advising representative of the firm.

A firm registered as an adviser is required to have an individual registered as its ultimate designated person (UDP) and an individual registered as its chief compliance officer (CCO).

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 a portfolio 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 Exam of 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 an investment dealer, a registered adviser or an investment fund manager, or (2) provided professional services in the securities industry for 36 months and worked for a registered dealer, a registered adviser or an investment fund manager for 12 months.

SECOND STANDARD:

- has the Canadian Securities Exam and the PDO Exam and has either:
 - worked for an investment dealer or a registered adviser for 5 years, including for 36 months in a compliance capacity, or
 - worked for 5 years at a Canadian financial institution in a compliance capacity relating to portfolio management and worked at a registered dealer or a registered adviser for 12 months.

THIRD STANDARD:

- has the PDO Exam and has met the proficiency requirements for registration as an advising representative 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 the firm to register occurs only within the division, or an individual acting in a similar capacity.

Capital and Insurance Requirements

An adviser is subject to capital and insurance requirements as follows:

- minimum capital of \$25,000;
- requirement that excess working capital be not less than zero;
- for advisers that do not handle, hold or have access to clients' assets, bonding or insurance in respect of each prescribed clause in the amount of \$50,000 for each clause; and
- for advisers that do handle, hold or have access to clients' assets, bonding or insurance in respect of each prescribed clause and in the highest of the following amounts for each clause:
 - one percent of assets under management that the adviser handles, holds or has access to or \$25,000,000, whichever is less,
 - one percent of the adviser'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 adviser.

Financial Reporting to Regulators

An adviser will be required to deliver to the regulator 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 they intend to require registrants to adopt international financial reporting standards for financial years beginning on or after January 1, 2011.

Business Operations and Client Relationship Rules for Portfolio Managers

Advisers are subject to the conduct rules under 31-103, which include:

- know your client requirements;
- suitability requirements;
- the requirement to provide relationship disclosure information before the portfolio manager first advises the client. This information is all information that a reasonable investor would consider important about the client's relationship with the portfolio manager and is to include, for example, a discussion that identifies which products or services are offered by the firm, a discussion of the types of risk a client should consider when making an investment decision, a description of the conflicts of interest that the portfolio manager is required to disclose under securities legislation, and disclosure of all costs to a client for the operation of an account;
- segregation requirements for clients' assets;

- records requirements; and
- compliance system requirements.

The terms on which a portfolio manager may participate in a referral arrangement are prescribed in 31-103.

Conflicts of Interest

31-103 consolidates a number of conflicts of interest requirements that previously appeared in various places in securities legislation. It requires that a portfolio manager make reasonable efforts to identify material conflicts of interest or potential material conflicts of interest between the firm and its clients, to respond to such conflicts of interest and, where the client, acting reasonably, would expect to be informed of such a conflict of interest, to disclose the nature and extent of the conflict of interest to the client. The CSA note in 31-103CP that this would include disclosure about related or connected issuers when the portfolio manager is recommending securities of those issuers.

31-103 prohibits a portfolio manager from implementing certain types of transactions for investment portfolios managed by it. Among the types of transactions prohibited for a portfolio manager is the purchase or sale of a security between investment portfolios managed by the portfolio manager or other “responsible persons”.

A portfolio manager is required to ensure fairness in the allocation of investment opportunities among its clients.

Handling of Client Complaints and Disputes

Under 31-103 a portfolio manager is required to document and respond to each complaint made to it about its products or services, in a manner that a reasonable investor would consider fair and effective, and is required to ensure that independent dispute resolution or mediation services are made available, at the firm’s expense, to resolve client complaints.

Prohibition on Providing Margin or Lending to Clients

Like all registrants other than IIROC members, a portfolio manager is prohibited from lending money, extending credit or providing margin to a client.

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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