

Registration Reform

IN CANADA
The Finish Line is Here

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

**Impact on Private Equity
and Venture Capital Funds**



Impact on Private Equity and Venture Capital Funds

There are no provisions of the final proposal for National Instrument 31-103 *Registration Requirements and Exemptions* (31-103) and the related amendments to the provinces and territories' Securities Acts and other instruments and policies that are specific to private equity funds or venture capital funds, so the application of the registration requirements under 31-103 and the related amendments will need to be considered under the basic principles of the regime. These basic principles are generally that a person in the "business of trading" in securities is required to be registered as a dealer; a person in the business of advising others as to the investing in or the buying or selling of securities is required to be registered as an adviser and a person who acts as an investment fund manager (that is, who directs the business, operations or affairs of an investment fund) is required to be registered as an investment fund manager.

Meaning of "Investment Fund"

Key for the investment fund manager registration requirement is the meaning of "investment fund", since it is only managers of investment funds that must register. The term "investment fund" is defined in the securities legislation of the various provinces and territories (jurisdictions) and refers to:

- a mutual fund, being an issuer whose primary purpose is to invest money provided by its security holders and whose securities are redeemable on demand, or within a specified period after demand, at an amount computed by reference to the value of the fund's net assets, or
- a non-redeemable investment fund, being an issuer that is not a mutual fund and whose primary purpose is to invest money provided by its security holders and that does not invest for the purpose of seeking to exercise control of an issuer or of being actively involved in the management of any issuer in which it invests.

In each case, the facts will be key in assessing the impact of the new registration regime in 31-103 for any fund, including one that characterizes itself as a private equity or venture capital fund. Some guidance has been provided by the Canadian Securities Administrators (CSA) in Companion Policy 31-103CP *Registration Requirements and Exemptions* (31-103CP) on how this test for investment fund status would be applied in particular factual situations. The CSA have indicated that they anticipate providing supplemental guidance at a later date.

In 31-103CP, the CSA note that:

- venture capital and private equity investing are distinguished from other forms of investing by the role played by venture capital and private equity management companies (collectively, VCs). This type of investing includes a range of activities that may require registration;
- VCs typically raise money under one of the prospectus exemptions in NI 45-106, including for trades to “accredited investors”. The investors typically agree that their money will remain invested for a period of time. The VC uses this money to invest in securities of companies that are not publicly traded. The VC usually becomes actively involved in the management of the company, often over several years;
- examples of active management in the company include the VC having:
 - representation on the board of directors;
 - direct involvement in the appointment of managers; or
 - a say in material management decisions;
- the VC looks to realize on the investment either through a public offering of the company’s securities, or a sale of the business. At this point, the investors’ money can be returned to them, along with any profit.
- investors rely on the VC’s expertise in selecting and managing the companies it invests in. In return, the VC receives a management fee or “carried interest” in the profits generated from these investments. They do not receive compensation for raising capital or trading in securities;
- applying the business trigger factors to the VC activities as described above, there would be no requirement for the VC to register as:
 - a portfolio manager, if the advice provided in connection with the purchase and sale of companies is incidental to the VC’s active management of these companies; or
 - a dealer, if both the raising of money from investors and the investing of that money in companies are occasional and uncompensated activities;
- if the VC is actively involved in the management of the companies it invests in, the investment portfolio would generally not be considered an investment fund. As a result, the VC would not need to register as an investment fund manager; and

- the business trigger factors and investment fund manager analysis may apply differently if the VC engages in activities other than those described above.

For a discussion of the registration requirements for dealers, advisers and investment fund managers in the context of investment funds, see the discussion under the topics Impact on Investment Fund Managers and Impact on Investment Funds.

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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