

1.1.2 CSA Staff Notice 31-312 – The Exempt Market Dealer Category under NI 31-103 Registration Requirements and Exemptions

CSA STAFF NOTICE 31-312

THE EXEMPT MARKET DEALER CATEGORY  
UNDER NATIONAL INSTRUMENT 31-103  
REGISTRATION REQUIREMENTS AND EXEMPTIONS

National Instrument 31-103 *Registration Requirements and Exemptions (NI 31-103)* expands the requirement to register to include exempt market dealers (**EMDs**). In Ontario and in Newfoundland and Labrador, the EMD category replaces the category of limited market dealer (**LMD**). In all other jurisdictions, this is a new category of registration. NI 31-103 is expected to come into force on September 28, 2009 (the **Implementation Date**).

This notice summarizes the key requirements and transition process for the new EMD category. The information contained in this notice is applicable to: 1) LMDs registered under the existing registration regime in Ontario and Newfoundland and Labrador, 2) firms trading in reliance on the registration exemptions in National Instrument 45-106 *Prospectus and Registration Exemptions (NI 45-106)* prior to the Implementation Date in jurisdictions other than Ontario and Newfoundland and Labrador, and 3) EMDs seeking registration after the Implementation Date under the new registration regime set out under NI 31-103. This notice is not intended to be a substitute for reading NI 31-103, which was published on July 17, 2009. We encourage you to read NI 31-103 thoroughly and to seek legal advice when necessary.

1. Key requirements for EMDs under NI 31-103

a) Requirement to register as an EMD

Under NI 31-103, a business trigger replaces the trade trigger for registration. A person or company *in the business of* trading or holding themselves out as being in the business of trading will be required to register, unless an exemption applies. The business trigger is explained in more detail in section 1.3 of the Companion Policy to NI 31-103.

**Individuals**

The categories of registration for individuals are set out in Part 2 of NI 31-103. The relevant categories of registration for individuals acting on behalf of an EMD are dealing representative, ultimate designated person and chief compliance officer.

**Firms**

The categories of registration for firms are set out in Part 7 of NI 31-103. The EMD category restricts an individual or firm to acting as a dealer in the “exempt market”. Specifically, a firm registered as an EMD is permitted to engage in the following activities set out under paragraph 7.1(2)(d):

- (i) act as a dealer by trading a security that is distributed under an exemption from the prospectus requirement, whether or not a prospectus was filed in respect of the distribution
- (ii) act as a dealer by trading a security that, if the trade were a distribution, would be exempt from the prospectus requirement
- (iii) receive an order from a client to sell a security that was acquired by the client in a circumstance described in subparagraph (i) or (ii), and may act or solicit in furtherance of receiving such an order, and
- (iv) act as an underwriter in respect of a distribution of securities that is made under an exemption from the prospectus requirement

**Exemptions**

Currently, most of the dealer registration exemptions are located in NI 45-106. As of March 28, 2010, the registration exemptions in NI 45-106 will no longer be available. All registration exemptions will be set out in Part 8 of NI 31-103, or in local rules or blanket orders. See CSA Notice *Notice of Repeal and Replacement of National Instrument 45-106 Prospectus and Registration Exemptions and Related Forms and Companion Policy* published on July 17, 2009 for more information.

The securities regulators in Alberta, British Columbia, Manitoba, the Northwest Territories, Nunavut and the Yukon Territory (the **Northwestern jurisdictions**) intend to issue local orders exempting individuals and firms from the dealer registration requirement when they trade in securities in certain circumstances (the **Northwestern exemption orders**). These orders will be

issued when the registration exemptions in NI 45-106 expire on March 27, 2010. They will exempt from registration persons or companies who trade in securities distributed under one or more of the following prospectus exemptions (the **capital raising exemptions**) set out in NI 45-106:

- Section 2.3 - accredited investor
- Section 2.5 - family, friends and business associates
- Section 2.9 - offering memorandum
- Section 2.10 - minimum \$150,000 purchase of a security in one transaction

The Northwestern exemption orders will contain a number of conditions that restrict the availability of the exemption. If an individual or firm does not meet any of the following conditions, it must register as an EMD. An individual or firm must:

- not be registered in any category of registration in any jurisdiction
- not provide suitability advice about the trade to the purchaser
- except in British Columbia, not otherwise provide financial services to the purchaser
- not hold or have access to the purchaser's assets
- provide risk disclosure in the prescribed form to the purchaser, and
- file an information report with the securities regulatory authority

For more information on the Northwestern exemption orders:

- British Columbia: British Columbia published its local order and a companion policy along with advance notice of NI 31-103. Please refer to BC Notice 2009/12 *Advance Notice of National Instrument 31-103 Registration Requirements and Exemptions*.
- For all other Northwestern jurisdictions: Please refer to Appendix D of the Notice to NI 31-103 or contact CSA staff.

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

#### **b) Transition provisions**

Part 16 of NI 31-103 contains a number of transition provisions for EMDs and individual representatives of EMDs. These transition provisions apply only to firms that are: 1) registered as LMDs in Ontario or in Newfoundland or Labrador, or 2) trade in reliance on the registration exemptions in NI 45-106 on the Implementation Date in all other jurisdictions. You can find more detailed information about transition timelines in Appendix B of CSA Staff Notice 31-311 *Proposed NI 31-103 Registration Requirements and Exemptions – Transition into the new registration regime* published on June 12, 2009.

#### **Market participants in Ontario and Newfoundland and Labrador**

Under the existing registration regime, a firm that acts as a dealer in the exempt market in Ontario or in Newfoundland and Labrador must register as an LMD. Section 16.3 of NI 31-103 provides that firms that are registered as LMDs on the Implementation Date will be automatically registered in the new EMD category. For firms that intend to start acting as a dealer in the exempt market *after the Implementation Date*, the firm must register as an EMD before carrying on business (i.e. no transition period is available).

#### **Market participants in all other jurisdictions**

Under the existing registration regime, a firm that acts as a dealer in the exempt market in jurisdictions other than Ontario and Newfoundland and Labrador may rely on the various registration exemptions in NI 45-106. Section 16.7 of NI 31-103 provides a one year transition period for EMDs active prior to the Implementation Date to apply for registration unless an exemption is available. Accordingly, under NI 31-103, a firm acting as a dealer in the exempt market prior to the Implementation Date must either comply with the conditions of the Northwestern exemption orders (as described above) when the NI 45-106 exemptions expire on March 27, 2010, or apply for registration as an EMD on or before September 28, 2010.

Firms that start acting as a dealer in the exempt market in jurisdictions other than Ontario and Newfoundland and Labrador after the Implementation Date should consider whether they will have to register as an EMD when the NI 45-106 exemptions expire on March 27, 2010. As of March 28, 2010, if such a firm cannot rely on the Northwestern exemption orders (as described above), it must cease operations until it becomes registered as an EMD.

**Note:** To the extent that a firm is required to register as an EMD before carrying on business, the firm must be able to demonstrate that it meets all of the requirements in NI 31-103 that apply to EMDs at the time of application for registration.

**c) Proficiency, financial and operational requirements**

Under NI 31-103, EMDs are subject to proficiency, financial, operational and client relationship requirements. The table below summarizes the key requirements and any applicable transition information. References to transition periods are from the Implementation Date. All section references are to NI 31-103.

Proficiency requirements	Reference	Transition	Reference
<p><b>Exempt market dealer – dealing representative</b> An individual must:</p> <ol style="list-style-type: none"> <li>1) pass the Canadian Securities Course Exam</li> <li>2) pass the Exempt Market Products Exam, or</li> <li>3) satisfy the proficiency requirements of an advising representative of a portfolio manager</li> </ol>	3.9	Individuals who are registered in ON or NL as a dealing representative of an EMD on September 28, 2009 must satisfy the proficiency requirements within one year.	16.10(3)
<p><b>Exempt market dealer – chief compliance officer</b> An individual must:</p> <ol style="list-style-type: none"> <li>1) pass the PDO Exam (the Officers', Partners' and Directors' Exam or the Partners, Directors and Senior Officers Course Exam) and either the Canadian Securities Course Exam or Exempt Market Products Exam, or</li> <li>2) satisfy the proficiency requirements of a chief compliance officer of a portfolio manager</li> </ol>	3.10	<p>All registered firms must apply for the registration of a chief compliance officer through the National Registration Database (<b>NRD</b>) within three months.</p> <p>If an individual applies to be registered as the chief compliance officer of an EMD in ON or NL within three months of September 28, 2009, the individual has one year to satisfy the proficiency requirements.</p>	16.9(1)  16.9(4)
Financial requirements	Reference	Transition	Reference
<p><b>Working capital</b> The minimum capital is \$50,000 for a registered dealer.</p>	12.1-12.2	Sections 12.1 [ <i>capital requirements</i> ] and 12.2 [ <i>notifying the regulator of a subordination agreement</i> ] do not apply for one year to existing LMDs in ON or NL who convert to the category of EMD.	16.3(4)

<p><b>Insurance</b> A registered dealer must maintain bonding or insurance that:</p> <ol style="list-style-type: none"> <li>1. Contains the required bonding and insurance clauses set out in Appendix A [<i>bonding and insurance clauses</i>] and in the highest of the following amounts for each clause:                     <ol style="list-style-type: none"> <li>(a) \$50,000 per employee, agent and dealing representative or \$200,000, whichever is less</li> <li>(b) one per cent of the total client assets that the dealer holds or has access to, as calculated using the dealer's most recent financial records, or \$25,000,000, whichever is less</li> <li>(c) one per cent of the dealer's total assets, as calculated using the dealer's most recent financial records, or \$25,000,000, whichever is less, or</li> <li>(d) the amount determined to be appropriate by a resolution of the dealer's board of directors, or individuals acting in a similar capacity for the firm</li> </ol> </li> <li>2. Provides for a double aggregate limit or a full reinstatement of coverage</li> </ol>	12.3-12.7	Sections 12.3 [ <i>insurance – dealer</i> ] and 12.7 [ <i>notifying the regulator of a change, claim or cancellation</i> ] do not apply for six months to existing LMDs in ON and NL who convert to the category of EMD.	16.3(5)
<p><b>Audits</b> A registered firm must direct its auditor in writing to conduct any audit or review required by the regulator during its registration and must submit a copy of the direction to the regulator.</p>	12.8-12.9	No transition period.	n/a
<p><b>Financial reporting</b> A registered dealer must deliver the following no later than the 90th day after the end of its financial year:</p> <ol style="list-style-type: none"> <li>1. Its annual audited financial statements for the financial year</li> <li>2. A completed Form 31-103F1 <i>Calculation of Excess Working Capital</i></li> </ol>	12.10-12.14	No transition period.	n/a
<b>Operational requirements</b>	<b>Reference</b>	<b>Transition</b>	<b>Reference</b>
<p><b>Compliance</b></p> <ul style="list-style-type: none"> <li>• <b>Compliance system.</b> Registered firms must establish, maintain and apply policies and procedures that establish a system of controls and supervision.</li> <li>• <b>Designating an ultimate designated person.</b> Registered firms must designate an ultimate designated person, who must fulfil specific responsibilities.</li> <li>• <b>Designating a chief compliance officer.</b> Registered firms must designate a chief compliance officer, who must fulfil specific responsibilities. Proficiency requirements apply.</li> </ul>	<p>11.1-11.4</p> <p>11.1</p> <p>11.2 5.1</p> <p>11.3 5.2 3.10</p>	<p>No transition period.</p> <p>All registered firms must apply for the registration of an ultimate designated person through NRD within three months.</p> <p>All registered firms must apply for the registration of a chief compliance officer through NRD within three months.</p>	<p>n/a</p> <p>16.8</p> <p>16.9(1)</p>

<b>Books and records</b> Registered firms must maintain records.	11.5-11.6	No transition period.	n/a
<b>Certain business transactions</b> Registered firms must not engage in tied settling of securities transactions or tied selling. Registrants must give notice if they acquire a registered firm's securities or assets. Registered firms must also give notice if its securities are acquired.	11.7-11.10	No transition period.	n/a
<b>Client relationship requirements</b>	<b>Reference</b>	<b>Transition</b>	<b>Reference</b>
<b>Know your client and suitability</b> Registrants must comply with certain know your client and suitability obligations.	13.1-13.3	No transition period.	n/a
<b>Conflicts of interest</b> Registered firms must have certain policies and procedures to handle conflicts of interest.	13.4-13.6	No transition period.	n/a
<b>Referral arrangements</b> Registrants may participate in a referral arrangement under certain conditions.	13.7-13.11	Division 3 [ <i>referral arrangements</i> ] of Part 13 does not apply for six months to a person or company that is a registrant on September 28, 2009.	16.15
<b>Loans and margin</b> Registrants are restricted from lending to clients. Registrants must provide certain disclosure to clients when recommending the use of borrowed money.	13.12-13.13	No transition period.	n/a
<b>Complaints</b> Registered firms must have a system for handling complaints. Registered firms in Québec comply with sections 168.1.1 to 168.1.3 of the Québec <i>Securities Act</i> .	13.14-13.16	Section 13.16 [ <i>dispute resolution service</i> ] does not apply for two years to a person or company that is a registered firm on September 28, 2009. No transition period in Québec.	16.16
<b>Disclosure to clients</b> Registered firms must make certain disclosure to clients.	14.2-14.5	Section 14.2 [ <i>relationship disclosure information</i> ] does not apply for one year to a person or company that is a registrant on September 28, 2009.	16.14
<b>Client assets</b> A registered firm may only hold client assets as prescribed.	14.6-14.9	No transition period.	n/a
<b>Client accounts</b> A registered firm must provide certain disclosure when selling or assigning client accounts.	14.10-14.11	No transition period.	n/a
<b>Account activity reporting</b> A registered dealer must provide certain trade confirmations and client statements.	14.12-14.14	No transition period.	n/a

## 2. Frequently asked questions about transition

**Q:** What do LMDs have to do to become registered in the new EMD category?

**A:** LMDs will be converted to the new EMD category automatically. They do not have to make an application. However, all LMD firms registered in the new EMD category (including the individuals acting on behalf of it) must comply with the new requirements under NI 31-103 before the expiry of the transition periods.

**Q:** My firm is registered as an LMD in Ontario and/or Newfoundland and Labrador today but is also acting as an EMD in another jurisdiction of Canada (e.g. Québec). Will my firm automatically be registered in that other jurisdiction?

**A:** No. An LMD registered in Ontario and/or Newfoundland but operating in another jurisdiction is required to apply for registration in the other jurisdiction by September 28, 2010.

**Q:** My firm is registered as an LMD in Ontario and/or Newfoundland and Labrador today but is also acting as an EMD in the Northwestern jurisdictions. Can it rely on their local exemptions from dealer registration?

**A:** No. The Northwestern exemption orders are not available to registrants.

**Q:** My firm manages a private investment fund in the Northwestern jurisdictions. Can it avoid EMD registration by selling units only to accredited investors in the Northwestern jurisdictions?

**A:** No. If your firm is required under NI 31-103 to register as an investment fund manager, it must also register as an EMD to trade in units in that fund. The Northwestern exemptions are not available to registrants, even if all registerable activity is confined to those jurisdictions.

**Q:** I am registered as a representative of a firm that has been converted from the LMD category to the new EMD category. How do I notify the regulator that I have satisfied the proficiency requirements for a dealing representative or chief compliance officer of an EMD?

**A:** Your firm must notify the regulator through NRD. We will be requesting proof of successful completion of courses on a random basis.

**Q:** What if my firm or an individual acting on behalf of my firm is unable to meet the new requirements under NI 31-103 within the transition period?

**A:** Your firm or the individual acting on behalf of your firm should cease conducting registerable activities until the requirements are met. Notify the regulator immediately.

### Questions

Please refer your questions to any of the following CSA staff:

#### Alberta

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