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Nova Scotia Securities Commission  
Superintendent of Securities, Newfoundland and Labrador  
Registrar of Securities, Northwest Territories  
Registrar of Securities, Yukon Territory  
Registrar of Securities, Nunavut

**RE: RESPONSE TO REQUEST FOR COMMENTS – PROPOSED NATIONAL INSTRUMENT 31-103**

Thank you for the opportunity to comment on proposed National Instrument 31-103 (“NI 31-103”).

At the outset, the Canadian Securities Administrators are to be commended for their effort to harmonize, streamline and modernize the registration requirements across Canada. The objectives of

harmonizing, streamlining and modernizing are critical to ensuring a robust and efficient securities regulatory regime and capital markets in Canada. In the context of an overall welcome change to the registration system in Canada, the purpose of this letter is to raise concerns respecting the impact of NI 31-103 on those persons who are currently registered as limited market dealers in the provinces of Ontario and/or Newfoundland and Labrador and would otherwise be unregistered in other provinces of Canada.

### **Overview of Concerns Relating to the Exempt Market Dealer Requirements**

As a general observation, it is difficult to assess whether the business and regulatory costs that would be imposed upon limited market dealers or unregistered intermediaries in the “exempt market” are proportionate to the significance of the regulatory objectives sought to be realized, in that the objectives cited in the Notice and Request for Comment for NI 31-103 dated February 20, 2007 do not provide any apparent basis for the broad imposition of financial, custodial, proficiency and other requirements on these parties<sup>1</sup>. In this regard, the Notice and Request for Comment indicates that British Columbia is considering not adopting the exempt market dealer category in part because it is not convinced that there is a market problem in this area in British Columbia that is addressed by the registration requirement. It is not clear that the limited market dealer registration regime in Ontario has been problematic since its inception to precipitate the proposed more onerous and extensive regime for exempt market dealers set out in NI 31-103, or if it has that the problems experienced support the imposition of the requirements proposed for exempt market dealers (either at all, or relative to the costs and burdens that would be experienced as a consequence).

There has been some suggestion that the reason for the imposition of the exempt market dealer registration requirement is to prevent “free riders” from enjoying the benefits of Canada’s capital markets without paying their fair share. With respect, that should not be the basis for imposing costly and burdensome regulatory requirements on market participants (especially when it has not been shown that the existing regulatory regime has posed a problem to investors, regulators or other participants in the Canadian securities markets).

If the imposition of additional obligations and costs is warranted, insufficient consideration may have been given to the fact that limited market dealers (and exempt actors in jurisdictions other than Ontario and Newfoundland and Labrador) operate in various and distinct segments of the securities marketplace and that not all such activities require all of the extensive obligations proposed by NI 31-103 of an exempt market dealer for the public to be adequately protected and for the integrity of the capital markets to be preserved. The objective of streamlining and simplification does not justify the imposition of requirements unrelated to the business activities affected.

For instance, there are limited market dealers registered in the province of Ontario whose function is focused upon the introduction of sophisticated investors (i.e. accredited investors) to issuers undertaking private placements, and who in the discharge of that function, do not accept payment for

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<sup>1</sup> Section 2.1(6) of the *Securities Act* (Ontario) states that in pursuing the purposes of the Act, the Ontario Securities Commission shall have regard to a number of fundamental principles including that “Business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized”.

the securities being offered by the issuer on a private placement basis (as the proceeds are paid directly to the issuer or its counsel), and do not maintain custody of the privately placed securities. It is not clear that there is any benefit gained from imposing a capital, fidelity bond or audited financial statement obligation on that limited market dealer. If the limited market dealer is acting as an intermediary in connection with the trade of a specific type of security (such as a mortgage syndication in certain provinces, or the issuance of government or government guaranteed debt), and/or in connection with trades only to sophisticated parties (e.g. accredited investors), it is not clear that there is any benefit from imposing broad securities related proficiency requirements on that limited market dealer. If in fact there is some perceived benefit from the foregoing obligations, it is not clear that the cost and burden of the proposed requirements of NI 31-103 for exempt market dealers who carry out these activities outweigh any perceived benefit.

**Description of Specific Concerns**

It is submitted that NI 31-103 should approach each requirement proposed to be imposed on an exempt market dealer in a way that imposes the requirement only if the activities being undertaken are such that the potential protections intended by the requirement are reasonably necessary.

Set out below are those requirements applicable to exempt market dealers in NI 31-103 that should apply only if the business of the exempt market dealer is such that the benefit of the requirement viewed in the context of the activities being undertaken outweighs the cost and burden of the requirement:

<b>Section of NI 31-103</b>	<b>Requirement</b>	<b>Comment</b>
4.7	Proficiency requirements for a dealing representative of an exempt market dealer	An exempt market dealer that carries on a limited activity (for instance, acting as an intermediary in the issuance of government or government guaranteed debt, the private placement of equity or debt securities to accredited investors or the syndication of mortgages in British Columbia, Manitoba, Quebec and Saskatchewan (Section 9.6(3)) should not require its dealing representatives to satisfy the examination requirements which cover subject matters that would be wholly or mostly unrelated to the limited activities of the registrant.
4.8	Proficiency requirements for the chief compliance officer of an exempt market dealer	Consistent with the submission made in respect of Section 4.7 above, the requirement for the chief compliance officer of an exempt market dealer to satisfy examination requirements which may be wholly or mostly unrelated to

Section of NI 31-103	Requirement	Comment
		the limited activities of the registrant should be eliminated.
4.14, 4.16	Capital and insurance requirements for an exempt market dealer	In circumstances where an exempt market dealer does not hold its clients cash or other assets (for instance, where the registrant acts solely as an intermediary and all cash is remitted and made payable directly to the issuer and all securities purchased are forwarded from the issuer directly to the purchaser) the capital and insurance requirements impose a cost and burden on a registrant without any corresponding benefit.
4.20	Requirement for an exempt market dealer to appoint an auditor	The requirement for audited financial statements should apply only to those registrants whose activities or size suggest that any benefits of an audit outweigh the audit cost. Those issuers who do not handle clients assets should be exempted from this requirement as the audited statements would serve no purpose from the perspective of protecting the public. In addition, the requirement for an audit should be subject to a de minimus exception for registrants whose annual income from its registrant related activities is lower than a specified amount (say, \$1 million). In that way, the cost to the registrant of compliance with the audit requirement would not represent an unduly high percentage of the income generated from those activities.
4.22	Delivery of financial statements of an exempt market dealer	The delivery requirements should not apply to those registrants who would be exempt from the audit requirement referred to above for the same reasons set out above. However, should the audit requirement remain, the requirement for the filing of interim financial statements set out in Section 4.22(2) should be eliminated for exempt

Section of NI 31-103	Requirement	Comment
		market dealers for the reasons set out above with respect to the audit requirement and because the cost and effort of a quarterly filing cannot reasonably correlate to any benefit or perceived benefit in the regulation of the exempt market dealer.
5.21	Confirmation of trades	Similar to the exemption available in Section 5.24 respecting confirmation of a trade in a security of a mutual fund, an exempt market dealer should be exempt from the requirements of Section 5.21 if the trade is the issuance of a security (for instance, a private placement of equity securities or the issuance of government or government guaranteed debt) and the issuer provides confirmation of the trade to the purchaser.
5.25	Statements of account and portfolio	NI 31-103 should clarify that no such statement is required if the exempt market dealer does not hold any cash or securities on behalf of the client.
5.30, 5.32	Participation in a dispute resolution service or reporting to the regulator	Although an exempt market dealer should document and effectively deal with complaints (Section 5.29) and have policies for recording and examining complaints and resolving disputes (Section 5.31), the registrant should not be required to participate in a dispute resolution service or report annually to the regulator unless there have been a number of complaints (say five in the prior fiscal year), that would suggest that the cost of complying with these two requirements is outweighed by the benefit. This would ensure that exempt market dealers whose activities do not generally give rise to disputes or complaints do not need to incur the expense of a dispute resolution service that would not likely be called upon.

Should the exceptions referred to above be incorporated into NI 31-103, each exempt market dealer (regardless of the nature of its activities) would still be required to:

- i) designate an ultimate designated person and chief compliance officer who must be registered (subject to the comment above concerning the application of the proficiency requirements to the chief compliance officer) [2.8, 2.9]<sup>2</sup>
- ii) register each dealing representative (again, subject to the comment above concerning the application of the proficiency requirements to such persons) [4.7]
- iii) maintain account opening documentation for each client [5.2]
- iv) satisfy the know-your-client and suitability requirements [5.3, 5.4]
- v) satisfy the requirements for leverage disclosure [5.6]
- vi) satisfy the requirements for relationship disclosure [5.8 to 5.12]
- vii) satisfy the custody requirements [5.13 to 5.16]
- viii) comply with the prohibition on extending credit [5.17]
- ix) satisfy the record keeping requirements [5.19, 5.20]
- x) satisfy the compliance requirements [5.26 to 5.28]
- xi) satisfy the requirements to document, effectively deal with, record, examine and resolve complaints [5.29, 5.31]
- xii) comply with the conflict provisions of Part 6, the suspension and revocation provisions of Part 7 and the information sharing requirements of Part 8.

Thus, the objective of imposing relevant and appropriate requirements on exempt market dealers would be satisfied without imposing an unnecessary burden on the registrant. Further, these are the requirements that are tied to the investor protection benefits which are identified in the “Anticipated Costs and Benefits” section in the Notice and Request for Comment.

It is recognized that the foregoing approach would require NI 31-103 to be revised to consider the particular business activities of the various types of exempt market dealers. It is submitted that the effort required to so revise NI 31-103 is worthwhile when the alternative is to impose unnecessary, burdensome and expensive requirements on certain participants in the securities industry.

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<sup>2</sup> Numerical references are to the section numbers in NI 31-103.

**Alternatives**

The Notice and Request for Comment states in footnote 14 that “Transition provisions are being worked on as well as NRD mapping requirements in order to make the transition from the current categories to the new categories as efficient as possible”. If, following the comment process, the limited market dealer registration category is replaced with the exempt market dealer category (with the latter being still subject to the more onerous and extensive requirements which are the subject of these comments), it is submitted that certain limited market dealers whose business is limited to a discrete segment of the securities marketplace (such as those acting as an intermediary in the trade of government or government guaranteed debt) be exempted from the additional requirements or have their limited market dealer status grandfathered. If the proficiency requirements for exempt market dealers remains, it is submitted that the implementation of the proficiency requirements should be delayed until at least 12 months has passed from the date that a specific course and related examination which focus specifically on the business of exempt market dealers starts to be offered (and correspondingly, NI 31-103 should provide that the passing of this newly established examination satisfies the proficiency requirements).

In addition, the proposed restricted dealer status should not be limited to activities that do not fall within other firm categories as the Notice and Request for Comment states in “Part 2: Categories of Registration and Permitted Activities, New Firm Categories, Restricted dealer”. Rather, this category should be available to those entities whose activities are such that the more extensive registration requirements of another category (such as exempt market dealer) are not appropriate. This would be consistent with the definition of restricted dealer in NI 31-103 which states that it is “a dealer that is limited by conditions on its registration to dealing in a specified security or class of security”. The restricted dealer category contemplates that the restrictions and requirements that will apply to a restricted dealer will be dependent on the activities carried on by it. NI 31-103 and its Companion Policy should clarify that the restricted dealer category is available in circumstances where the exempt market dealer category may impose conditions which are too onerous in the context of the limited range of activities being undertaken by a person that would otherwise need to register as an exempt market dealer.

It is recognized that this approach is inconsistent with the statement in Section 2.2 of the Companion Policy that the CSA intends to use the restricted dealer category “rarely”. If the requirements for an exempt market dealer are not made more flexible as this submission recommends, then that flexibility can be afforded through the ability to establish conditions and requirements of registration for a restricted dealer that are appropriate for the specified security or class of security with which the registrant is involved. Consistent with the foregoing, NI 31-103 should provide that the regulator can establish requirements of registration for a restricted dealer that are appropriate for the conditions of registration which limit the securities with which it can deal<sup>3</sup>. It is submitted that this approach would be preferable to requiring those who might otherwise need to be registered as an exempt market dealer to seek an exemption pursuant to Part X of NI 31-103.

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<sup>3</sup> Section 2.5 of the Companion Policy provides for flexibility in respect of the proficiency requirements for a restricted dealer. The same flexibility should be available for all of the requirements of NI 31-103.

Any of the foregoing alternatives would be consistent with the statement in Part IX of the Notice and Request for Comment that those in the business of dealing in securities (including "safe securities") (i.e. government guaranteed debt) be registered. It is our submission that any registration requirements which apply should better suit the business being carried on.

### **Summary**

In summary, the imposition of the onerous registration requirements of an exempt market dealer on those who are currently registered as limited market dealers in Ontario and Newfoundland and Labrador (or who are unregistered in other provinces) (a) would impose costs and burdens not clearly warranted, and (b) is a blunt instrument which treats alike all those whose activities merit separate and less onerous regulation; regulation that is commensurate with the activities being undertaken.

If the exempt market dealer requirements are retained, then NI 31-103 should provide exemptions from those of the requirements applicable to exempt market dealers that are not necessary in the context of that dealer's business. If the Canadian Securities Administrators do not wish to address this concern on this basis, an alternative such as grandfathering or the availability of the restricted dealer category should be introduced into NI 31-103 to enable those who have participated in the capital markets as limited market dealers or without registration can continue to carry on their business without unnecessary, expensive and burdensome registration requirements. Addressing this concern would facilitate (not detract from) maintaining a robust and efficient securities regulatory environment and a capital markets that operates with integrity.

Thank you again for the opportunity to comment. Should you have any questions respecting this submission please feel free to contact the writer. These submissions represent the views of the writer himself together with the views of certain clients he represents and not the collective views of Goodmans LLP.

Yours very truly,



David J. Matlow