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October 11, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission

c/o

Robert Blair, Secretary (Acting)
Ontario Securities Commission
20 Queen Street West, 22nd Floor
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comments@osc.gov.on.ca

-and-

Me Anne-Marie Beaudoin
Secrétaire de l'Autorité des marchés financiers
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Ladies and Gentlemen,

RE: Request for Comment on the Canadian Securities Administrators' *Proposed Amendments to NI 31-103 and its Policy, NI 33-109 and OSC Rule 33-506* dated July 7, 2016

Thank you for the opportunity to comment on the Canadian Securities Administrators' ("**CSA**") *Proposed Amendments to NI 31-103 and its Policy, NI 33-109 and OSC Rule 33-506* dated July 7, 2016 (the "**Proposed Amendments**").

This letter represents the general comments of certain members of the Financial Products & Services practice group at Stikeman Elliott LLP (and not those of the firm generally or any client of the firm) and are submitted without prejudice to any position taken or that may be taken by our firm on its own behalf or on behalf of any client.

Our comments on the Proposed Amendments are set out below and grouped by theme.

1. Exempt market dealer permitted activities

The policy rationale for the proposed amendments to section 7.1(2) (the "**EMD Amendments**") of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**") and the specific investor/market protection issues sought to be addressed by these additional restrictions to the permitted activities of exempt market dealers are unclear. In particular, we do not understand why there is a policy concern for restricting exempt market dealers from acting as selling group members or otherwise in respect of the investment of prospectus-qualified securities to their clients where a prospectus exemption is available. To the extent there is a policy concern or the CSA are aware of any abuse based on the current exemptions, such circumstances should be clearly explained. As currently proposed, the EMD Amendments would prohibit the sale by an exempt market dealer of prospectus-qualified mutual fund securities to qualified accredited investors, although the exempt market dealer could continue to sell, to the same class of investors, non-prospectus-qualified pooled funds (which are subject to less regulatory oversight) created for the same strategy. In addition, if the proposed alternative fund amendments to National Instrument 81-102 *Investment Funds* ("**NI 81-102**") are adopted, exempt market dealers which currently offer alternative strategies in a pooled fund format to qualified accredited investors could not offer the same strategy in an NI 81-102-compliant prospectus-qualified format to the same class of investors. Significantly, these additional restrictions would come at a time when the CSA have already implemented robust exempt market reform and CRM2 amendments which exempt market dealers have had to work into their compliance programs in order to continue to service the exempt market for investment fund products.

The exempt market dealer category of registration is critical to the business model of independent manager-manufacturers of conventional mutual funds and would be equally critical to sponsors of NI 81-102-compliant alternative funds. If adopted, the EMD Amendments may deprive these managers of access to the institutional market, access which is vital to the design, development and evolution of new and competing demand-driven asset management solutions in a mutual fund format. Significantly, the dealer registration exemption in section 8.6 (Investment fund trades by adviser to managed account), as amended, would not address this gap since advisory arrangements in the institutional market covering a manager-manufacturer's mutual fund product solutions are commonly entered into on a non-discretionary basis.

Further, in our view the proposed guidance in the Companion Policy to NI 31-103 in respect of the participation of EMDs in the sale of special warrants that are convertible into prospectus-qualified securities adds significant ambiguity to the proposed subsection

7.1(2)(d)(i). As certain market observers have noted, the proposed amendments outlined in the CSA's Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* of April 28, 2016, if implemented as proposed, may have the effect of restricting access to third party distribution channels for independent manufacturers of mutual fund and alternative fund products**.** The EMD Amendments, if adopted, may further compound these restrictions by removing access to demand in the exempt market. We would respectfully recommend that the CSA reconsider the EMD Amendments because a fair and efficient capital market should foster competing business models and choice for investors.

2. International adviser exemption

The proposed amendments to section 8.26(3) of NI 31-103 is described by the CSA as being a housekeeping amendment of a minor nature. We respectfully submit that section 8.26(3) is clear as presently drafted. The proposed amendments, which replace "securities of Canadian issuers" with "securities that are not foreign securities", may amount to a substantive change by restricting the scope of permitted advisory activities. The double negative introduced by this amendment reduces rather than enhances the clarity of this provision. We would recommend that the CSA leave section 8.26(3) unchanged.

3. Form 33-109F6 and Form 33-109F5

Section 4.2 of Form 33-109F6 *Firm Registration* ("**Form 33-109F6**") requires that a firm disclose the exemptions from registration or licensing to trade or advise in securities or derivatives on which the firm is relying. As amended, the form would not require disclosure of exemptions which the firm has already notified to the regulator under the terms of the exemption. As part of its business, a firm may also rely on various exemptions under applicable securities laws under a number of different instruments, some of which merely require that certain conditions be met without prescribing any further action (such as a notification or other filing). We would respectfully recommend that the CSA further clarify the scope of section 4.2 of Form 33-109F6 to state that the only exemptions which must be disclosed under this heading are those for which the firm has previously obtained from a securities regulator a discretionary exemption or other decision-based relief (as appears to be the intention given the information to be set out in the disclosure box under this heading (e.g., "date of exemption (yyyy/mm/dd)").

On a related note, if the firm is relying on a discretionary exemption previously granted by a securities regulator, we would respectfully submit that no late fees should be payable for a late filing of Form 33-109F5 *Change of Registration Information* relating to the disclosure of that exemption in section 4.2 of Form 33-109F6.

4. Custodial requirements

We recognize the critical importance of prescribing clear rules regarding the custodial arrangements governing the safekeeping of the assets of a registered firm's clients and investment funds under management and, in particular, prescribing acceptable custodial arrangements and detailed safekeeping, segregation, record-keeping, reporting

and disclosure requirements to ensure that customer collateral and positions are properly segregated and readily identifiable, consistent with international regulatory best practices.

We are, however, concerned that, as drafted, proposed sections 14.5.2 and following may require material changes to be made to longstanding and otherwise secure custodial and sub-custodial arrangements involving already highly regulated and well capitalized custodians. For certain registrants, these arrangements may be difficult to amend or restructure without undertaking a detailed review of firm and client-directed custodial arrangements, significant third party due diligence and contractual negotiations, material changes to IT and other operational infrastructure, related systems testing and client communications and disclosure on changes to existing custodial arrangements. It seems unlikely that even minor, let alone material, changes to existing custodial arrangements could reasonably and prudently be accomplished over a transition period of only six months. We would respectfully recommend that the CSA provide for a more realistic transition period consistent with the scope of the changes proposed to be introduced.

In addition, we would also respectfully request that the CSA consider the following additional points:

(a) The custodial provisions of NI 81-102 are well established and understood. They prescribe a clear and objective code of acceptable custodial and sub-custodial arrangements that recognizes the reality and importance of foreign custodial arrangements for the safekeeping of assets of NI 81-102-investment funds held outside of Canada. We respectfully submit that, consistent with the approach in NI 81-102, prescribing requirements for acceptable "foreign custodians" should be sufficient without requiring that the registered firm also determine whether "a reasonable person would conclude that using a foreign custodian is more beneficial to the client or investment fund than using a Canadian custodian". Neither NI 81-102 nor proposed National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* employ this "reasonable person" standard and it is not clear what added value it would bring to custodial arrangements. The registered firm is already subject to applicable standards of care that apply to its activities under one or more categories of registration and to the obligations under Part 11 of NI-103 and CP 31-103 in dealing with third party service providers, and these standards and regulatory requirements would apply equally to the selection of a qualified "foreign custodian".

(b) The proposed custodial requirements under sections 14.5.2 and following could be clarified and simplified based on objective requirements. The Companion Policy to NI 31-103 ("**CP 31-103**") could set out concise and practical guidance on best practices with respect to the implementation of custodial arrangements with, respectively, a "Canadian custodian" and a "foreign custodian". This could include recommended provisions in custodial agreements, recognizing that these agreements are very commonly non-negotiable and that a registered firm should only be required to use "reasonable commercial efforts" with respect to the negotiation of custodial arrangements which it may have very little leverage to influence.

(c) The exemptions proposed in section 14.5.2(7) of NI 31-103 are well considered but merit further consideration. The Proposed Amendments relating to custodial requirements could disrupt many existing custody arrangements that non-resident registrants have previously implemented for their Canadian clients on the basis of the alternative custodial arrangements contemplated under section 14.7 of NI 31-103. Unless the exemptions proposed in section 14.5.2(7) are expanded, or existing custodial arrangements are grandfathered, many existing custodial arrangements could be materially disrupted, potentially resulting in the imposition of additional costs for, in some cases, limited marginal benefits to clients or investment funds.

(d) For example, section 14.5.2(7) of NI 31-103 should clearly except an investment fund established or managed by a registered firm outside of Canada where the custodial arrangements are entered into with one or more firms that are qualified "foreign custodians". Custodial arrangements for clients resident outside of Canada should similarly be excepted.

(e) Paragraph (b) of the definition of "foreign custodian" should be broadened to refer to an affiliate of an entity referred to in paragraph (a) under conditions similar to those specified in paragraph (b) in relation to a "Canadian custodian".

(f) There should be no restrictions on holding cash directly through qualified "foreign custodians".

(g) With respect to the guidance specified in CP 31-103 "for registered firms other than investment fund managers", we question the ability of a registered firm to conduct due diligence and periodic reviews of custodians with which only its client, but not the firm itself, has a contractual arrangement and the requirement to do so on the same level as an investment fund manager must do in the selection and appointment of custodians for the investment funds managed by it.

5. Other comments

In addition to the foregoing comments, we wish to bring to the attention of the CSA two important matters worthy of consideration while NI 31-103 and National Instrument 33-109 *Registration Information* ("**NI 33-109**") and the related forms remain open for comment.

A. Form 33-109F4

We note that Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals* ("**Form 33-109F4**") should be amended to accommodate filing by individual trustees and other individuals that have direction or control over voting securities of a registrant carrying 10 per cent or more of the votes carried by all outstanding voting securities. This category of "permitted individual" is missing from the form.

Despite this omission, in our experience, OSC staff treat individual trustees like "major shareholders" and they require disclosure be made by such individuals under Item 17 and Schedule N to Form 33-109F4 in respect of securities over which direction or control is exercised. However, Item 17 and Schedule N only contemplate beneficial owners of securities, namely a partner (which is not a defined term) and a major shareholder, not an individual with direction or control over securities. This makes the form confusing to clients and we suspect that the disclosure is inconsistent as a result.

We have encountered this issue in the context of firms that have one or more family trusts as shareholders. Such trusts typically have a small number of individual trustees (and not infrequently only one trustee).

Accordingly, we propose that both Item 17 and Schedule N be revised to accommodate disclosure by a "control individual" (as defined below). We suggest the use of the defined term "control individual" to be consistent with the "permitted individual" terminology and to avoid confusion with the term "control person".

Under NI 33-109, a "permitted individual" means:

(a) a director, chief executive officer, chief financial officer, or chief operating officer of a firm, or a functional equivalent of any of those positions,

(b) an individual who has beneficial ownership of, or direct or indirect control or direction over, 10 percent or more of the voting securities of a firm, or

(c) a trustee, executor, administrator or other personal or legal representative, that has direct or indirect control or direction over, 10 percent or more of the voting securities of a firm;

Under Form 33-109F4 (and Form 33-109F7 *Reinstatement of Registered Individuals and Permitted Individuals*), "major shareholder" and "shareholder" mean a shareholder who, in total, directly or indirectly owns voting securities carrying 10 per cent or more of the votes carried by all outstanding voting securities.

We suggest the following amendments to NI 33-109 and Form 33-109F4:

1. Add a new definition under Section 1.1 of NI 33-109: "control individual" means an individual, other than a partner or a major shareholder, who has direct or indirect control or direction over 10 percent or more of the voting securities of a firm including an individual acting in the capacity of trustee, executor, administrator or other personal or legal representative;";

2. In Item 17 of Form 33-109F4, replace "a partner or major shareholder" with "a partner, major shareholder or control individual";

3. In Schedule N of Form 33-109F4, add a third category after "What is your relationship to the firm?": "☐ Control individual";

4. In Schedule N, in paragraph (a) under "Provide the following information:", replace "own or propose to acquire" with "own, propose to acquire or over which you will have direct or indirect control or direction";

5. In Schedule N, in paragraph (f) under "Provide the following information:", insert "or over which you will have direct or indirect control or direction" after "held by you";

6. In Schedule N, paragraph (g) under "Provide the following information:", should be amended to accommodate the name of a trust or other person in addition to an individual;

7. In Schedule N, in paragraph (i) under "Provide the following information:", replace "Occupation" with "Occupation, if applicable:"; and

8. In Schedule N, in paragraph (h) under "Provide the following information:", replace "Residential Address:" with "Residential or registered address:".

B. CSA Staff Notice 31-346

We are supportive of CSA Staff Notice 31-346 *Guidance as to the Scope of the International Dealer Exemption in relation to Foreign-Currency Fixed Income Offerings by Canadian Issuers* and of the efforts of CSA members to recommend exemptive relief allowing international dealers to deal with institutional investors for the purpose of facilitating resales of foreign currency-denominated fixed income securities. We would encourage the CSA go a step further and, in due course, amend subsection 8.18(2)(b) of NI 31-103 to incorporate the substance of the proposed exemptive relief.

* * *

We thank the Canadian Securities Administrators for the opportunity to comment on NI 33-109 and we would be pleased to discuss these issues further.

"Junaid Subhan"

Junaid Subhan
on my own behalf and on behalf of

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