POLICY STATEMENT TO *REGULATION 31-103 RESPECTING REGISTRATION REQUIREMENTS*

Introduction

The purpose of this Policy Statement is to help users understand how the provincial and territorial securities regulatory authorities (we) interpret or apply the provisions of *Regulation 31-103 respecting Registration Requirements* (Regulation 31-103) and related securities legislation. This Policy Statement explains, discusses and gives examples for various parts of Regulation 31-103 and other relevant securities legislation applicable to registration requirements.

Regulation 31-103 is the primary Canadian Securities Administrators' (the CSA) instrument regulating registration requirements; however, it is not exhaustive. Registrants should refer to securities legislation of their local jurisdiction and to other CSA instruments for additional requirements that may apply to them.

PART 1 DEFINITIONS AND INTERPRETATION

1.1. Definitions

Unless defined in Regulation 31-103, terms used in Regulation 31-103 have the meaning given to them in local securities legislation or in National Instrument 14-101 *Definitions*.

1.2. Exchange contracts

Securities legislation in British Columbia, Alberta and Saskatchewan includes provisions governing persons that deal or advise in exchange contracts. For the purposes of those sections of Regulation 31-103 whose application is equivalent to both securities and exchange contracts, reference to the term "security" or "securities" is deemed to include "exchange contract" or "exchange contracts". In some cases, the registration requirements for dealing or advising in exchange contracts are distinct from those concerning securities. Accordingly, persons should consult local securities legislation for additional provisions governing persons that deal or advise in exchange contracts.

1.3. Business trigger

There are two elements to the business trigger for requiring registration. The first step is to assess whether the activity in question is: (i) dealing in securities; (ii) advising in securities; or (iii) acting as an investment fund manager. If the activity is one or more of the foregoing, the second step is to assess whether the activity is conducted as a business.

A person acting as an investment fund manager will always be considered to be conducting that activity as a business.

Securities legislation lists factors to consider in assessing whether an activity is conducted as a business. These factors are not exhaustive. The following elaborates on some of the factors:

- *undertaking the activity, directly or indirectly, with repetition, regularity, or continuity*

The frequency of transactions is a common factor in determining whether a person has engaged in a business. We consider a person who habitually deals or advises in ways capable of producing profits to be engaged in a business. This view is consistent with guidance from international jurisdictions that have a business trigger. However, whether a person has other sources of income and how much time the person spends on the activity are also relevant factors when determining a business purpose. The activity need not be a person's sole endeavour or even their primary endeavour to constitute being in a business.

- *being, or expecting to be, remunerated or otherwise compensated for undertaking the activity*

Expectation by a person of remuneration for the activity, irrespective of whether compensation is actually received or the manner in which it is conveyed, reflects a business purpose in the activity. The receipt of compensation, whether transaction or value based, reflects a business purpose. Having the capacity or being able to carry on the activity to produce profit is also a relevant factor. On the other hand, gratuitous activity or that which is incidental to another business may suggest the absence of a business purpose.

- *soliciting, directly or indirectly, others in connection with the activity*

Contacting others by any means to solicit securities transactions or offer advice services is reflective of a business purpose. Solicitation includes contacting people by any means, including advertising, for the purpose of proposing that they purchase or dispose of securities or participate in a securities transaction or to offer services or advice for such purposes.

We do not consider an entity setting up a web site (i.e. bulletin board) for third parties to post information on investment opportunities to be in the business of advising or dealing in securities if that entity has no other role in any trades that may take place between parties who use the bulletin board.

- *holding oneself out, directly or indirectly, as being in the business of the activity*

Merely holding out as being willing to engage in dealing or advising in securities is sufficient to be engaged in the business for the purposes of securities legislation. Engaging

in practices similar to those used by registrants, such as disclaimers or having a readiness to buy or sell securities, is also reflective of a business purpose. Similarly, the use of hyperbole in promotions reflects a business purpose. Prior history as a registrant or special training inclined towards the securities business is a factor which suggests a person's activity has a business purpose. An activity in its infancy can still be considered a business.

1.4. Applying the 'in the business' factors

To further assist in understanding the business trigger, the following discussion explains how the 'in the business' factors might apply with respect to common situations.

Security issuers

Few issuers with an active non-securities business would also be in the business of dealing in securities. An issuer might be captured by the business trigger because of the fact it deals in securities on a regular basis, or because it holds itself out as being in the business of dealing in securities. These instances, however, will be the exception to the norm because in the context of capital raising:

- most issuers deal in securities on an infrequent basis
- most issuers are not remunerated, nor do they expect to be remunerated, for dealing in securities
- most issuers do not act in an intermediary capacity
- most issuers do not produce, or intend to produce, distinct profit from dealing in securities
- most issuers do not hold themselves out as being in the business of dealing in securities.

However, there may be situations where an issuer is in the business of dealing in securities. For example, an issuer that creates a secondary market in its securities or an issuer that is a market maker for its own securities would likely be considered to be in the business of dealing in securities. Similarly where an issuer employs or otherwise contracts with persons to perform activities on its behalf similar in character to those performed by a registrant, other than underwriting in the normal course of a distribution, the issuer is in the business of dealing in securities. Issuers are reminded that they are subject to the prospectus requirements contained in securities legislation and the discretionary authority of regulators to require an underwriter for a prospectus distribution.

Limited partnerships

A general partner (GP) of a limited partnership (LP) may be in the business of providing advisory services to its limited partners. Whether the GP must register as a

portfolio manager depends upon the nature of the services provided by the GP and the expectations of the other limited partners. The legal form of the investment vehicle is not determinative. If the GP is making investment decisions for the LP and the limited partners are primarily relying on the GP's expertise in choosing appropriate investments in securities for them (which is akin to portfolio management services), it will be providing advice to others (i.e. the limited partners).

In determining the nature of the GP's activities and whether it must register as a portfolio manager, consideration should be given to what the business purpose of the LP is and what services the investors (i.e. the limited partners) expect the GP to provide.

The limited partners may be relying on the GP for expertise other than providing advice on selecting investments in securities. For example, if a LP operates as a venture capital fund, the GP's role may be selecting companies in which the GP will participate in the active management and development of the companies. In such cases, we would not consider the GP's activities to be portfolio management activities requiring registration. The purchase and eventual sale of the securities are regarded as incidental to the operational business activity of the LP.

Alternatively, if the purpose of the LP is simply to invest in prospectus-exempt securities, the limited partners are relying on the GP's expertise in selecting the securities. The GP is not bringing special expertise to the operations of the underlying investment. In this case, the GP would be required to register as a portfolio manager.

Principal dealing activities

In most instances, we would not consider people whose main or sole activity is dealing for their own account to be in the business of dealing in securities. We do not intend to capture trading by, for example, individuals, day traders, or pension funds as a regulated activity when they are trading solely for their own account and do not have direct access to a marketplace (excluding those who have dealer-sponsored access). Applying the "in the business" factors discussed above, such persons would not be: (i) remunerated for undertaking the activity; (ii) soliciting others in connection with the activity; (iii) acting as an intermediary; or (iv) holding themselves out as being in the business of dealing in securities. Accordingly, such persons would not be in the business of dealing in securities.

However, principal dealing carried on by a registered firm is inherently different from that carried on by a non-registrant. The registrant has a unique position in and access to the markets and obligations to its clients. Regulators expect registrants to perform a "gatekeeper" function with respect to clients' access to the markets. For example, registrants routinely possess material undisclosed information about issuers and about client trading activities. Handling that information within the bounds of securities legislation is part of a registrant's responsibility as a gatekeeper to the securities markets. Also, principal trading can have a significant impact on a firm's financial viability, which introduces systemic risks. We therefore consider individuals who conduct principal trading on behalf

of a registered firm to be subject to the individual registration requirement, notwithstanding that such individuals may not necessarily trade on behalf of clients of the firm.

Other examples of activities not commonly in the business of dealing in securities

Registration would not generally be required for dealing activities:

- by an individual or other person when that person is acting as a trustee, executor, administrator or personal or other legal representative
- in connection with the sale of goods or supply of services
- that take place between affiliated companies
- in connection with the sale of a business.

Some of these activities are isolated and do not reflect a business of dealing in securities. In other cases, the overall activities are of a business nature but dealing in securities is a consequence of the primary purpose of the business.

Professionals providing advice incidental to their business

Persons such as lawyers, accountants, engineers, geologists and teachers who provide advice that is incidental to their principal business or occupation are generally not in the business of advising in securities. In each case, it is important to consider the advising activity in the context of other business activity and decide whether the advising activity is a stand-alone business.

Applying the "in the business" factors, such persons would not be: (i) advising in securities with repetition; (ii) receiving remuneration for the advising services separate from remuneration received for their professional services; (iii) soliciting clients on the basis of their advising services; (iv) acting as an intermediary; or (v) holding themselves out as being in the business of advising in securities. Accordingly, these professionals would not be in the business of advising in securities. They might, however, be in the business of advising in securities where, for example, the securities advice is a primary reason for the client's relationship with the professional (i.e. the professional regularly provides advice and solicits clients on the basis of providing advising services).

PART 2 CATEGORIES OF REGISTRATION

2.1. General

Firm categories of registration serve two main purposes. The first purpose is to specify the type of business that the firm may conduct and, therefore, the types of business that the firm is not registered to conduct and may not carry on. Securities legislation distinguishes between dealers, advisers and fund managers. The second purpose is to

provide a framework for the requirements the registrant must meet. From its category of registration, a firm can determine the fit and proper requirements and conduct rules that apply to the firm. Individual categories set out the qualifications necessary for an individual to perform particular roles on behalf of the firm.

2.2. Dealing in securities

Exempt market dealer

Section 2.1 of Regulation 31-103 restricts exempt market dealers to: (i) dealing in securities that are being distributed under an exemption from the prospectus requirement, or (ii) dealing in any security with persons to whom securities may be distributed under an exemption from the prospectus requirement. Exempt market dealers, for example, may deal in prospectus-qualified securities with accredited investors.

Restricted dealer

A restricted dealer's registration is limited by conditions imposed by the local regulator. The CSA intends to use this registration category rarely, in order to avoid the proliferation of distinct registration categories across jurisdictions. This category might be used, for example, by an issuer that must register because it is in the business of dealing in securities. The issuer's registration in this case would be restricted by conditions to dealing in securities for the purpose of distributing securities of its own issue, exclusively for its own account.

2.3. Dealing in securities – exemption for advisers

This exemption applies to an adviser who has *bona fide* fully-managed accounts (e.g. the adviser is actively managing the client's account). The exemption relieves the adviser from having to register as an exempt market dealer to distribute units of its pooled fund into client accounts. This exemption is not intended to apply to an adviser that is effectively operating an investment fund by virtue of the fact that the adviser dedicates more time to managing the fund as compared to managing the fully-managed accounts. The exemption is not available if the fully-managed account is set up with the intention of relying on the exemption. Advisers should be mindful of the prospectus requirement and the requirement to register as an investment fund manager under securities legislation.

2.4. Advising in securities

Specific advice

"Advising in securities" is intended to capture "specific advice"; in other words, advice tailored to the needs and circumstances of the person receiving the advice and that is about a particular security. Specific advice includes discretionary account management.

Generic advice

Section 9.12 of Regulation 31-103 contains an exemption for those providing generic advice. Generic advice is advice that is not tailored to the needs and circumstances of the person receiving the advice.

Generic advice about particular securities but not purporting to be tailored to the needs and circumstances of the recipient has traditionally been delivered through investment newsletters and through articles in general circulation newspapers and magazines. It is now commonly delivered through the Internet and other electronic means, whether on web sites, via e-mail, or in chat rooms and on bulletin boards. Generic advice can also be given at conferences, and will not be considered to be specific advice except if the purpose of the conference is to solicit securities transactions.

Another form of generic advice is asset allocation where a recommendation is made to allocate certain proportions of a portfolio to different asset classes but the advice does not specify particular securities. This form of generic advice usually purports to be tailored to the recipient's needs and is often provided as part of a financial plan.

Restricted portfolio manager

A restricted portfolio manager is limited by conditions imposed on its registration by the local regulator. This category is intended to permit persons to advise on securities of issuers in specified industries. For example, an adviser with extensive experience in oil and gas issuers but lacking the prescribed proficiency of a portfolio manager might be registered as a restricted portfolio manager to advise solely in securities of oil and gas issuers.

2.5. Associate advising representative

An individual who does not meet the education and experience requirements for registration as an advising representative of a portfolio manager may register as an associate advising representative. This category allows an individual to work at an adviser firm while he or she completes the proficiency requirements needed to be an advising representative. It also enables a former advising representative to be reinstated as an advising representative by gaining the necessary working experience set out in section 4.9 of Regulation 31-103.

The associate advising representative category is primarily intended to be an apprentice category for individuals who intend to become full advising representatives but who do not meet the experience or education requirements. However, there is no requirement for an associate advising representative to subsequently register as an advising representative. This category, for example, accommodates individuals who are responsible for client relationships with a portfolio manager, but who do not perform portfolio management for clients.

In order to discharge its obligation to maintain an effective compliance system, an adviser firm must ensure that each of its associate advising representatives are supervised by one or more advising representatives. As required by section 2.7 of Regulation 31-103, advice provided by an associate advising representative must be pre-approved by an advising representative. It would be prudent for the adviser firm to document its policies and procedures for the discharge of these obligations and maintain specific records where advice is approved.

2.6. Managing investment funds

Persons in the business of managing an investment fund must register in the category of investment fund manager. Managing an investment fund includes administering the fund but does not include acting as a portfolio manager for the fund. *Regulation 81-102 Mutual Funds* defines a manager as "a person or company that directs the business, operations and affairs of a mutual fund". The fund manager generally organizes the fund and contractually accepts responsibility for its management and administration. The administrative services may include information gathering, performance reporting and handling client assets. The mutual fund trust or company very broadly delegates these responsibilities to the fund manager under a management agreement. Most agreements provide the manager with the ability to sub-delegate these responsibilities to other service providers. As mentioned below in section 5.1 on outsourcing, the fund manager remains fully liable for the sub-delegated responsibilities.

2.7. Chief compliance officer and ultimate designated person

Securities legislation requires a registered firm to appoint a chief compliance officer (CCO) and ultimate designated person (UDP) to perform prescribed compliance functions on behalf of the firm. It must be emphasized that compliance is the responsibility of the firm as a whole, and not *only* the responsibility of the individuals who are registered to act on behalf of the firm in the capacities of UDP and CCO.

The UDP is the chief executive officer or the senior officer responsible for the division within the firm which is carrying on the activity which requires registration. The role of the UDP is to ensure that the firm has an effective compliance system in place. The UDP is not necessarily required to be involved in the day-to-day management of the compliance group. There is no proficiency requirement for the UDP.

The CCO is an operating officer whose role is to manage the day-to-day operation of the compliance group and supervise the other members of the compliance group. There is no requirement that other members of the compliance group be registered. The CCO will determine what knowledge and skills are necessary or desirable for individuals who report to the CCO. The CCO must meet the applicable proficiency requirements set out in Part 4 of Regulation 31-103.

The appropriate size and structure of a firm's compliance group will vary greatly, depending on the size and scope of the firm's operations. The UDP and the CCO may be the same person, so long as that person meets the requirements for both designations. We are of the view that a separation of functions is the best practice, but we also recognize that this might not be practical for some registrants. Note also that nothing precludes the UDP and/or CCO from also being registered in dealing or advising categories. Accordingly, a small registered firm might conclude that one individual can adequately function as UDP and CCO, while also conducting advising and/or dealing activities. At the other end of the scale, a large firm with diverse operations may require a large team of compliance professionals with several divisional heads of compliance reporting to a CCO dedicated entirely to a compliance role. The CCO may or may not, depending on the firm, also have authority to resolve compliance issues once they have been identified.

2.8. Multiple registrations

Multiple firm categories

Other than investment dealers, firms that deal in more than one category of securities must register in all applicable categories. For example, a mutual fund dealer that deals in prospectus-exempt securities and scholarship plans must be registered as a mutual fund dealer, an exempt market dealer, and a scholarship plan dealer. The firm will be subject to the provisions of Regulation 31-103 applicable to each of the three categories. As well, the firm will be subject to oversight by the CSA and an MFD SRO. Similarly, subject to having a registration exemption, a portfolio manager that manages an investment fund may have to register as a portfolio manager and an investment fund manager.

Firm solvency requirements set out in Part 4, Division 2 of Regulation 31-103 are not cumulative. A firm that is registered in more than one category will, by complying with the highest capital requirement of the categories in which it is registered, in most cases, have complied with the requirements of the other categories in which it is also registered.

Multiple individual categories

Individuals that perform more than one activity requiring registration on behalf of a registered firm must register in all applicable categories. For example, an advising representative of a portfolio manager who is also the CCO must register in the categories of advising representative and CCO.

Firm and individual categories

In some cases, an individual may be registered in both a firm and individual category. For example, a sole proprietor registered in the firm category of portfolio manager will also be registered in his or her individual capacity as an advising representative.

PART 3 SRO MEMBERSHIP

3.1. Requirement for SRO membership

A person applying for registration as an investment dealer or a mutual fund dealer and an individual applying for registration as a representative of a registered investment dealer or mutual fund dealer under securities legislation, must be an approved member of the Investment Dealers' Association of Canada (IDA) or an MFD SRO, as applicable.

As well, a registered investment dealer, mutual fund dealer, or registered individual of a registered investment dealer or mutual fund dealer, must maintain its status as an approved member in good standing with the IDA or an MFD SRO, as applicable, in order to maintain registration under securities legislation.

PART 4 FIT AND PROPER REQUIREMENTS

4.1. General

Suitability of a registrant is an ongoing requirement. Accordingly, the determination as to a firm's or individual's suitability for registration – sometimes referred to as the fit and proper determination – is an ongoing process for securities regulatory authorities and is not limited to a review of the initial application for registration. We may review a registrant's suitability at any time. If a registrant is no longer suitable for registration, the result may be that terms and conditions are imposed on the registration or that the registration may be suspended or revoked.

There are three fundamental criteria for determining whether a person is suitable for registration:

1. Integrity. Registrants must display integrity and be of honest character.

2. Competence. Registrants must meet the proficiency requirements prescribed by securities legislation, have adequate experience and demonstrate knowledge of securities legislation. Legislative proficiency requirements are intended to ensure registrants maintain a minimum level of product knowledge and ethics training before providing dealing or advising services to clients or managing a fund.

3. Solvency. Registrants must be solvent when applying to become registered. Depending on the circumstances, the regulator may consider a registrant's contingent liabilities to be relevant in assessing the registrant's solvency. Registrants generally should not have a history involving bankruptcy. Initial and ongoing capital requirements are intended to ensure a registered firm can meet the demands of its counterparties and, if necessary, wind down its business without loss to its clients. Where financial failure does occur, insurance requirements prescribed by securities legislation as well as investor protection funds, where applicable, serve to reduce the impact of failure on the registrant and its clients.

Other relevant factors when considering a registrant's suitability may include: other employment, partnerships or service as a member of a board of directors that may impact an individual's ability to devote sufficient time to clients and the sponsoring registered firm.

Potential conflicts of interest are also of relevance when assessing suitability. For non-residents, registration in good standing or equivalent status with appropriate regulators in the home jurisdiction may be taken into account. As well, the effectiveness of a registered firm in identifying and remedying compliance deficiencies will be considered an important element of its continuing suitability for unrestricted registration.

4.2. Application of proficiency requirements

Regulation 31-103 does not prescribe proficiency requirements for an investment dealer representative or a mutual fund dealer representative that is a member of the IDA or an MFD SRO, as applicable. Minimum entry proficiency requirements as well as ongoing proficiency requirements for such individuals are prescribed by the IDA or an MFD SRO, as applicable. Accordingly, investment dealer representatives and mutual fund dealer representatives should consult with IDA or MFD SRO rules, as applicable, for minimum proficiency requirements. We note, however, that whether an applicant for registration as an investment dealer or mutual fund dealer representative satisfies the minimum proficiency requirements prescribed by the IDA or MFD SRO, as applicable, is a relevant consideration towards whether the applicant is suitable for registration pursuant to securities legislation.

4.3. Exam-based proficiency requirement

Regulation 31-103 prescribes exam-based, rather than course-based, proficiency requirements where possible. For example, it is not necessary for an applicant to complete the Canadian Securities Course if alternative education has prepared them to successfully pass the Canadian Securities Exam. Although the course component is not a requirement, individuals without adequate alternative education may want to take an exam preparation course, such as the Canadian Securities Course, to assist them in satisfying the exam requirement.

4.4. Relevant experience

General

Relevant experience for the purposes of Part 4, Division 1 of Regulation 31-103 may include experience obtained working in:

- a dealing or advising firm
- a fund manager firm

- related investment fields such as investment banking, securities trading on behalf of a financial institution, securities research, portfolio management, investment advisory services or supervision of those activities

- legal, accounting and consulting practices related to securities legislation

- the provision of other professional services to the securities industry

- a securities-related business in a foreign jurisdiction.

Associate portfolio manager

Examples of relevant experience for the purposes of registration as an associate advising representative include:

- at least two years performing financial or investment research

- at least two years employment as a registered dealing representative with a registered dealer firm

- at least two years under the supervision of

(a) an unregistered investment manager of a Canadian financial institution,

(b) an adviser that is registered in another Canadian jurisdiction or a foreign jurisdiction, or

(c) an adviser that is not required to be registered under the laws of the jurisdiction or foreign jurisdiction in which the adviser carries on business.

The regulator will consider granting an exemption from any of the prescribed proficiency requirements in Part 4, Division 1 of Regulation 31-103 if the regulator is satisfied that an individual has qualifications or relevant experience that are equivalent to, or more appropriate in the circumstances than, the prescribed proficiency requirements.

4.5. Restricted dealer and restricted adviser – proficiency for representatives

The education and experience required to be registered as a dealing representative at a restricted dealer, as an advising representative at a restricted adviser or as a chief compliance officer for either, will be at the discretion of the regulator and will be determined in the course of assessing the individual's suitability for registration.

4.6. Registrant bankruptcy or insolvency

Among other items of financial disclosure, *Regulation 33-109 respecting Registration Information* requires a registrant to, among other things, notify the securities regulatory authorities within five business days of being petitioned into bankruptcy, making a voluntary assignment into bankruptcy, or making a proposal for insolvency.

The regulator will review the circumstances of a registrant's bankruptcy or insolvency on a case-by-case basis. If a review discloses evidence of activities such as unethical conduct or gross error in business judgment, the registrant's registration may be suspended or terminated. Less serious situations may result in conditions being imposed on the registrant's registration such as the need for close supervision of the individual and the delivery of progress reports to the securities regulatory authorities.

4.7. Financial records

Subsection 4.26(1) of Regulation 31-103 requires a registered firm to prepare its financial statements in accordance with generally accepted accounting principles, except that the statements are to be prepared on an unconsolidated basis. Section 5600 of the Handbook provides guidance for auditors signing an audit report concerning financial statements prepared in accordance with regulatory or legislative requirements. The audit report should clearly state that the financial statements are not intended to be and should not be used by anyone other than the regulator.

PART 5 CONDUCT RULES

5.1. Outsourcing

Outsourcing of certain components of a registered firm's operations, particularly non-core "back office" activities can be a cost-effective alternative to conducting those operations in-house. It can also be a way to access specialized expertise that would otherwise be unavailable or otherwise improve operations. However, registrants remain fully liable and accountable for any and all functions that are outsourced to a service provider. A written, legally binding contract should document the expectations of the parties to an outsourcing arrangement.

We believe prudent business practice requires a registrant to conduct a due diligence analysis of prospective third-party service providers (including affiliates of the registrant firm) to assess their reputation, financial stability, relevant internal controls and overall ability to deliver the services. Firms should ensure that third-party service providers maintain adequate information confidentiality safeguards and, where appropriate, disaster recovery capabilities. Firms should review the quality of outsourced services on a continuous basis and develop business continuity plans for the possibility that outsourced services may not be delivered in a satisfactory manner, potentially leading to disruption of a firm's business and negative consequences for its clients. Firms are reminded that other

legal requirements, such as privacy laws, should also be considered when entering into outsourcing arrangements.

Securities regulatory authorities, the firm and its auditors should have the same access to the work product of the service provider as if the activities had been performed by the registrant. Firms are expected to enter into contractual arrangements as may be necessary to ensure such access is provided.

5.2. Know-Your-Client

The know-your-client (KYC) obligation is an exercise in due diligence that protects the client, the registrant and the integrity of the capital markets.

The KYC obligation requires a registrant to learn the essential information about each and every client, document the results and keep the information current. Examples of essential information about an individual client include the following: investment objectives, investment knowledge and experience, risk tolerance, investment timeframe, employment status, income level and net worth.

In addition, registrants should collect the following information about clients that are not individuals: the nature of the client's business or other purposes of the entity, control structure and ownership. Where it is unduly difficult to determine ownership, the registrant should consider carefully the reasons why this might be so and whether it would be appropriate to closely scrutinize account activity pending identification of owners or even to decline to accept the client.

5.3. Suitability of investment

In order to adequately discharge the obligation to determine suitability of an investment for a client, a registrant must understand all products made available to clients, including each product's structure, features, full costs and buyer qualifications (i.e. restriction to accredited investors).

Although a suitability review is required whenever a dealer accepts an order from a client, there are exemptions for SRO members pursuant to SRO requirements. These exemptions generally apply to discount broker activity or certain institutional clients.

5.4. Leverage disclosure

General

Registrants are reminded that leveraging is an important factor to consider when determining suitability and when fulfilling other obligations to clients. Regulation 31-103 in no way implies that the provision of the leverage disclosure statement referred to in subsection 5.6(1) of Regulation 31-103 fulfils the registrant's ongoing duties to its clients.

Borrowed money

Subsection 5.6(1) of Regulation 31-103 requires that leverage disclosure be provided to a client when a registrant opens an account for a client, makes a recommendation to a client to purchase securities using in whole or in part borrowed money, or otherwise becomes aware of a client's intent to purchase securities using in whole or in part borrowed money. This requirement applies whether or not the borrowed money was specifically borrowed for the purpose of purchasing the securities.

Client acknowledgement

The acknowledgements of a client referred to in subsections 5.6(1) and 5.7(3) of Regulation 31-103 may be obtained by a registrant in a number of ways, including requesting the client's signature, requesting that the client initial an initial box or requesting that the client place a check in a check-off box. It is the responsibility of the registrant to draw the client's attention to the disclosure. The acknowledgement must be specific to the information disclosed to the client (i.e. disclosure regarding the risks of using leverage to purchase securities or the description of the nature of securities) and must confirm that the client has read the relevant information.

Exemption for margin accounts

Subsection 5.6(2) of Regulation 31-103 exempts registrants from the requirement to provide additional leverage disclosure to clients opening a margin account at a member of the IDA or an MFD SRO. The exemption is provided because the by-laws, rules, regulations or policies of the IDA or an MFD SRO may already require that clients with margin accounts acknowledge receipt of leverage disclosure in the account opening form.

Delivery of documents by electronic means

All disclosure or consents required by Regulation 31-103 may be delivered by electronic means and are subject to the provisions of all applicable federal or provincial legislation governing the delivery of electronic documents. Reference should also be made to *Notice 11-201 related to the Delivery of Documents by Electronic Means*, in Québec, and National Policy 11-201 *Delivery of Documents by Electronic Means*, elsewhere in Canada.

5.5. Relationship disclosure document

Content of relationship disclosure document

In addition to the prescribed content in section 5.12 of Regulation 31-103, the Relationship Disclosure Document may include any other information that the registered firm determines is necessary to clearly set out essential relationship information. For example, the document may include recommendations to the client regarding what the client should do to maintain a successful relationship with the firm. The registered firm may also describe the client’s responsibilities, including the following:

- provide full and accurate information to the firm and the registered individuals acting on behalf of the firm

- promptly inform the firm of a change to any information that could reasonably result in a change to the types of investments appropriate for the client, such as a change to the client's income, investment objectives, risk tolerance, time-horizon or net worth

- carefully review all account documentation, sales literature and other documents provided by the firm

- understand all fees and costs

- be aware of the potential risks and returns on investments

- clearly state the client's expectations about the firm

- ask questions and request information from the firm to resolve questions about the account, transactions, investments or the relationship with the firm or a registered individual acting on behalf of the firm

- pay for securities purchases by settlement date

- review all transaction confirmations, account statements and reports carefully and report any errors or concerns to the firm immediately

- review portfolio holdings and performance on a regular basis

- consult the appropriate professional, such as a lawyer or an accountant, for legal or tax advice.

If a registered firm decides that a major product or service will no longer be provided to clients, it should provide clients with reasonable notice of the change.

The purpose of identifying in the Relationship Disclosure Document which products or services offered by the registered firm will meet the client's investment objectives, and how they will do so, is to explain to the client what the firm will do for them and how it will do it. For example, the disclosure could include a reference to the firm's investment policies, ranges of typical asset allocations for various types of clients, or particular expertise in the firm to manage various investments that will meet the needs of the client. This explanation will, of course, be tailored to the nature of the firm and the needs of the client or particular category of client.

5.6. Recordkeeping – general

Specific records that a registrant should maintain include:

- material contracts
- reconciliations of bank statements and securities positions
- client correspondence including e-mails.

5.7. Retention of records

Activity Records

Paragraph 5.20(4)(a) of Regulation 31-103 requires a firm to retain activity records for at least seven years. Activity records include records of all actions taken leading to trade execution, settlement and clearance. This includes trades on exchanges, alternative trading systems, over the counter markets, debt markets, and distributions and trades in the prospectus-exempt market. Activity records record information about buy and sell transactions, referral transactions, portfolio management transactions, margin transactions, and any other activities relating to a client's account. Trade confirmation statements and summary information about account activity are examples of activity records. Communications between a registrant and its client about particular transactions are also activity records. Other transactions resulting from securities a client holds are also activity records (e.g. records of dividends or interest paid, or dividend reinvestment program activity). In determining what activity records are, a firm should consider the recordkeeping requirements in *Regulation 23-101 respecting Trading Rules*.

Relationship Records

Paragraph 5.20(4)(b) of Regulation 31-103 requires a firm to retain relationship records for at least seven years from the end of the relationship. Relationship records record information about a firm's relationship with its client, and any representatives' relationships with that client. They include communication between the registrant and its clients, including: (i) disclosure provided to clients; (ii) agreements entered into between the registrant and its clients; (iii) notes of verbal communications with a client; and (iv) all e-mail, regular mail, fax and other written communications to clients.

Examples of other types of relationship records include account opening information, change of status information provided by the client, disclosure and other relationship information provided by the firm, margin account agreements and ongoing communications that do not relate to a particular transaction. Client complaint records and conflicts records are also relationship records.

5.8. Third party access to records

All registrants should have proper safeguards in place to ensure that there is no unauthorized access to information, particularly confidential client information. If the registrant maintains books and records in a central location to which employees of a third

party have access, the registrant should be particularly vigilant in ensuring these safeguards are implemented and effective.

5.9. Compliance and recordkeeping

Provincial and territorial securities regulatory authorities conduct regular and spot compliance examinations of registrants. In preparation for these examinations, a registrant should consider regular testing to determine whether its records demonstrate compliance with applicable securities legislation. Registrants are reminded that securities legislation authorizes securities regulatory authorities and/or regulators to access, examine and take copies of a registrant's records.

5.10. Account opening and recordkeeping

Each record should clearly indicate the person and the account to which the record refers. Information in a record can cover only the accounts of the same accountholder or group and can include, if so specified, their registered account(s) such as RRSPs. For example, separate information should be obtained for an individual's personal accounts, accounts of a legal entity even where wholly owned by the individual and those held jointly with another party. As well:

- the financial details should note, where applicable, whether the information is that of an individual client or family information (including spousal income and net worth). For legal entity accounts, it should note whether the information refers to the entity or the owner(s) of the entity

- investment knowledge or experience for multi-party or legal entity accounts should note whose investment knowledge or experience is being described

- if a client is opening more than one account, the investment objectives and risk tolerance should indicate whether it is for a particular account or the client's whole portfolio across accounts.

All information relevant to suitability should take a form that makes it usable in the firm's supervision systems.

If the firm permits clients to complete new account forms themselves, the forms should use language that is clear and that avoids terminology that may be unfamiliar to unsophisticated clients.

5.11. Compliance system

We wish to emphasize that compliance is a firm-wide responsibility. The existence of a compliance monitoring group and individuals inside or outside that group with specific compliance and/or supervisory responsibilities does not relieve others in the firm of the obligation to report and act on compliance issues.

The purpose of a compliance system is to protect both clients and registrants. This contributes to greater investor confidence and participation in our capital markets.

A registered firm's compliance system should achieve each of the following objectives:

1. It should ensure that everyone in the firm, including the board of directors or partners, management, employees and agents (whether or not themselves registered) understands the standards of conduct applicable to their designated roles.

2. It should be reasonably likely to identify non-compliance at an early stage.

3. It should provide effective mechanisms for the timely correction of non-compliant conduct.

The compliance system has two inter-related elements: day-to-day supervision and systemic monitoring. Day-to-day supervision usually involves approving new account documents, monitoring and in some cases approving transactions, and taking corrective action where necessary. Systemic monitoring involves assessing, advising on and reporting on the registered firm's compliance with regulatory requirements. This includes ensuring that day-to-day supervision is effective. The entire firm has a responsibility to support compliance efforts. The CCO and the UDP must be authorized to take, on their own initiative, problems to executive management and the board of directors or partnership if satisfactory results are not otherwise being obtained.

Registered firms, when setting up their compliance systems, must consider their size, scope of operations, products, types of clients or counterparties, risks and compensating controls, along with any other relevant factors. As part of this process, firms must develop and enforce written policies and procedures for dealing with clients that conform with prudent business practices. Firms are also encouraged to go further and meet or exceed industry best practices to assist them in complying with regulatory requirements. The CSA or its member regulators from time-to-time publish recommendations for best practices for firms in one or more categories of registration. The SROs also do so for their members. Registered firms are encouraged to conduct an assessment of the effectiveness of the firm's compliance system on a regular basis.

In some firms, the compliance monitoring group itself may be authorized to take supervisory action, in others it may not – it is up to each firm to decide what model of compliance system is most appropriate for its operations. Elements of an effective compliance system at a registered firm will generally include:

- the visible commitment of senior management and the board of directors or partners

- sufficient resources to operate effectively

- detailed written policies and procedures that set out the firm's standards of conduct for regulatory compliance and the systems in place to monitor and enforce compliance with those standards – such policies and procedures should:

  (a) delineate clearly who is expected to do what, when and how,

  (b) be readily accessible for consultation by all those expected to know and follow them, *and*

  (c) be kept up-to-date with changes in regulatory requirements and the firm's business practices

- the designation of personnel to monitor the firm's compliance, identify any incidents of non-compliance and take supervisory action to correct them, including those assigned to fill those positions temporarily during absences (all such personnel must have the qualifications and authority to carry out the responsibilities assigned to them)

- training to ensure that everyone at the firm understands the standards of conduct and his or her role in the compliance system – including on-going communication and training regarding changes in regulatory requirements or the firm's policies and procedures

- records of activities conducted to identify and correct compliance deficiencies

- records of all instances where compliance deficiencies have been identified and the action taken to correct them.

Some elements noted above may be unnecessary or unworkable in smaller registered firms, but all registered firms must have systems, policies and procedures to ensure their compliance with regulatory requirements. That said, policies and procedures in themselves do not constitute an acceptable compliance system; an acceptable compliance system is one that in practice delivers reasonable assurance that all requirements of applicable securities laws and SRO rules are being met in a timely and ongoing manner.

Although Regulation 31-103 does not set out prescriptive requirements concerning account opening procedures and trade supervision or branch offices and branch managers, SRO members should be mindful of SRO requirements concerning such matters. Branch locations and branch managers must still be identified on NRD filings. With respect to effective compliance systems in non-SRO firms, we would normally expect that a manager will be designated at each branch location with responsibility to supervise account opening and trading activities. We recognize, however, that there may be circumstances in which a non-SRO firm may be able to demonstrate that other arrangements nonetheless enable it to operate an effective compliance system.

Registered firms must also ensure that their compliance monitoring and supervision

policies and procedures take conflicts of interest management issues into account. Those within the registrant who decide what is an appropriate action to take if a conflict of interest arises should not be significantly affected by the conflict themselves.

Managers or others designated by their registered firm with authority to supervise specified registered individuals, or individuals who should be registered, have a responsibility on behalf of the firm to ensure that each such individual:

- acts honestly toward clients
- is fit and proper and appropriately registered with the local securities regulator before engaging in activity requiring registration
- provides clients with continuous access to firm services during normal business hours, even where the individual does not carry out their activities on a full-time basis
- maintains an appropriate level of proficiency on an on-going basis.

5.12. Client complaints

An effective complaint system deals with all formal and informal complaints or disputes internally or refers them to the appropriate external person or process, in a timely and fair manner. Registrants should be fully aware of all applicable processes – internal or through an SRO if applicable – for dealing with complaints and should disclose to all clients the channels available for pursuing different types of complaints (for example, regarding conduct, service or product performance).

Some registrants are also registered or licensed to do business in other sectors, such as insurance. In this case, these registrants must inform clients of the differing complaint resolution mechanisms for each sector in which they do business and how the clients can use those mechanisms. If a registrant is also insurance licensed, it will be subject to applicable insurance regulations in this area.

A registered firm must document all complaints made, or legal actions or other dispute resolution proceedings commenced, against the firm and its representatives for potential compliance review by regulators. A registered firm should respond in writing to any client who complains about a firm or one of its representatives, beginning with acknowledging receipt in writing to the complainant within five business days.

A complaint is the expression of at least one of the following elements that persists after being considered and examined at the operational level capable of making a decision on the matter: a reproach against the firm, the identification of a real or potential harm that a client has experienced or may experience or a request for remedial action.

The initial expression of dissatisfaction by a client, whether in writing or otherwise, will not be considered a complaint where the issue is settled in the ordinary course of business. However, if the client remains dissatisfied and such dissatisfaction is referred to the firm's compliance staff, then it will be considered a complaint. The complaint should be handled promptly by sales supervisors or compliance staff, and in most cases, a resolution should be provided within three months of the date the complaint was received.

Registrants must ensure that all complaints and pending legal actions are made known to the CCO and appropriate supervisors. Registrants should also ensure that procedures are in place so that senior management is made aware of all complaints of serious misconduct and of all legal actions.

The registrant must keep an up-to-date record of complaints which includes the following information for each complaint:

- the date of the complaint
- the complainant's name
- the name of the person who is the subject of the complaint
- the security or services which are the subject of the complaint
- the date and conclusions of the decision rendered in connection with the complaint.

5.13. Non-resident registrants

Certain factors may indicate that a firm is resident in a jurisdiction or foreign jurisdiction. A firm's head office is usually located in the jurisdiction or foreign jurisdiction in which the firm is resident. In unusual circumstances, a firm may be resident in a different jurisdiction or foreign jurisdiction than its head office. If so, the jurisdiction or foreign jurisdiction in which the firm is resident may be indicated by the location of the firm's records, or by the jurisdiction or foreign jurisdiction in which the firm's officers and directors are resident or primarily work.

PART 6 CONFLICTS

6.1. Definition of conflict of interest

General

Conflicts of interest are circumstances in which the interests of different parties, such as the interests of clients and those of the registrant, its affiliates, its representatives and non-registered employees or agents, are inconsistent or divergent.

Conflicts of interest between clients

Sometimes the interests of clients conflict. For example, there can be a conflict of interest between the interests of investment banking clients who want the highest price, lowest interest rate or best terms in general for their issues and the interests of the retail clients who will buy the product. Firms should have internal systems to evaluate the balance struck between these interests, so that firms consider whether the product meets the retail clients' needs and is competitive with alternatives available in the market.

6.2. Dealing with conflicts of interest

Mechanisms

The three mechanisms that registrants generally use to deal with conflicts of interest are:

1. *Avoid* – first determine if the registrant should avoid the conflict of interest because it is sufficiently contrary to the interests of a client or it is prohibited by law.

2. *Control* – if the registrant does not avoid the conflict of interest, consider what internal structures or policies and procedures the registrant should have to reasonably address the conflict.

3. *Disclose* – if the registrant does not avoid the conflict of interest, the registrant must consider if it is required to disclose the conflict.

Consistency

A registrant should apply consistent criteria when dealing with conflicts of interest of a similar nature.

6.3. Avoiding conflicts of interest

Some conflicts of interest experienced by a registrant are so contrary to another person's interest that they cannot be managed by controlling the conflict and/or through disclosure. In those cases, the registrant should avoid the conflict or refrain from either providing that service or dealing with the client. A registrant's conflicts management policies and procedures should enable the registrant and its representatives to identify those conflicts of interest that should be avoided.

Serious conflicts need to be avoided, not because they will always lead to actual harm to clients or to the market, but because allowing those conflicts to continue creates a high risk of that harm occurring. Registrants should take a risk management approach and ask themselves to what level of risk their conflicts of interest expose them. With some conflicts, the risk of an adverse client or market integrity outcome is too high and these conflicts need to be avoided.

6.4. Controlling conflicts of interest

General

Depending on the conflict of interest, it may be appropriate to control the conflict by:

- assigning another representative to provide the service to the particular client
- creating, or referring the matter to, a group or committee to review, develop or approve responses
- monitoring
- initiating internal or external disciplinary action (such as referring the matter to a professional body or regulator)
- using another control method that is appropriate in the circumstances.

Internal structures

Registrants should ensure that their internal structures and reporting lines enable them to control conflicts of interest effectively. It is important that internal structures and reporting lines support a registrant's conflicts of interest management.

Registrants should consider how their organizational structure, physical layout and reporting processes affect their conflicts control. For example, the following would likely raise a conflict:

- having advisory staff reporting to marketing staff
- having 'stand-alone' advice units within the organisation in the same physical location as sales or investment management staff
- having compliance or internal audit staff reporting to a business unit.

Robust information barriers may help a registrant control its conflicts of interest. They may allow a registrant to insulate one group of staff from the information or other circumstances that give rise to a particular conflict, so that the group is not affected by that conflict. To be effective, the barriers must prevent information being passed to the relevant group of staff.

Remuneration

Registrants should consider their remuneration practices (including non-monetary benefits) to ensure that they meet their obligations to

- operate honestly and fairly
- have in place adequate conflicts management policies and procedures.

Registrants should consider whether any particular benefits, compensation or remuneration practices are inconsistent with the requirement to have adequate policies and procedures in place to manage conflicts of interest or with the requirement to provide its services in an efficient, honest and fair manner.

Robust conflicts management policies and procedures are important if a registrant relies heavily on commission-based remuneration.

Multiple roles for individuals

If a representative serves on a board of directors, several conflicts of interest could arise, including conflicting fiduciary duties owed to the company and to a registrant or client, possible receipt of inside information, and conflicting demands on the representative's time. Registrants should consider requiring their representatives to seek permission from the registrant to serve on the board of directors of a public issuer or restricted issuer. Registrants should also consider having policies for board participation that identify the circumstances in which the activity would be in the best interests of the registrant and its clients.

Outside business activities

Registrants need to consider potential conflicts of interest prior to approving any outside business activities, including compensation as well as the nature of the relationship between the individual and the outside entity. If any conflict of interest cannot be properly managed, the outside activity should not be permitted.

6.5. Disclosing conflicts of interest

General

Registrants should make appropriate disclosure of conflicts of interest to clients. While disclosure alone will often not be enough, disclosure is an integral part of managing conflicts of interest. Registrants should ensure that clients are adequately informed about any conflicts of interest that may affect the services the registrant provides to them. Generic disclosure is unlikely to satisfy the registrant's obligations to manage conflicts properly.

Disclosure about conflicts of interest should:

- be prominent, specific, clear and meaningful to the client, so that the client can understand the conflict of interest and its potential impact on the service the client is being offered

- occur before or when the service is provided, but in any case at a time that allows the client a reasonable time to assess its effect.

Registrants should ensure that:

- partial disclosure is not misleading
- detailed and exhaustive disclosure is not used to obscure conflicts of interest.

Inappropriate disclosure

There are some situations in which disclosing a particular conflict of interest will be inappropriate. For example, conflicts of interest may arise that are confidential, or commercially sensitive, or even amount to 'inside information' under the insider trading provisions. In those situations, registrants will need to assess whether any disclosures can be given and whether the conflict can be adequately managed through other mechanisms. It may be that the conflict must be avoided by, for example, declining to provide the affected service.

Registrants may disclose material, non-public information only if it is in the necessary course of business. Otherwise, it would be considered "tipping". Registrants should have specific procedures for dealing with inside information.

6.6. Other legal considerations

Conflicts of interest requirements may arise outside of securities legislation. Registrants should comply with other legislative requirements, regulations, rules, and common and civil laws that apply to their conflicts of interest.

6.7. Fairness in allocation of investment opportunities

The following disclosures should, at a minimum, be included in a portfolio manager's fairness policy, where applicable to its investment processes:

- the method used to allocate price and commission among clients when trades are bunched or blocked
- the method used to allocate block trades and initial public offerings among client accounts
- the method used to allocate block trades and initial public offerings among clients that are partially filled, such as pro-rata.

A portfolio manager's fairness policy should also address any other situation in which investment opportunities must be allocated.

6.8. Acquisition of securities or assets of a registrant

For the purposes of section 6.7 of Regulation 31-103, purchasing the book of business of a registrant would be 'a substantial part of the assets' of the registrant.

6.9. Relationship pricing

Canadian securities regulatory authorities are aware that industry participants offer financial incentives or advantages to certain clients, a practice that is commonly referred to as relationship pricing. The tied selling provision in section 6.10 of Regulation 31-103 is intended to prevent certain abusive sales practices and is not intended to prohibit relationship pricing or other beneficial selling arrangements similar to relationship pricing. We are of the view that section 6.10 of Regulation 31-103 would be contravened, for example, if a financial institution refused to make a loan unless the client acquired securities of mutual funds that are sponsored by the financial institution, where the client otherwise met the financial institution's criteria for making loans.

6.10. Referral arrangements

Application

The purpose of Part 6, Division 2 of Regulation 31-103 is to deal with the abuse, misuse or misinterpretation of referral arrangement relationships involving registrants. There are many kinds of referral arrangements. Some referral arrangements require that one or both parties be registered. Whether a party needs to be registered depends on the activities carried out by the parties to the referral arrangement. There are a number of factors to consider in determining whether an arrangement is a referral that requires registration.

Part 6, Division 2 of Regulation 31-103 applies to the referral of a client to or from a registrant. A referral of a client also includes a referrer passing a client name and contact information to the person receiving the referral for a referral fee. A referral fee means any compensation paid for the referral of a client, including sharing or splitting any commission resulting from the purchase or sale of a security.

Scope of Activities

Typically, a client will rely on the registrant to have the ability to invest their portfolio and to give appropriate investment advice. Therefore, if a registrant does not have the expertise or appropriate registration to provide a service, it is expected that the registrant will refer their client to an appropriately qualified person.

Part 6, Division 2 of Regulation 31-103 applies to any referral to a registrant where the registrant is paying for the referral and to referrals from a registrant to a person that provides investment products or services, including:

- a mortgage broker for a mortgage
- a financial planner for financial planning services
- an exempt market dealer for trading in flow-through shares
- a portfolio manager for discretionary management services.

Some issuers, dealers and non-registrants are actively promoting and marketing specific securities through third party registrants who then merely execute the trade. An example of a referral activity that raises concerns is a mutual fund dealer that enters into a referral arrangement with a portfolio manager where the mutual fund dealer recommends the specific product and meets with clients to conduct know-your-client and suitability reviews. The portfolio manager's role is limited to providing instructions to complete the trade. The concern is that the mutual fund dealer is giving advice and making recommendations with respect to a specific security without the appropriate registration or proficiency. The portfolio manager is the party that should be conducting know-your-client and suitability reviews, as is required under the portfolio manager's registration requirements. Another example includes the situation where a referrer refers clients to a discount broker that does not provide investment advice and the referrer continues to meet with clients to provide advice relating to the portfolio. While these arrangements are held out as referrals, they are in fact advising on and/or trading in a specific security. By providing advice on a specific security, individual registrants may be acting on behalf of a registrant other than their dealer or adviser, contrary to securities legislation.

Clients

Once a client is referred to another person, it is considered to be the client of the person receiving the referral for the purposes of the services being provided under the referral arrangement. The person receiving the referral, if registered, must satisfy all requirements and obligations of a registrant toward the client including know-your-client and suitability obligations.

Written Agreement

Parties to the referral arrangement should clarify their relationship and each party's roles and responsibilities within the written agreement. Parties to the referral should set out the terms of the referral arrangement clearly in the written agreement, and may wish to include the following areas:

- the roles and responsibilities of each party
- limitations on any party to the referral arrangement that is not a registrant to ensure that they are not engaging in any activities requiring registration;

- the method of calculating the referral fee and, to the extent possible, the amount of the fee

- the disclosure to be provided to clients and by whom

- if the person receiving the referral is a registrant, the registrant is responsible for meeting its obligations under securities laws, including know-your-client, suitability review responsibilities, and communication with the client going forward.

Registrants are reminded that they cannot contract out of the obligations of their registration. In addition, registrants should be aware of other legal obligations that may impact on referral arrangements, including privacy legislation.

Supervision

It is essential that dealers and advisers be aware of all referral arrangements in order to supervise representatives. For this reason, section 6.12 of Regulation 31-103 requires that the dealer or adviser be a party to the written agreement. While section 6.12 of Regulation 31-103 requires the dealer or adviser to be a party to the written agreement, it does not preclude the individual registrant from also being a party to the agreement. This ensures that representatives are not entering into agreements on behalf of their dealer or adviser without the dealer's or adviser's knowledge, as a person with appropriate signing authority to legally bind the firm would have to review and execute the agreement. Also, this ensures that the dealer or adviser is aware of its legal responsibilities under the referral arrangement and is able to monitor compliance. This includes, but is not limited to ensuring that the receipt or payment of the referral fees is recorded on the records of the dealer or adviser.

Disclosure to Clients

Section 6.13 of Regulation 31-103 mandates specific disclosure so clients can assess any potential conflicts of interest created by the referral arrangement and to help clients make an informed decision regarding the referral. We expect registrants to provide adequate written disclosure to clients that clarifies which entity the client is dealing with, that explains that the referrer has a financial interest in the referral arrangement and that discloses any relationship that may give rise to a conflict of interest. The referral fee should be disclosed in sufficient detail and clarity to permit the client to determine the amount of the referral fee paid to the referrer. In addition, we require the registrant to disclose any other information that a reasonable client would consider important in evaluating the referral arrangement.

The registrant should manage any conflict by exercising responsible business judgment in the best interest of the client. If the referral fee is excessive in relation to the service to be provided, the dealer or adviser should assess whether this creates a conflict that could motivate representatives to refer clients to a particular person even though it may not be in the best interest of the client. Clients should receive sufficient information to

evaluate the extent of any conflict. In addition, registrants should have controls in place to ensure that clients are not misled as to the nature of the relationship between the parties to the referral arrangement, or as to any limitations or conditions on registration of the parties to the referral arrangement.

Reasonable Diligence

Pursuant to section 6.14 of Regulation 31-103, a registrant referring a client to another party must take reasonable steps to ensure that the party receiving the referral is appropriately qualified to perform the services, and if applicable, is appropriately registered to provide those services. It is the responsibility of the registrant to determine the reasonable steps that are appropriate in the particular circumstances. For example, this may include an assessment of the type of clients that the referred services would be appropriate for.

PART 7 SUSPENSION AND REVOCATION OF REGISTRATION

7.1. General

Registration remains effective until it is suspended or terminated by a triggering event; there is no annual or other renewal requirement. Triggering events include the following: an individual ceasing to have a sponsoring firm, the regulator's acceptance of a request from the registrant to surrender registration or suspension or revocation of registration by the regulator or securities regulatory authority. Suspension is a restricted state of registration.

7.2. Transfer or termination of a registrant's employment

If a registered firm terminates the employment, partnership or agency relationship of a registered individual for any reason (e.g. the individual resigns, is dismissed, retires etc.), the firm has five days after the effective date of the individual's termination in which to file the prescribed notice of termination (Form 33-109F1). If the termination notice indicates that the individual resigned or was dismissed (and not retired or completed a temporary employment contract), the former sponsoring firm has 30 days from the date of termination in which to file additional prescribed information concerning the reasons for the termination. This information is necessary for the regulator to determine whether there may be concerns about the individual's conduct that would be relevant to his or her suitability for registration.

7.3. Automatic suspension

The registration of an individual whose only registered employment, partnership or agency relationship is terminated by his or her sponsoring firm will be automatically suspended as of the effective date of the termination. If the registration of a firm is suspended, the registration of each of its individual dealing or advising representatives is suspended. If the registration of a firm is revoked, the registration of all of its

representatives is suspended. An individual's registration will also be automatically suspended if his or her sponsoring firm is required to be an SRO member and the SRO revokes or suspends the firm's membership or the individual's approval.

There is no opportunity to be heard in the case of an automatic suspension.

A suspended registrant must cease activity that requires registration but otherwise remains a registrant, subject to the jurisdiction of the securities regulator.

7.4. Automatic reinstatement

An individual who leaves a sponsoring firm, voluntarily or involuntarily, is automatically suspended. If the individual joins another sponsoring firm within 90 days of leaving the previous position the individual will be reinstated automatically, provided the individual is seeking registration in the same category as previously held. This means that as a practical matter, a registrant who transfers directly from one sponsoring firm to another may start engaging in activities requiring registration from the first day with the new firm provided the new firm has filed Form 33-109F4.

However, suitability for registration is an ongoing requirement and the regulator has discretionary power to revoke an individual's registration or restrict it with conditions at any time. If the regulator receives information from the termination notice or other sources that calls into question the individual's continued suitability for registration, the regulator may use this power. The individual will be provided with an opportunity to be heard before the regulator revokes registration or imposes conditions.

If the individual joins another sponsoring firm more than 90 days after leaving the previous position, an initial application for registration will have to be filed by the new sponsoring firm. The individual will not be able to conduct activities requiring registration until the regulator has granted registration.

7.5. Surrender of registration

A registrant that intends to cease activity requiring registration may apply to surrender its registration. The surrender of registration will take effect upon notice from the regulator that it has been accepted. Until such notice is received, the individual or firm remains registered. Before accepting a firm's surrender, the regulator will require evidence that its clients have been dealt with appropriately. This is not necessary in the case of an individual who applies to surrender registration, as the sponsoring firm will continue to be responsible for the discharge of obligations to clients who may have been served by the individual. The regulator has the authority to suspend the registration of a registrant that has applied to surrender it.

An individual who wants to terminate his or her registration does not need to apply to surrender his or her registration. The individual may simply resign from his or her sponsoring firm and allow the 90 day suspension period to lapse. However, an individual

may apply to surrender registration if, for example, he or she is registered in multiple jurisdictions with the same sponsoring firm and wishes to have his or her registration revoked in one or more of them, while remaining registered elsewhere with that same sponsoring firm.

The regulator may consider the following when reviewing a registered firm's application to surrender its registration:

- whether the firm has ceased carrying on activity requiring registration already or proposes an effective date within six months of the date of the application to surrender (revocation of registration to take effect on or after that date as notified by the regulator)

- whether at the time of filing the application to surrender, any previously outstanding fees and filings have been brought up-to-date in a satisfactory manner

- whether the application to surrender registration has:

(i) disclosed the firm's reasons for ceasing to carry on activity requiring registration;

(ii) provided satisfactory evidence that the firm has given all of its clients reasonable notice of its intention to cease carrying on activity requiring registration, including an explanation of what that will mean for them in practical terms;

(iii) included copies of the firm's most recent unaudited financial statements; and

(iv) where the firm is a member of an SRO, provided evidence that it has provided appropriate notice to the SRO

- whether the regulator has received or waived receipt of the following from the registrant in satisfactory form, supported by an officer's or partner's certificate and auditor's comfort letter:

(i) evidence the firm has resolved all outstanding client complaints (including litigation, judgments and liens) or made reasonable arrangements to deal with and fund payments in respect of them, as well as any subsequent client complaints or settlements/liabilities;

(ii) confirmation that all money or securities owed to clients has been returned or transferred to another registrant, wherever possible in accordance with client instructions;

(iii) up-to-date audited financial statements; and

(iv) where it is a member of an SRO, evidence that it has satisfied the SRO's requirements for withdrawal from membership.

The regulator will have reference to all information provided by the registrant and any other regulatory concerns that pertain to the registrant, including undischarged conditions of registration and compliance issues among other things, in determining whether it would be prejudicial to the public interest to accept the surrender of registration.

Depending on the circumstances, individuals who were directors and officers of a registered firm that has failed to comply with the surrender procedure may not be considered eligible for registration or to be a permitted director or officer of another registrant unless the non-compliant firm brings itself into compliance.

PART 8 EXEMPTIONS FROM REGISTRATION

8.1. Mobility exemption

In limited circumstances, the mobility exemption allows a registrant to continue dealing with a client, and certain family members of that client, that moves to a different jurisdiction without registering in that other jurisdiction. Relocation of a client to another jurisdiction triggers the availability of the mobility exemption.

Under section 9.20 of Regulation 31-103, a person must give notice to the securities regulatory authority in the jurisdiction in which it is dealing in securities or advising in securities in reliance on the mobility exemption as soon as practicable after relying on the exemption. A person should indicate which exemption it is relying on in an e-mail sent to the e-mail addresses set out in Form 31-101F2. The notice should also contain the name of the firm, the applicable individual representative and the principal regulator.

A firm's compliance system must have appropriate policies and procedures for supervision of individual representatives relying on a mobility exemption. As well, registrants must keep appropriate records to demonstrate compliance with the conditions of the mobility exemptions.