

## Notice and Request for Comment

### **Draft Regulation 32-102 respecting Registration Exemptions for Non-Resident Investment Fund Managers**

### **Draft Policy Statement to Regulation 32-102 respecting Registration Exemptions for Non-Resident Investment Fund Managers**

**February 10, 2012**

## **Introduction**

### ***Context***

The Ontario Securities Commission, the Autorité des marchés financiers, the New Brunswick Securities Commission and the Financial Services Regulation Division, Service NL, Government of Newfoundland and Labrador (collectively, we) are publishing for a 60 day comment period draft *Regulation 32-102 respecting Registration Exemptions for Non-Resident Investment Fund Managers* (the “Regulation” or “Regulation 32-102”) and *Policy Statement to Regulation 32-102 respecting Registration Exemptions for Non-Resident Investment Fund Managers* (the “Policy Statement” or “Policy Statement 32-102”).

The Regulation and the Policy Statement would apply in Ontario, Québec, New Brunswick and Newfoundland and Labrador (collectively, the jurisdictions) and relate to proposed registration exemptions for investment fund managers

- that do not have their head office or their principal place of business in a jurisdiction of Canada (international investment fund managers); and
- that do not have a place of business in the local jurisdiction (domestic non-resident investment fund managers).

We refer to international and domestic non-resident investment fund managers, collectively, as non-resident investment fund managers.

### ***Temporary exemptions from investment fund manager registration***

*Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (Regulation 31-103) currently provides temporary exemptions until September 28, 2012 for non-resident investment fund manager registration. The jurisdictions propose to adopt new temporary exemptions, which would cease to have effect on December 31, 2012.

### ***Implementation of the Regulation and Policy Statement***

The Regulation and the Policy Statement are published with this notice and will also be available on the Ontario Securities Commission website at [www.osc.gov.on.ca](http://www.osc.gov.on.ca) and on the Autorité des marchés financiers website at [www.lautorite.qc.ca](http://www.lautorite.qc.ca).

## **Substance and Purpose**

The Regulation would exempt non-resident investment fund managers from the requirement to register in the jurisdictions in circumstances where there are no significant connecting factors to the local jurisdiction.

The distribution of investment fund securities in the local jurisdiction is, in our view, a significant connecting factor to that jurisdiction. A non-resident investment fund manager triggers the registration requirement if either the investment fund or the

investment fund manager distributes or has distributed investment fund securities in the jurisdiction.

If an investment fund has security holders in the local jurisdiction, this gives rise to investment fund management activities in that jurisdiction, including activities reflecting the relationship between the fund, the investment fund manager (who is responsible for directing those activities), and the security holders. Such activities include the delivery of financial statements and other periodic reporting, calculating net asset values and fulfilling redemption and dividend payment obligations.

Certain risks associated with those activities give rise to investor protection concerns, in the same manner as domestic investment fund managers with a place of business in the local jurisdiction.

## **Background**

On October 15, 2010, the Canadian Securities Administrators (the CSA) published for comment draft amendments to Regulation 31-103 and to *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (Policy Statement 31-103) related to the registration requirement for non-resident investment fund managers (the CSA October 2010 Proposal).

The CSA October 2010 Proposal provided that non-resident investment fund managers would be required to register in a CSA jurisdiction if the investment fund has security holders resident in that jurisdiction, and the investment fund manager or the investment fund actively solicited the purchase of the fund's securities by residents in that jurisdiction. The CSA October 2010 Proposal also provided for certain exemptions from the requirement to register as an investment fund manager.

The comment period for the CSA October 2010 Proposal ended on January 13, 2011. The CSA received 24 comment letters on the CSA October 2010 Proposal. Copies of the comment letters are posted on the Ontario Securities Commission website at [www.osc.gov.on.ca](http://www.osc.gov.on.ca) and on the Autorité des marchés financiers website at [www.lautorite.qc.ca](http://www.lautorite.qc.ca). Annex A of this notice provides a summary of these comments and our responses.

## **Summary of the Draft Regulation**

### ***Exemption from the investment fund manager registration requirement based on the absence of security holders or active solicitation***

Regulation 32-102 provides an exemption from the requirement to register as an investment fund manager in circumstances where there are no security holders of the investment fund, or active solicitation of residents, in the local jurisdiction. In those circumstances, we take the view that registration is not necessary to ensure investor protection. We propose guidance in the Policy Statement on what would and would not be considered active solicitation.

### ***Exemption from the investment fund manager registration requirement based on a distribution only to permitted clients***

Under the CSA October 2010 Proposal, an international investment fund manager, without a place of business in Canada, would have had an exemption from the investment fund manager registration requirement if the Canadian distribution of the fund's securities was restricted to permitted clients. Threshold limitations on fund assets attributable to Canadian investors were also proposed as a condition for this exemption. In view of the comments received, we are again proposing this exemption but without the threshold limitations.

***Notices to securities regulatory authority when relying on the permitted client exemption***

We propose to include a requirement to notify the securities regulatory authority of the reliance on this exemption, including disclosure of the assets under management attributable to investors in the local jurisdiction. This would provide the regulator with information for monitoring purposes. We also propose to include a requirement to file with the securities regulatory authority a notice of regulatory action.

***Notice to permitted clients***

We propose to include a requirement to notify the permitted client of the fact that the investment fund manager is not registered in the local jurisdiction together with certain prescribed disclosure. We do not expect international investment fund managers to notify the existing permitted clients who have invested in the fund at the time of coming into force of Regulation 32-102. Rather, the international investment fund manager will be required to provide this notice prior to any new permitted client making an investment after the coming into force of Regulation 32-102.

***Notice to investors by international investment fund managers***

Section 5 of Regulation 32-102 would require that an international investment fund manager give notice to investors which includes, in substance, the disclosure required pursuant to section 14.5 of Regulation 31-103. This requirement would come into effect on March 31, 2013.

***Transition***

We propose to adopt new temporary exemptions from registration for non-resident investment fund managers, which would be in effect until December 31, 2012. These investment fund managers would have until the end of this new transition period to apply for registration.

**Consequential Amendment to Policy Statement 31-103**

A draft consequential amendment to section 7.3 of Policy Statement 31-103 is published with this Notice. The purpose of this amendment is to provide references to applicable guidance on the registration requirement for non-resident investment fund managers. Each CSA member is proposing this amendment to Policy Statement 31-103.

**Anticipated Costs and Benefits**

The draft Regulation and Policy Statement provide clarity and guidance to the industry relating to the registration requirement for non-resident investment fund managers and strike an appropriate balance between providing an efficient system of registration and protecting investors.

**Alternatives Considered**

No alternatives to the Regulation were considered.

**Request for Comments**

We welcome your comments on draft *Regulation 32-102 respecting Registration Exemptions for Non-Resident Investment Fund Managers* and *Policy Statement to Regulation 32-102 respecting Registration Exemptions for Non-Resident Investment Fund Managers*.

Please submit your comments in writing on or before April 10, 2012. If you are not sending your comments by email, please send a CD containing the submissions (in

Microsoft Word format). Address your submission **only** to the following CSA members, as follows:

Autorité des marchés financiers  
 Ontario Securities Commission  
 New Brunswick Securities Commission  
 Financial Services Regulation Division, Service NL, Government of Newfoundland and Labrador

Please deliver your comments **only** to the addresses below:

M<sup>e</sup> Anne-Marie Beaudoin  
 Corporate Secretary  
 Autorité des marchés financiers  
 800, square Victoria, 22<sup>e</sup> étage  
 C.P. 246, tour de la Bourse  
 Montréal (Québec) H4Z 1G3  
 Fax : 514-864-6381  
[consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

John Stevenson, Secretary  
 Ontario Securities Commission  
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 Suite 1900, Box 55  
 Toronto, Ontario M5H 3S8  
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We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period.

## Questions

Please refer your questions to any of the following:

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## Annex A

**Summary of Comments and Responses of  
the Autorité des marchés financiers,  
the Ontario Securities Commission,  
the New Brunswick Securities Commission and  
the Financial Services Regulation Division, Service NL,  
Government of Newfoundland and Labrador  
to the Amendments Proposed by the CSA on October 15, 2010 to  
*Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing  
Registrant Obligations*  
and to *Policy Statement to Regulation 31-103 respecting Registration Requirements,  
Exemptions and Ongoing Registrant Obligations***

### Introduction

The Canadian Securities Administrators (the CSA) received 24 comment letters on the draft amendments to *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (Regulation 31-103) and *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations*. The amendments relate to the registration requirement for

- international investment fund managers that do not have their head office or principal place of business in a jurisdiction of Canada; and
- domestic investment fund managers that do not have a place of business in the local jurisdiction

(collectively, non-resident investment fund managers).

The amendments were published for comment on October 15, 2010 (the CSA October 2010 Proposal).

This document summarizes the written public comments received on the CSA October 2010 Proposal. This annex consolidates and summarizes the material comments and the responses of the Ontario Securities Commission, the Autorité des marchés financiers, the New Brunswick Securities Commission and the Financial Services Regulation Division, Service NL, Government of Newfoundland and Labrador (collectively, we or the jurisdictions). The responses are provided by theme.

### Drafting suggestions

We received some drafting comments on the draft amendments. While the draft *Regulation 32-102 respecting Registration Exemptions for Non-Resident Investment Fund Managers* (the Regulation or Regulation 32-102) and *Policy Statement to Regulation 32-102 respecting Registration Exemptions for Non-Resident Investment Fund Managers* (the Policy Statement) incorporate some of the suggestions, this document does not include a summary of any drafting changes.

### Comments outside the scope of the CSA October 2010 Proposal

We have not provided responses to the comments we received that are fact specific or outside the scope of the CSA October 2010 Proposal, including:

- registration fees
- national regulator
- redundancy of the investment fund manager registration requirement

- revisiting the definition of permitted client in section 1.1 of Regulation 31-103
- exemptions for federally regulated financial institutions in CSA jurisdictions other than Ontario.

## Responses to comments received

### 1. Registration Requirement

#### *Jurisdictional authority*

Many commenters suggested that an entity should only be required to register in those jurisdictions where it carries out some investment fund manager activities.

Also, some commenters did not agree that the ownership of securities of an investment fund, by a resident in the local jurisdiction should require investment fund manager registration, since this is not considered consistent with the statutory formulation of the investment fund manager registration requirement.

A number of commenters suggested that the CSA's proposed interpretation of the investment fund manager registration requirement was too broad and that the CSA should adopt a more narrow interpretation.

We are of the view that the distribution of the fund's securities in the local jurisdiction is a sufficient connecting factor to that jurisdiction.

Some commenters are of the view that the CSA October 2010 Proposal expands the meaning of "acting as an investment fund manager" by mixing in concepts related to distribution of and trading in securities, which they consider inappropriate given that distribution and trading are concepts that apply to dealers and not to the functions of an investment fund manager. The jurisdictions do not agree.

We are of the view that although we have dealer registration and prospectus requirements, these requirements do not provide the same ongoing protections or address the same risks that the draft amendments to the investment fund manager registration requirements aim to achieve.

#### *Investment fund manager registration does not reduce the risks to investors*

Some commenters have indicated that the registration requirements in the CSA October 2010 Proposal do not reduce the risks to investors associated with investment in an investment fund that would justify the additional financial and administrative burdens.

The jurisdictions do not agree. The investment fund manager category of registration is designed to address the ongoing operational risks of managing a fund.

In order to be registered, an investment fund manager will be required to meet certain criteria, and once registered, will have to comply with various regulatory requirements, including capital, insurance, financial reporting and proficiency requirements. Registered investment fund managers will also be subject to ongoing obligations to establish and maintain internal controls and risk management systems. These requirements aim to ensure that the investment fund manager has adequate resources and systems in place to carry out its functions.

#### *Investment fund manager registration in multiple jurisdictions of Canada*

Some commenters suggest that requiring an entity to register as an investment fund manager in multiple jurisdictions of Canada does not enhance regulatory oversight and investor protection. These commenters are of the view that registration in multiple jurisdictions is not without additional cost and administrative burdens, which will put additional strain on the financial and time resources of an investment fund manager.

The jurisdictions do not agree. The approach proposed by the jurisdictions is consistent with the registration of dealers and advisers in each jurisdiction where they trade securities or act as an adviser.

*“Look through” and “flow through”*

Several commenters are of the view that the requirement for a Canadian investment fund manager to register in multiple jurisdictions contradicts the CSA’s position that it will not “look through” an investment fund. These commenters have expressed that the investment fund manager registration requirement should not be based on the residency of investors of an investment fund.

We do not agree. There is no “flow-through” concept being applied either in the CSA October 2010 Proposal or in the draft Regulation.

## **2. Exemptions from the investment fund manager registration requirement**

### *Threshold limitations in the international investment fund manager exemption*

Many commenters raised concerns that the threshold limitations proposed in the exemptions from the investment fund manager registration requirement available to international investment fund managers (international investment fund manager exemption) were too restrictive and meaningless. This is because the proposed \$50 million threshold is too low, and many international investment fund managers would not be able to rely on the exemption and would need to register.

Other commenters have expressed that low threshold limitations may require an international investment fund manager to register as a result of market conditions or transactions in fund securities unrelated to subscriptions by Canadian investors, such as periodic redemptions by non-Canadian investors.

Some commenters have also raised concerns that the proposed threshold limitations may inadvertently create barriers for investments by permitted clients in non-Canadian investment funds. This is because the threshold limitation tests create costly monitoring issues. International investment fund managers will have to implement mechanisms to determine, at any time, whether a portion of the fair value of any of the funds structure is attributable to securities beneficially owned by residents of Canada. As a result, an international investment fund manager may be less likely to offer investment fund securities in Canada.

Certain commenters also suggest that the asset threshold limitations should not apply to an international investment fund manager that distributes the securities of its investment funds only to permitted clients. The comments suggest that permitted clients have less need for the investor protection that comes from the oversight of international investment fund managers as these are highly sophisticated clients who have resources to perform their own due diligence and continue to assess the ongoing services of the investment fund manager.

The jurisdictions agree that the proposed threshold limitations in the international investment fund manager exemption were too restrictive and we are not proposing them in the Regulation. This means that an international investment fund manager would no longer be required to monitor the assets of the fund attributable to residents of Canada in order to rely on the exemption.

### *Inconsistent with the international dealer and international adviser exemptions*

Some commenters are of the view that the CSA October 2010 Proposal is inconsistent with the other exemptions in Regulation 31-103 available to international dealers and advisers. This is because reliance on the international investment fund manager exemption requires that the investment fund manager monitor the value of the securities beneficially owned by Canadian investors, whereas other exemptions for international dealers and advisers focus on the type of security and type of client.



We have not included threshold limitations in the international investment fund manager exemption in the draft Regulation.

*International investment fund manager exemption - Investment funds formed or created in a foreign jurisdiction*

Some commenters suggested that the condition requiring an investment fund be formed or created in a foreign jurisdiction in the international investment fund manager exemption is not relevant. The jurisdictions agree and that condition does not form part of the exemption in the draft Regulation.

*Investment fund managers regulated in their home jurisdiction*

Some commenters are of the view that the CSA should tailor the regulatory framework with respect to investment fund managers that are also registered or regulated by their home jurisdiction or with their local regulator, or create a new exempt category of registration requiring mandatory disclosure.

We do not agree. Given the different regulatory approaches for investment fund regulation in foreign jurisdictions, we are not proposing that regulation in the home jurisdiction should be a condition to the international investment fund manager exemption. We will consider applications, on a case-by-case basis, from the investment fund manager registration requirement where an international investment fund manager cannot avail itself of an exemption.

*Active solicitation*

Some commenters have indicated that the “active solicitation” test relates to the distribution of securities, not to “acting as an investment fund manager”.

The criteria for “active solicitation” define an active step taken in the local jurisdiction. It is not a test for distribution. We use the concept of “active solicitation” to determine whether or not the fund or the investment fund manager has activities in the local market.

Some commenters are concerned that responding to unsolicited or administrative queries from current or prospective investors may be considered “active solicitation” and require registration.

We would not consider responding to inquiries of an administrative nature as “active solicitation”. We have included guidance in the Policy Statement to clarify what we mean by active solicitation.

### **3. Regulatory burden**

*Limited investment opportunities for Canadian investors*

Several commenters are of the view that the increased regulatory burden of an international investment fund manager having to register in Canada is not justified. These commenters have suggested that the increased regulatory burden may deter the presence of international investment funds in Canada, and reduce investment choices and opportunities for Canadian investors.

The investment fund manager category of registration is designed to address risks to investors associated with their investment in an investment fund by imposing regulatory requirements, including capital, insurance, financial reporting and proficiency which aims to ensure that the investment fund manager has adequate resources to carry out its functions. We are of the view that where an investment fund manager has an appropriate connection to a jurisdiction, investors should receive protection from these risks. This approach strikes an appropriate balance between providing an efficient system of registration and protecting investors.

*Proficiency and other registration requirements*

Some commenters are of the view that international investment fund managers will not be able to satisfy the registration requirements under the CSA October 2010 Proposal including those relating to compliance, capital, insurance, financial reporting and proficiency requirements particularly because some requirements are unique to Canada.

We do not agree. There are currently many foreign entities registered in other categories of registration that are subject to the registration requirements of Regulation 31-103, including the proficiency requirements. We will, however, consider applications for exemptive relief from certain registration requirements for international investment fund managers on a case-by-case basis, where appropriate.

*Financial reporting*

Some commenters are of the view that complying with the financial statement reporting obligations, particularly the requirement to prepare financial statements in accordance with Canadian GAAP is burdensome for international investment fund managers. We do not agree. Section 3.15 of *Regulation 52-107 respecting Accounting Principles and Auditing Standards* recognizes acceptable accounting principles other than Canadian GAAP for foreign registrants.

**4. Other comments***Notice of non-resident status of domestic investment fund managers*

Several commenters are of the view that it is unnecessary for a non-resident investment fund manager to provide notice of its non-resident status to its clients in each jurisdiction. The notice requirement we propose would apply only to investment fund managers whose head office or principal place of business is outside Canada.

*Outsourcing*

One commenter suggests that the non-resident registration requirement, for an investment fund manager that outsources or delegates its investment fund manager activities to a service provider in a jurisdiction other than where it has a place of business, is not consistent with the existing guidance on outsourcing and does not provide additional protections.

We agree that the delegation of certain functions by an investment fund manager would not, on its own, require the investment fund manager to register in the jurisdiction where the service provider is located. However, the investment fund manager is responsible for these functions and must supervise the service provider. If an entity delegates or outsources activities to a service provider to such a level that the service provider is directing or managing the business, operations or affairs of an investment fund in the jurisdiction, then the service provider must also register as an investment fund manager.

**List of commenters**

- Alternative Investment Management Association
- BlackRock, Inc.
- BNP Paribas Investment Partners Canada Ltd.
- Borden Ladner Gervais LLP
- Brandes Investment Partners & Co.
- Canadian Imperial Bank of Commerce
- Canadian Pension Plan Investment Board
- Capital International, Inc.
- Davies Ward Phillips & Vineberg LLP
- Fidelity Investments Canada ULC
- GreyStone Managed Investments Inc.
- Invesco Trimark Ltd.
- Managed Funds Association
- Marathon Asset Management LLP
- McMillan LLP
- Orbis Investment Management Limited
- Pension Investment Association of Canada
- Portfolio Management Association of Canada
- RESP Dealers Association of Canada
- Stikeman Elliott LLP
- The Canadian Advocacy Council for Canadian CFA Institute Societies
- The Investment Adviser Association
- The Investment Funds Institute of Canada
- Veronica Armstrong Law Corporation