Companion Policy 31-501CP
Registration Requirements, Exemptions and Related Matters

PART 1 INTRODUCTION AND DEFINITIONS

1. Introduction
2. Definitions
3. Interpretation

PART 2 REGISTRATION REQUIREMENTS

6. Over-the-counter trading and reporting

PART 3 EXEMPTIONS FROM THE REQUIREMENT TO REGISTER

8. Non-resident investment fund manager

Companion Policy 31-501CP
Registration Requirements, Exemptions and Related Matters

PART 1 INTRODUCTION AND DEFINITIONS

1. Introduction

Purpose of this Companion Policy

This Companion Policy explains how the Authority interprets and applies the provisions of CMRA Regulation 31-501 *Registration Requirements, Exemptions and Related Matters* (the Regulation).

Numbering system

Except for Part 1, the numbering of Parts and sections in this Companion Policy correspond to the numbering in the Regulation. Any general guidance for a Part appears immediately after the Part name. Any specific guidance on sections in the Regulation follows any general guidance. If there is no guidance for a Part or section, the numbering in this Companion Policy will skip to the next provision for which there is guidance.

2. Definitions

Unless defined in the Regulation, terms used in the Regulation and in this Companion Policy have the meaning given to them in the Act, CMRA Regulation 11-501 *Definitions, Procedure, Civil Liability and Related Matters*, or National Instrument 14-101 *Definitions*.

3. Interpretation

For the purposes of Part 2 of this Companion Policy, “dealer” has the same meaning as the term “investment dealer” in section 1 of the Regulation.

PART 2 REGISTRATION REQUIREMENTS

6. Over-the-counter trading and reporting

Application

The requirements in subsections 6(3) through 6(10) of the Regulation do not apply to dealers that deliver to the Authority an undertaking in the form of Form 31-501F1 *Undertaking* not to trade in securities of OTC issuers.

On occasion, a client of a dealer that has delivered an undertaking to the Authority may wish to make an isolated trade in securities of an OTC issuer. To accommodate these circumstances, the undertaking includes an exception. If a dealer wants to rely on the exception, it must record the relevant details of the trade, including:

- the name of the issuer,
- the number of securities traded,
- the date of the trade,
- the price, and
- the circumstances that the dealer believed brought the trade within the exception.

Depending on the circumstances of the trade, there may be additional information that is also relevant to creating an audit trail demonstrating that the trade fits within the exception.
Dealers who file an undertaking, and later decide to withdraw it, must provide the Authority with 10 days' advance written notice before they can trade in securities of OTC issuers.

Risk management

Section 11.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) requires a dealer to manage the risks associated with its business in accordance with prudent business practices.

The risks associated with trading securities of OTC issuers include the risks related to trading by market participants who engage in illegal, manipulative market activities through the over-the-counter markets in the United States.

A typical scenario involves unscrupulous promoters who, through deceptive means, gain control of an OTC issuer, then promote it by making misleading disclosure. After the stock price rises significantly, the promoters sell their shares into the market to unsuspecting investors. Since the company has no legitimate business or prospects, the stock soon becomes worthless. The promoters walk away with profits and the new investors lose their investment.

A primary indicator of risk is the acquisition by an individual closely connected to the issuer of large quantities of securities from private placements.

To comply with the requirements of section 11.1 of NI 31-103, dealers should implement policies and procedures that establish a system of controls and supervision that is effective in managing these risks. An effective system would include regular monitoring to ensure it is working as intended.

Monitoring, recordkeeping and reporting

(a) Requirement

Subsection 6(3) requires dealers to record and report data related to trading in securities of OTC issuers through an office in a CMR Jurisdiction. The Authority will use this data to monitor the impact of section 6 on trading in those securities.

Some of the data may also be useful to dealers as part of the systems they use to manage the risks associated with trading in securities of OTC issuers. For example, it may help dealers detect disproportionate or anomalous trading in those securities.

(b) Risk indicator

A primary indicator of risk is the deposit of shares of OTC issuers by insiders, control persons, founders and persons who conduct or cause to be conducted investor relations activities relating to the OTC issuer (closely-related persons). These deposits can enable a closely-related person to sell the securities to public investors at inflated prices through the US OTC markets. Both electronic deposits and physical deliveries made through an office in a CMR Jurisdiction must be recorded and reported under subsection 6(3).

(c) Refused deposits of OTC issuer securities

Paragraph 6(3)(d) requires dealers to record the number of deposits of OTC issuer securities they refuse under subsection 6(10). For each refused deposit, dealers must report in Form 31-501F2 *Investment Dealer Trading in OTC Issuer Securities* (Form 31-501F2) all relevant information about the securities and the reason the deposit was refused. Relevant information includes:

- the date of the attempted deposit,
- the name of the issuer,
- the number of securities, and
- the name of the client.

Depending on the circumstances, there may be additional information that is also relevant.

(d) Obligations of introducing and carrying brokers

Where an introducing broker is in a relationship with a carrying broker, the introducing broker is responsible for monitoring, recording and reporting OTC trading activity through offices in CMR Jurisdictions. The carrying broker should assist the introducing broker in gathering the information necessary for the introducing broker to comply with section 6 of the Regulation. If the introducing broker is not subject to section 6 (because, for example, it is located outside a CMR Jurisdiction), but the carrying broker is subject to the Regulation, the carrying broker is responsible for monitoring, recording and reporting OTC trading activity through offices in CMR Jurisdictions.

(e) Derivatives

When calculating commissions under subsection 6(3), dealers should not include commissions earned from derivatives since the reports required under subsection 6(3) relate to equity securities.

(f) Fee-based accounts

Subsection 6(3) requires affected dealers to report commissions earned by the dealer from trading OTC issuer securities through an office in a CMR Jurisdiction. Where clients trade OTC issuer securities through fee-based accounts, dealers should report either

(a) the pro-rated portion of all fees earned during the reporting period based on the proportional value of OTC issuer securities traded in the fee-based account as follows:

(i) calculate the total value of all OTC issuer securities traded in the fee-based account for the quarter,

(ii) calculate the total value of all securities, including OTC issuer securities, traded in the fee-based account for the quarter,

(iii) divide (i) by (ii) to calculate the proportional value of OTC issuer securities traded in the fee based account, and

(iv) multiply (iii) with the fees earned from the fee-based account for the quarter;

or

(b) the total fees collected from one or more segregated accounts created for the purpose of trading OTC issuer securities.

(g) Joint commissions

If a dealing representative has joint or shared commissions with another dealing representative, dealers should specify in Form 31-501F2 the amount of commissions that each dealing representative receives from the dealer.

(h) Salaried dealing representatives

If a dealing representative receives a salary from the dealer, rather than commissions, the dealer may include the Chief Compliance Officer's name in item 3 of Form 31-501F2 (rather than the dealing representative's names) along with the commissions earned from trading OTC issuer securities through offices in CMR Jurisdictions.

Form 31-501F2 that the dealer submits should state in the "Additional comments" section that dealing representatives receive salaries from the dealer rather than commissions.

(i) Nil report

We do not require a report for any quarter in which the dealer has not traded any securities of OTC issuers.

Establishing beneficial ownership

Subsections 6(4) through 6(6) require dealers to identify the beneficial owner of securities of an OTC issuer a client seeks to sell, and to determine that person's relationship with the issuer.

(a) Dealer's responsibility

Dealers act as gatekeepers of the markets, and help to prevent illegitimate and abusive market activity. In part, this means that dealers must be able to form a reasonable belief that they know

the true identity of each beneficial owner of the OTC issuer securities. If a dealer's inquiries show that a holding company, or some other entity other than an individual, is the beneficial owner, subsection 6(4) requires the dealer to make further inquiries to establish the identities of the individuals who control that entity.

To comply with subsection 6(4), dealers should use reasonable and reliable methods to determine beneficial ownership and the relationship between the beneficial owner (or person who gives trading instructions on the account) and the OTC issuer. This might include, for example:

- if the client is not the beneficial owner, direct contact with those the client has identified as the beneficial owner,
- a review of account activity,
- confirmation of information with the OTC issuer,
- making independent inquiries with third parties.

Ultimately, dealers are responsible for ensuring that the desired outcome is achieved – to identify the beneficial owner (and those who control non-individual beneficial owners) of the OTC issuer securities to be traded.

(b) Obligations of custodians for omnibus or institutional client accounts

To comply with subsections 6(4) through 6(6) for omnibus or institutional client accounts, a dealer will have to apply the requirements to the beneficial owner.

If the account holder is another dealer that is subject to the requirements of section 6, the dealer in its capacity as custodian should enter into an agreement with the account holder stating that the account holder agrees to be responsible for meeting the requirements of section 6.

Form 31-501F2 that the custodian submits should identify the account holder and state that the account holder has agreed to be responsible for meeting the requirements of section 6for that account. The custodian may provide this information in the "Additional comments" section of Form 31-501F2.

(c) Accounts of foreign institutions

To comply with subsections 6(4) through 6(6) for accounts of foreign institutions, a dealer will have to delve beyond agency relationships to identify the actual beneficial owner. If, because of bank secrecy or similar legislation, the dealer cannot satisfy itself of the information required by section 6, subsection 6(4) prohibits the dealer from selling the securities.

(d) Previous inquiries

If a dealer has already made inquiries of a client under subsections 6(4) through 6(6) about the client's ownership of securities of a particular OTC issuer and the client's relationship to it, the dealer is not required to make those inquiries again in the absence of indications that the circumstances have changed. Dealers should apply their judgment about whether these indications are present. For example, significant changes in trading volume or frequency, or

unusual deposits of securities into the client account may suggest that circumstances have changed sufficiently for the dealer to make further inquiries.

Responsibility of designated individual

Subsections 6(7), (9) and (10) impose obligations on the dealer's designated individual.

A dealer may choose the most appropriate individual to appoint as its designated individual to manage and enforce the dealer's obligations under section 6, provided that the individual has the qualifications set out in subsection 6(8).

A dealer must not accept physical deposits of securities of an OTC issuer without the approval of the designated individual. A dealer can accept other forms of transfers of securities of OTC issuers, such as Depository Trust Company transfers and delivery against payment orders, but cannot execute orders to sell those securities until it complies with subsections 6(4), (5) and (6).

A physical deposit of securities of an OTC issuer is a primary indicator of risk. Before accepting a physical deposit of securities of an OTC issuer, a dealer should ensure that the designated individual makes all the inquiries required under subsections 6(4), (5) and (6).

A dealer's supervision and compliance system should identify those who will act as alternates in the absence of the designated individual. The designated individual remains responsible for the activities of any delegate and should ensure the delegate has adequate knowledge and experience to perform the role of the designated individual.

PART 3 EXEMPTIONS FROM THE REQUIREMENT TO REGISTER

8. Non-resident investment fund manager

This guidance applies to 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 are domestic investment fund managers which do not have a place of business in a CMR 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.

Requirement to register as an investment fund manager

An investment fund manager is required to register if it directs or manages the business, operations or affairs of one or more investment funds. Some of the functions and activities that an investment fund manager directs, manages or performs include:

- establishing a distribution channel for the fund,
- marketing the fund,

- establishing and overseeing the fund's compliance and risk management programs,
- overseeing the day-to-day administration of the fund,
- retaining and liaising with the portfolio manager, the custodian, the dealers and other service providers of the fund,
- overseeing advisers' compliance with investment objectives and overall performance of the fund,
- preparing the fund's prospectus or other offering documents,
- preparing and delivering security holder reports,
- identifying, addressing and disclosing conflicts of interest,
- calculating the net asset value (NAV) of the fund and the NAV per share or unit,
- calculating, confirming and arranging payment of subscriptions and redemptions, and arranging for the payment of dividends or other distributions, if required.

Where to register as an investment fund manager

(a) Investment fund managers with a place of business in a CMR Jurisdiction

An investment fund manager is required to register in a CMR Jurisdiction if it directs or manages the business, operations or affairs of one or more investment funds from a place of business in that jurisdiction.

(b) Non-resident investment fund managers

An investment fund manager is also required to register if it directs or manages the business, operations or affairs of an investment fund from outside a CMR Jurisdiction and knows or reasonably ought to know that the investment fund has a security holder resident in the jurisdiction.

To the extent the person is acting as an investment fund manager, the next question is whether the non-resident investment fund manager is managing one or more investment funds that have a security holder in a CMR Jurisdiction.

If one or more of the investment funds managed by the investment fund manager have a security holder in a CMR 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.

Exemptions from investment fund manager registration

(a) General

An investment fund manager cannot rely on the exemptions in section 8 of the Regulation in a CMR Jurisdiction if the investment fund manager is registered to conduct the activities covered by the exemption in that particular CMR Jurisdiction or in any other CMR Jurisdiction. We expect registrants to conduct activities within a CMR Jurisdiction under their category of registration, in full compliance with securities legislation.

Generally, a non-resident investment fund manager will not be required to register if

- the investment fund has security holders in a CMR Jurisdiction but has not actively solicited residents in a CMR Jurisdiction after the CMR launch date,
- the security holders are permitted clients.

No active solicitation

(a) Conditions of the exemption

An investment fund manager that does not have a place of business in a CMR Jurisdiction is exempt from the investment fund manager registration requirement if there is no active solicitation by the investment fund manager or any of the investment funds in a CMR Jurisdiction after the CMR launch date.

(b) Active solicitation

One of the conditions of this exemption is that the investment fund manager and the investment funds it manages have not, after the CMR launch date, actively solicited the purchase of the funds' securities by residents in a CMR Jurisdiction. Active solicitation refers to intentional actions taken by the investment fund or the investment fund manager to encourage a purchase of the fund's securities, such as pro-active, targeted actions or communications that are initiated by an investment fund manager for the purpose of soliciting an investment.

Actions that are undertaken by an investment fund manager at the request of, or in response to, an existing or prospective investor who initiates contact with the investment fund manager would not constitute active solicitation.

Examples of active solicitation include:

- direct communication with residents of a CMR Jurisdiction to encourage their purchases of the investment fund's securities,
- advertising in Canadian or international publications or media (including the internet), if the advertising is intended to encourage the purchase of the investment fund's securities by residents of a CMR Jurisdiction (either directly from the fund or in the secondary/resale market),
- purchase recommendations being made by a third party to residents of a CMR Jurisdiction, if that party is entitled to be compensated by the investment fund or

the investment fund manager, for the recommendation itself, or for a subsequent purchase of fund securities by residents of a CMR Jurisdiction in response to the recommendation.

Active solicitation would not include:

- advertising in Canadian or international publications or media (including the internet) only to promote the image or general perception of an investment fund,
- responding to unsolicited enquiries from prospective investors in a CMR Jurisdiction,
- the solicitation of a prospective investor that is only temporarily in a CMR Jurisdiction, such as in the case where a resident from another jurisdiction is vacationing in a CMR Jurisdiction.

Permitted clients

An investment fund manager that does not have its head office or its principal place of business in Canada is exempt from the investment fund manager registration requirement if the outstanding securities of its investment funds have been distributed in a CMR Jurisdiction to permitted clients only and certain other conditions set out in subsection 8(4) are satisfied.

If an investment fund manager is relying on the exemption, it must provide an initial notice by filing a Form 31-501F3 *Submission to Jurisdiction and Appointment of Agent for Service for International Investment Fund Manager* (Form 31-501F3) with the Chief Regulator. If there is any change to the information in the investment fund manager's Form 31-501F3, the investment fund manager must update it by filing a replacement Form 31-501F3 with the Chief Regulator. So long as the investment fund manager continues to rely on the exemption, it must file an annual notice with the Chief Regulator. Subsection 8(5) does not prescribe a form of annual notice. An e-mail or letter will therefore be acceptable.

If an investment fund manager is relying on the exemption in more than one CMR Jurisdiction, it may satisfy the requirement to file a Form 31-501F3, annual notice and Form 31-501F4 *Notice of Regulatory Action* by making a single filing with the Chief Regulator. Such filing will constitute a filing under the Act in all CMR Jurisdictions.