

## REGISTRATION REFORM ROUND TWO: Key features for investment fund managers, foreign funds and private equity funds

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This newsletter forms part of a series of updates prepared by Stikeman Elliott's Securities Group on the second round of **registration reform proposals issued in February of 2008.**

On February 29, 2008, the Canadian Securities Administrators (CSA) published their revised proposals relating to national registration requirements for dealers, advisers and investment fund managers. Over 260 comment letters were received on the original proposals (published in February of 2007). These proposals constitute an overhaul of registration requirements and registration exempt activities, and are intended to present a streamlined and harmonized approach to the regulation of investment activities across Canada. The revised proposals are open for comments until May 29, 2008.

The key features of the revised proposals with respect to Canadian investment fund managers, mutual fund dealers, foreign investment funds offered into Canada on a private placement basis and private equity funds include the following:

### Registration of investment fund managers

- > Persons or companies which are "investment fund managers" (i.e., which are permitted to direct the business, operations and affairs of an investment fund) will be required to register and comply with prescribed "fit and proper" requirements, conduct rules and conflicts of interest standards.
- > The key elements of this new category of registration include: (a) a registration requirement for a person or company acting as an investment fund manager; (b) two new categories of individual registration requiring all registered investment fund managers to designate an individual as the ultimate designated person (UDP) and the chief compliance officer (CCO); (c) proficiency requirements for the CCO (but not the UDP); (d) insurance requirements; (e) a \$100,000 minimum excess working capital requirement (for non-SRO members); and (f) conduct rules.
- > Under the "new business trigger" for registration (which will apply in most, but not all, provinces), additional dealer or adviser registrations will be required if the investment fund manager is also engaged in the business of trading or advising in securities as a business. The CSA have expanded the guidance for the business trigger test and indicated that firms registered in multiple categories will have to comply with the most stringent "fit and proper" requirements and conduct rules.

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- > The CSA have clarified that investment fund managers will be required to register only in the jurisdiction where the investment fund manager is located.
- > The Ontario Securities Commission (OSC) has clarified that investment fund managers which are registered or exempt from registration in Ontario will be required to pay capital market participation fees under OSC Rule 13-502 *Fees*.

## **Foreign investment funds**

- > The new registration rule will introduce significant changes to the private placement rules on the basis of which foreign fund offerings have been effected in Canada. The main change is the repeal, for the most part, of the dealer registration exemptions contained in National Instrument 45-106 *Prospectus and Registration Exemptions*, including the exemption for trades with "accredited investors" and the introduction of a universal dealer registration requirement based on the new business trigger for registration.
- > The first draft of 31-103 had given rise to considerable uncertainty with respect to the application of the dealer, adviser and investment fund manager registration requirements in cross-border fund offerings. In response to significant comments on this issue, the CSA have made a number of changes which, if adopted, should simplify the process of privately placing foreign fund securities to a new category of super-accredited investors called "permitted clients". These permitted clients are a subset of the "accredited investor" category and include institutional and similar entities, as well as qualified high net worth individuals (net financial assets over C\$5M), entities legally and beneficially owned by qualified individuals and qualified corporations (shareholders' equity over C\$100M).
- > First, the revised proposals introduce key exemptions from the dealer and adviser registration requirements for qualified "international dealers" and "international advisers" engaging in certain limited trading and advisory activities with "permitted clients".
- > As a result of these exemptions, the securities of foreign investment funds could be sold into Canada either to a "permitted client" through a dealer registered in a foreign jurisdiction which relies on the international dealer registration exemption or through a locally registered dealer to any other category of accredited investor. Certain other limited types of fund offerings which would not trigger the application of the dealer registration requirement under the new business trigger test could potentially be made directly to any Canadian-resident accredited investor.
- > Second, the CSA have effectively discarded the application of the "look through" principle historically applied by the OSC as a result of which the foreign portfolio manager of a non-resident investment fund which issues securities to Ontario-resident investors is deemed to be providing advice in Ontario and is therefore subject to the adviser registration requirement unless an exemption is available. However, unless the international dealer exemption is available, the offering of securities of non-resident funds in any province will generally have to be made through a locally registered dealer.
- > Third, the CSA have clarified that if an investment fund manager is located outside of Canada, there is no requirement for it to be registered as an investment fund manager in Canada, unless it is directing the management of an investment fund from inside Canada.

## **Private equity funds – venture capital**

- > The application of the proposed registration rules with respect to private equity funds and a range of other funds which do not fall within the definition of "investment fund" for purposes of the securities rules is uncertain. In response to substantial comments seeking greater clarity as to the specific application of the business trigger test, the CSA have issued additional guidance with respect to activities they characterize as "venture capital" investing.
- > In particular, the CSA have noted that the "expectations and reliance of investors" must be considered when applying the business trigger factors to venture capital.
- > The Companion Policy gives specific guidance in respect of registration requirements for general partners of limited partnerships, specifically in the portfolio manager context. For example, if the purpose of the limited partnership is to invest in a trading portfolio of securities and the limited partners are relying on the general

partner's expertise in selecting and transacting securities, the CSA would require that the general partner register as an adviser.

- > Conversely, the Companion Policy indicates that the adviser registration requirement will not necessarily be triggered in cases where, for example, a limited partnership is operating as a venture capital fund and the general partner's role is to select small private companies that the general partner will actively manage and develop. The stated basis for the CSA's position in this context is that the purchase and sale of the securities of these companies is incidental to the general partner's activities on behalf of the limited partners.
- > The CSA have also clarified that M&A specialists advising parties to a transaction would not be required to register as advisers since the business purpose of these specialists is to effect corporate transactions and not to trade in securities. The CSA have not specifically addressed the trading aspect of these activities but presumably the same analysis applies.

### **Dealer registration exemption for pooled funds sold to fully-managed accounts**

- > The revised proposals include a dealer registration exemption for registered advisers or advisers relying on the "international adviser" exemption covering the purchase and sale of securities of pooled funds administered by the adviser for fully-managed accounts established and managed by the adviser.
- > The exemption is only available if the adviser gives written notice to the relevant regulator within 5 business days of the first use of the exemption and if the fully-managed account or the pooled fund is not created or used primarily to qualify for the exemption.

### **SRO relief**

- > The revised proposals include broader relief from a number of "fit and proper" and conduct-related requirements for registrants that are members of an SRO, including the Investment Dealers Association of Canada (IDA) and the Mutual Fund Dealers Association of Canada (MFDA) or Quebec-registered mutual fund dealers which comply with the rules applicable to mutual fund dealers in Québec.

### **Mutual fund dealers**

- > Following public consultations in 2007, the *Autorité des marchés financiers* of Québec (AMF) has indicated that Québec mutual fund dealers, scholarship plan dealers and investment contract dealers and their representatives which are currently subject to the Quebec *Act respecting the distribution of financial products and services* will become subject to securities laws, including 31-103. They will continue to be supervised by the AMF and their representatives will continue to be required to be members of the *Chambre de la sécurité financière*. They will not be required to become members of the MFDA.
- > The CSA have also clarified the ability of mutual fund dealers in certain jurisdictions (excluding Québec) to trade in securities of investment funds that are labour sponsored investment fund corporations or labour sponsored venture capital corporations and, in British Columbia, securities of scholarship plans or educational trusts.

### **Transition**

The amendments to the original proposals now also include specific transition provisions. Existing registrants will, in most cases, be deemed to be registered in the equivalent new category (and given six months to comply with new requirements, such as relationship disclosure and complaint handling). New registrants, such as investment fund managers, will have six months to apply for registration and to comply with most of the requirements of the new rules.

Please visit our website, at [www.stikeman.com](http://www.stikeman.com), for further detailed updates on these developments in upcoming weeks. Updates published by Stikeman Elliott on the original proposals are also available on our website.

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