

investment funds and asset management bulletin

August 2008

Legal Considerations In Establishing A Hedge Fund Administration Business In The Province Of Ontario

Introduction

The following is intended to provide you with a broad overview of some of the legal matters which you may wish to consider in making a decision to provide hedge fund and other administrative services from the Province of Ontario.

Registering Business Name for a Non-Incorporated Business

In order to operate a hedge fund administration business in Ontario, you are required to either register your existing business name in the Province or establish a new entity. The name under which a business operates constitutes that business' trade-name. This is so regardless of whether it is the name of a corporation, a partnership, or an individual.

In situations where you have chosen not to establish a new entity or if the entity established operates under a different trade-name, you will need to register the new business trade-name with the Province of Ontario. Shortly after registering the new business name, you will receive a Master Business Licence. You may then register the business name in several ways. The registration is valid for five years.

Before registering a business name, you must check to see whether the name is already in use. Ontario provides an Enhanced Business Name Search service which allows all business names registered with the Ontario Ministry of Government Services to be searched.

Incorporation

If you intend to provide administration services through a newly incorporated company you will have the option to incorporate such entity either federally (under the *Canada Business Corporations Act*) or provincially (under the *Business Corporations Act* (Ontario)). Incorporation under the laws of other Canadian provinces or territories may also be considered but, in such case, the company would need to register as an extra-provincial corporation in the Province of Ontario.

Registrations Required for an Administration Business

Generally speaking, there are no specific registrations, licences or proficiency requirements related to the provision of administrative services in Ontario. However, if you intend to provide certain ancillary services to your clients,

registration under certain laws may be required. If you intend to offer the services of a trustee, bailee, agent, executor, administrator, receiver, liquidator, assignee, guardian of property or attorney under a power of attorney for property, and you receive deposits from clients and lend or invest such deposits, then you must be registered under the *Loan and Trust Corporations Act* (Ontario) (the "LTCA").

Anti-Money Laundering and Anti-Terrorism Requirements

Administrators must also familiarize themselves with the applicable Canadian anti-money laundering and anti-terrorism requirements in connection with the performance of certain administrative services such as the processing of subscription and redemption payments. These requirements are monitored and published in Canada by the Financial Transactions and Reports Analysis Centre (FINTRAC), a specialized agency created by the federal government under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (Canada) and the regulations thereto (collectively, the "AML Act").

Under the AML Act, Administrators have client identification obligations, particularly with respect to transactions that are not conducted in a "face-to-face" manner with clients. For example, when opening an account for a corporation or other entity, you are required to take reasonable measures to obtain the names, addresses and occupations of all persons with ownership or control of 25 percent or more. When opening an account for an individual, you must take reasonable steps to determine whether the client is a "politically exposed foreign person". You must also identify any individual or entity conducting a large cash transaction and determine whether a third party is involved. With respect to non-face-to-face account openings, firms are required to ascertain clients' identities using prescribed combinations of 2 identification methods.

You must report any suspicious transactions related to money laundering or terrorist activity financing, any property suspected to be owned or controlled by a terrorist group and all large cash transactions or international electronic funds involving amounts greater than \$10,000.

In addition, Administrators have record keeping obligations under the AML Act, and must keep records on, among others, large cash transactions, account operating agreements, official corporate records, account holder information, new account applications, confirmations or purchase or sale, guarantees, trade authorizations, powers of attorney, joint account agreements, certain correspondence, account statements, suspicious transaction reports and beneficial ownership records.

Finally, an Administrator is required to implement an anti-money laundering compliance program and will need to: (i) appoint an anti-money laundering compliance officer; (ii) assess the risks of being used for money laundering and terrorist financing purposes and document the measures to mitigate the risks; (iii) prepare written policies and procedures for compliance; (iv) implement an ongoing anti-money laundering training program; and (v) review the effectiveness of the above at least once every two years.

If you engage in the activities listed above but only as an agent or mandatary for a hedge fund manager, you are not required to register but the hedge fund manager will have to register and provide information about all of its agents or mandataries.

Tax Considerations

In 2008, an Administrator operating as an Ontario resident corporation would generally be subject to tax at the corporate rate of 33.5% (comprised of a federal tax rate of 19.5% and an Ontario tax rate of 14%). However, if administration services are being provided to an offshore fund (ie. not resident in Canada) you will have to consider whether the provision of such services would result in the offshore fund becoming subject to taxation in Canada. In general terms, provided that certain conditions are satisfied, an offshore fund will not be considered to be carrying on business in Canada (and therefore subject to tax in Canada) solely because a "Canadian service provider" provides "designated investment services" to the offshore fund. These conditions vary according to whether the offshore fund is a corporation, trust or partnership. In addition, there is a further condition limiting the level of ownership by the Administrator

(or its affiliates) in the offshore fund which is aimed at ensuring that a reasonable measure of independence exists between the Administrator and the offshore fund.

Intellectual Property - Trade-marks

If the Administrator has been using a word, design, combination of words and designs, or slogan to distinguish wares or services manufactured, sold, leased or performed by the business from those manufactured, sold, leased or performed by others, then the Administrator should consider registering that trade-mark under the *Trade-marks Act* (Canada) in order to benefit from the exclusive right to use the mark throughout Canada for fifteen years (and registration may be renewed indefinitely). A registration application may be based on actual use or proposed use of the mark in Canada or, in certain circumstances, on the basis of registration and use in a foreign country.

Investment Canada Act

Whenever a non-Canadian establishes a new Canadian business or acquires control of an existing Canadian business (regardless of whether that "Canadian business" is then owned by non-Canadians), a notification under Canada's foreign investment legislation is required. This is a straightforward two-page form. There is no filing fee and, in the ordinary course, submission of the form does not trigger a substantive review.

Currency or Exchange Controls

Notably, neither Ontario nor Canada has a system of currency or exchange controls restricting the repatriation of Canadian business capital or earnings to non-Canadian investors.

Immigration Considerations

In general, only a Canadian citizen or permanent resident may work in Canada without a valid employment authorization. Non-resident employees

of the Administrator may seek either temporary or permanent permission to work in Canada. The employment authorization procedure seeks to ensure that positions secured by non-Canadians could not have been filled from the Canadian labour force.

Labour and Employment Law Considerations

When the Administrator becomes an employer in Ontario, there are certain responsibilities that arise, including: registration with the Ontario Ministry of Labour; regular payments on behalf of the employees and contributions to the federal and provincial governments (for example, for Income Tax, Canada Pension Plan, Employment Insurance, paid vacation and statutory holidays), maintenance of employee records and provision of a safe and non-discriminatory workplace.

In addition, the Administrator must abide by standards for employment and occupational health and safety under the responsibility of the Ministry of Labour, including the following Ontario laws *Employment Standards Act*, *Pay Equity Act*, *Occupational Health and Safety Act* and *Smoking in the Workplace Act*.

Conclusion

The above summary is intended to assist you in determining the suitability of operating your business from the Province of Ontario. The guide in no way constitutes an exhaustive analysis of the statutes, regulations and conventions relevant to doing business in Ontario. Accordingly, Administrators hoping to establish a business in Ontario are strongly encouraged to consult with their own legal, tax and business advisors as well as Ontario legal counsel prior to making a decision to operate in the Province of Ontario.

Written by Michael Burns, Wendy Chun and Laura Stoddard.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

ABOUT McMILLAN LLP

McMillan LLP, a leading Canadian business law firm, is committed to advancing our clients' interests through exemplary client service combined with thoughtful and pragmatic advice. The firm is a values-driven organization that takes a dynamic and sophisticated approach to providing practical and creative solutions to its clients. Our client first, team-based approach draws effectively upon our diverse expertise. The firm has a national, cross-border and international practice and has grown to be one of the top 20 largest firms in Canada. The firm is agile and flexible, and committed to always striving for excellence.

The lawyers in McMillan LLP's Investment Funds and Asset Management Group carry on a broadly based legal practice, which includes expertise in the development and ongoing operation of hedge funds, closed-end funds, labour-sponsored funds, private equity funds, structured products such as principal protected notes and, of course, conventional publicly offered mutual funds.

Our lawyers have a long history of involvement with the Canadian investment funds industry and, in particular, have been involved in the Canadian hedge fund industry since its inception. We helped build the Canadian hedge fund market and we continue to stay at the leading edge as the industry matures. In addition, the group has extensive experience in helping Canadian based managers reach foreign investors through the use of offshore structures and assisting foreign-based managers in making their products available to Canadian investors.

Applying a wealth of experience and creativity, the lawyers in the group are able to deliver a complete range of legal services to investment fund managers and distributors, from advising on securities regulatory, derivatives and tax issues to designing innovative products and bringing them to market. A keen knowledge of the players and the marketplace (domestic and global) gives the group an edge in helping clients achieve their goal, whether it be successfully launching a new fund or product or ensuring the continued growth of an existing family of funds.

For further information, please contact one of the McMillan LLP investment funds and asset management lawyers listed below:

Michael Burns	416.865.7261	michael.burns@mcmillan.ca
Margaret C. McNee	416.865.7284	margaret.mcnee@mcmillan.ca
Jennifer A.C. Parkin	416.865.7109	jennifer.parkin@mcmillan.ca
Kimberly Poster	416.865.7890	kimberly.poster@mcmillan.ca
Mark D. Pratt	416.865.7141	mark.pratt@mcmillan.ca

www.mcmillan.ca



McMillan LLP

Toronto | t 416.865.7000 | f 416.865.7048
Montreal | t 514.987.5000 | f 514.987.1213

Barristers & Solicitors