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mcmillan investment funds and asset management bulletin

further reforms to the registration regime in Canada

The Canadian Securities Administrators (***CSA***) published on April 15, 2011 amendments (***Amendments***) to National Instrument 31-103 *Registration Requirements and Exemptions* (***NI 31-103***), Companion Policy 31-103CP *Registration Requirements and Exemptions* (***Companion Policy***), certain forms under NI 31-103 as well as to related instruments. The Amendments deal with both technical adjustments and more substantive matters, and are expected to come into force on July 11, 2011. Once the Amendments are in force, NI 31-103 and the Companion Policy will be renamed as *Registration Requirements, Exemptions and Ongoing Registrant Obligations.*

In this bulletin, we provide an overview of the Amendments that will have a greater effect on the registration obligations of investment fund industry participants.

investment fund manager registration requirements

repeal of prior guidance on investment fund manager registration for limited partnerships

Any person or company with a head office in Canada that directs the business, operations or affairs of an investment fund must be registered as an investment fund manager. Since the obligations of this category of registration are quite onerous and include capital and insurance requirements, many groups of affiliated investment funds have organized themselves such that only one entity performs the operational functions of investment fund manager for all the funds in the group. In particular, many groups which manage funds organized as limited partnerships have delegated management duties to one affiliate. Such delegation was specifically contemplated in the current Companion Policy, which provides guidance to the effect that

multiple registrations may not be necessary if each general partner in the affiliated group enters into a contract with one registered investment fund manager within the group (who is not the general partner). Presumably, this was permissible because such entity, and not the general partner, was the entity actually exercising direction over the operation of the fund.

However, this guidance is being repealed as part of the Amendments, and the CSA now considers that simply delegating the investment fund manager functions to a registered entity within the fund complex is insufficient for registration purposes. Fund complexes which have more than one entity that can be considered to direct the business, operations or affairs of an investment fund (including any general partner) will be directly affected by the change and may require multiple investment fund manager registrations. In situations where an investment fund manager is subject to registration but wishes to delegate the management function to a registered affiliate instead of registering itself as an investment fund manager, the CSA expects an application to be made for discretionary relief from the registration requirements.

The new guidance will increase the costs of compliance for investment fund complexes or groups because they will be required to expend time and effort to prepare and file an exemption application for discretionary relief (the Ontario filing fees for which are currently $3250 for an organization that pays capital markets participation fees (i.e., registrant firms and unregistered exempt international firms) and $5250 for an organization that does not pay such participation fees). If an exemption is not sought (or granted), the fund complex will face substantially greater costs of compliance if more than one entity is required to obtain registration as an investment fund manager. This is particularly problematic for general partner corporations, which are often initially thinly capitalized.

Exemption applications will be considered on a case-by-case basis, and the CSA has indicated that the following factors will be considered when reviewing such applications:

- if there is a management agreement in place delegating all or substantially all of the investment fund management function to an affiliate registered as an investment fund manager;

- if the majority of the investment fund management functions are performed by the registered affiliate; and
- if the investment fund manager seeking the relief and the registered affiliate have directors and officers in common.

It is currently unclear what other representations or undertakings will be required to be made by applicants in order to obtain relief or what conditions may be imposed on the filers. We anticipate that a large number of applications will be submitted due to this new guidance.

investment fund manager registration for funds organized as trusts or corporations

In addition to the commentary with respect to limited partnerships/fund complexes, the CSA has added guidance to the Companion Policy with respect to their expectations for registration in situations where the board of directors or the trustee(s) of an investment fund are themselves directing the business, operations or affairs of an investment fund and there is no separate legal entity. In these circumstances, the investment fund itself may be considered the investment fund manager and therefore required to register in the investment fund manager category. The CSA also indicate that further terms and conditions may be imposed in order to address investor protection concerns and the practical issues of applying ongoing registration requirements to an investment fund. These new provisions may be particularly relevant to non-resident investment funds in light of the proposed amendments to NI 31-103 released on October 15, 2010 with respect to the registration requirements applicable to international investment fund managers. On a positive note, the CSA has extended the transition period for international investment fund managers to September 28, 2012 (a one year extension) while they review comments submitted on the proposed October amendments.

clarifications on use of international dealer and international adviser exemptions

Many foreign dealers and advisers rely on the exemptions provided in NI 31-103 to international dealers and international advisers to undertake limited activities in Canada, primarily with

very high net worth individuals and institutions that qualify as "permitted clients". The Amendments clarify that a "permitted client" must be a Canadian permitted client (i.e., a resident of Canada if an individual, governed by the laws of a jurisdiction of Canada if a trust, or otherwise incorporated, organized or continued under the laws of a jurisdiction of Canada or of Canada).

A new adviser exemption is provided to persons and companies who are exempt from the dealer registration requirement under the international dealer exemption, if the person or company provides advice to a client and the advice is in connection with the activity or trade made in reliance on the dealer exemption, and is not in respect of a managed account of the client. This additional exemption will be helpful to those persons who may have been unable to rely on the international adviser exemption.

The international adviser exemption is not available if more than 10% of the aggregate consolidated gross revenue of the adviser, its affiliates and affiliated partnerships is derived from portfolio management activities in Canada. The Amendments clarify that the 10% limit should only be calculated as at the end of the adviser's most recently completed financial year and not on an ongoing basis.

Prior to trading with a Canadian permitted client (as an international dealer) or providing advice to a Canadian permitted client (as an international adviser), the dealer or adviser must provide the client with specified notices. The Amendments vary the requirements of the prescribed notice, but as the amendments are not retroactive, existing clients need not be sent a revised notice. However, existing forms of client notices should be reviewed in light of the new prescribed language for future use.

In addition, dealers and advisers must notify the regulator if they have relied on the exemption during the preceding 12 month period by December 1 of each year (the current requirement is to notify the regulator 12 months after the person first provides a submission to jurisdiction and appointment of agent for service to the regulator).

time limits for proficiency requirements

The CSA has relaxed slightly some of the proficiency requirements with respect to examinations. An individual must generally have passed the required exams within 36 months prior to the date of his or her application for registration. NI 31-103 currently provides an exemption if the individual was registered in the same category for any 12 months during the previous 36 month period, and the Amendments will instead provide an exemption if the individual was registered at any time during the 36 month period.

In addition, the CSA will now recognize the Chief Compliance Officers Qualifying Exam as an alternative examination to the PDO Exam in certain cases and will generally not require a person who has earned the CFA Charter to write the Canadian Securities Course.

investment fund trades by advisers to managed accounts

Under the Amendments, the CSA has augmented an exemption from the dealer registration requirement by eliminating the previous restriction that the trade must be of a non-prospectus qualified investment fund. By relaxing the exemption to include all investment funds, the Amendments will provide an exemption from dealer registration to an adviser trading in the securities of an investment fund, if the adviser acts as the adviser and investment fund manager of the investment fund and distributes units of the investment fund only to the managed accounts of the adviser's clients.

financial reporting for IIROC and MFDA members

Under the Amendments, the CSA will allow a registered firm that is a member of the Investment Industry Regulatory Organization of Canada (***IIROC***) and that is also registered as an investment fund manager to calculate its minimum capital and its risk adjusted capital in accordance with the IIROC Form 1 Joint Regulatory Financial Questionnaire and Report instead of the Form 31-103F1 Calculation of Excess Working Capital (***Form 31-103F1***). Following the same policy rationale, the CSA will also

allow a mutual fund dealer that is a member of the Mutual Fund Dealers Association of Canada (***MFDA***) and that is also registered as an exempt market dealer, scholarship plan dealer or investment fund manager to calculate its minimum capital and its risk adjusted capital in accordance with the Form 1 MFDA Financial Questionnaire and Report instead of the Form 31-103F1.

content and delivery of trade confirmations

The CSA has added a new requirement for registered investment fund managers to send a trade confirmation to a security holder when the investment fund manager executes a redemption order received directly from a security holder. However, the CSA clarified that this requirement is not intended to apply to trades by an adviser that is also an investment fund manager relying on the dealer registration exemption for trades to managed accounts discussed above.

account statements

Where there is no dealer of record, an investment fund manager will be required to send account statements to investors at least once every 12 months in the prescribed form.

dispute resolution services

Following the industry comments received on the requirement to make dispute resolution services available to clients, the CSA decided not to list the specific matters that require independent dispute resolution and instead maintained the existing requirement to provide such dispute resolution services for any trading or advising activity. In addition, the CSA has extended the transition period for the coming into force of these provisions to September 28, 2012 (a one year extension) for all registrants that have been registered since September 28, 2009, except those registered in Québec. The purpose of this extension is to allow the CSA to further consider this regime in light of the comments received and the CSA has indicated that further proposed amendments may be published for comments in the future.

conclusion

Investment funds and investment fund managers should familiarize themselves with the Amendments, and in particular, managers with multiple entities and/or those within a group of affiliated limited partnerships should review and evaluate which entities can be considered as directing the business, operations or affairs of an investment fund in light of the new CSA guidance. If other entities may require registration in one or more Canadian jurisdictions, such fund complexes may wish to make the necessary exemption applications, or make adjustments to their capitalization and contractual arrangements to conform to the requirements of NI 31-103 and prepare registration applications as soon as possible.

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