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Limited Market Dealers Association of Canada

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June 18, 2007

VIA email: jstevenson@osc.gov.on.ca

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c/o Ontario Securities Commission
20 Queen Street West, 19th Floor, Box 55
Toronto, ON M5H 3S8
Attention: John Stevenson, Secretary

Dear Sirs and Mesdames

Re: Proposed National Instrument 31-103 *Registration Requirements*

This submission is made by the Limited Market Dealers Association of Canada ("LMDA") in reply to the request for comments published February 23, 2007 on proposed National Instrument 31-103 *Registration Requirements* ("Proposed NI 31-103").

Our comments are presented in the following order: general comments, comments in answer to specific requests contained in the request for comments (and which are reproduced below in italics and numbered to correspond to the notice) and additional comments on certain aspects of Proposed NI 31-103.

General Comments

We are supportive of the Canadian Securities Administrator's (the "CSA") Registration Reform Project to harmonize, streamline and modernize the registration regimes across Canada. We are, however, concerned that, while the CSA states in Proposed NI 31-103 that the CSA held industry consultations for the past two years,[1] the CSA chose not to consult the LMDA with respect to how Proposed NI 31-103 might affect the existing limited market dealers/exempt market dealers ("LMD/EMDs"). We are extremely concerned that Proposed NI 31-103 does not take into consideration the diversity of business models under which LMD/EMDs operate or the diversity of products and services LMD/EMDs provide.

We note that the CSA states that one of the purposes of Proposed NI 31-103 is to " reduce regulatory burden and increase regulatory efficiency".[2] However, Proposed NI 31-103 as drafted will have the distinct opposite effect for LMD/EMDs. We are concerned about the additional regulatory burden that Proposed NI 31-103 will impose on capital market participants and the ability of the regulators to adequately process the influx of registration applications or requests for exempt relief that we believe will follow should Proposed NI 31-103 be implemented as drafted. Moreover, the number of such applications, their associated filing fees and the ensuing regulatory oversight costs resulting from Proposed NI 31-103 will cause increased costs for the venture capital market in both time and money. These increased costs do not appear to be justified by any real or apparent investor protection concerns with respect to the LMD/EMD industry, nor has the CSA provided any specific industry concerns from issuers or investors that support the level of regulatory burden Proposed NI 31-103 will impose on the LMD/EMD industry.

The CSA states that they "looked at the scope of the market problems or risks".[3] However, the imposition of the working capital, financial Institution bond, audit and account reporting requirements on LMD/EMDs that do not hold or possess client assets reflects the absence of prior consultation with participants in the LMD/EMD industry. The LMDA respectfully submits that the risks associated with the various business models employed by LMD/EMDs have not been adequately evaluated by the CSA and the issues we address herein speak to that lack of evaluation.

Our membership has advised us that the working capital, financial Institution bond, audit and account reporting requirements will increase the cost of operations prohibitively for LMD/EMDs such that many LMD/EMDs may have to exit the market place. We also note that there is no proposed provision for an exemption from the working capital, financial Institution bond, audit and account reporting requirements for those LMD/EMDs that do not hold client assets. We believe this is a significant oversight in Proposed NI 31-103.

We concur with the British Columbia Securities Commission that the LMD/EMD registration requirements as contemplated will have a negative effect on the ability of issuers to raise venture capital, in British Columbia, and we respectfully submit that the negative effects of Proposed 31-103 will be felt in the venture capital market throughout Canada. The LMDA believes that the issues we have identified herein are the result of the absence of prior consultation with the LMD/EMD industry and request that the initial comment period be extended to allow LMD/EMDs to fully address their concerns to the CSA. The LMDA further requests the CSA engage LMD/EMDs in an extensive consultation process to ensure that

[1] National Instrument 31-103, *Registration Requirements*, Supplement to OSC Bulletin, February 23, 2007, p. 4.

[2] *Ibid*, p. 6.

[3] *Ibid.*

when the final version of Proposed NI 31-103 is implemented it will provide a positive effect on capital formation and market integrity without unwarranted disruption to the LMD/EMD industry.

Specific Comments

Fit and proper and conduct requirements

Question #1: What issues or concerns, if any, would your firm have with the proposed fit and proper and conduct requirements for exempt market dealers? Please explain and provide examples where appropriate.

a) Proficiency Requirements for LMD/EMDs

Requirement	Current Requirement	Comment
Proficiency Requirements for an Exempt market dealer include: (i) the Canadian Securities Exam and either the Conduct and Practices Handbook Exam or the Partners, Directors and Senior Officers Exam; (ii) the Series 7 Exam and the New Entrants Exam; or (iii) meet the requirement of a Portfolio Manager - Advising Representative	None	(i) The "relevant experience" guidance contained in s. 4.4 of the Companion Policy[4] states that the regulator may grant an exemption based on qualifications or relevant experience equivalent to, or more appropriate in the circumstances than, the prescribed proficiency requirements. This guidance should be codified in Proposed NI 31-103 to ensure that current registrants (Limited Market Dealers or "LMDs") and current exempt market participants that will be registered as exempt market dealers ("EMDs") pursuant to Proposed NI 31-103 are granted an exemption ("grandfathered") based on their experience in the LMD/EMD industry. The exemptions should include an exemption for professionals and other LMD/EMD industry participants (i.e. lawyers, accountants, real estate brokers) possessing qualifications and/or experience relevant to the LMD/EMD industry.

Proposed NI 31-103 will impact a significant number of exempt market dealers that have operated in the LMD/EMD industry for several years prior to the implementation of Proposed NI 31-103. The "real life education" LMD/EMDs have obtained over years of experience in the marketplace has not been, we submit, adequately considered in Proposed NI 31-103 and we submit that an exemption for current LMD/EMDs should be provided from the proficiency requirements of Proposed NI 31-103 as drafted. The LMDA supports the CSA objective of harmonizing the proficiency requirements across Canada; however, Proposed NI 31-103 does not take into consideration the diversity of LMD/EMD business models, the relevant experience of LMD/EMD participants or other proficiency requirements LMD/EMDs possess that are more applicable to the services LMD/EMDs provide to their clients than the proficiency requirements as proposed.

b) Capital Requirements

Requirement	Current Requirement	Comment
LMD/EMD Firms will be required to maintain excess working capital of at least $50,000 plus certain other capital requirements including, the deductible on their	None	(i) A significant number of LMD/EMDs find this provision prohibitive because they do not handle client assets. In addition, there does not appear to be any correlation between the excess working capital requirement and the risk to the investor given the nature of an LMD/EMD's operation. The "excess working capital" requirement does not serve an investor protection function where an LMD/EMD

[4] *Ibid*, Companion Policy, s. 4.4, p 77.

Financial Institution Bond ("FIB") insurance policy.		does not hold client assets in a trust account or where the LMD/EMD does not operate under a business model that has an obligation to counterparties. (ii) The CSA states that the excess working capital requirement serves as a solvency requirement to ensure that a registered firm can meet the demands of its counterparties and, if necessary, wind down its business without loss to its clients.[5] However, where LMD/EMDs do not hold client assets and have no obligations to counterparties with respect to such assets or to distribute such assets to their clients when they wind down their operations, this requirement serves no legitimate business function. An exemption should be provided to this requirement in situations where the LMD/EMD does not hold client assets or property in trust. (iii) "Excess working capital" should not be used as a barrier to entry into the LMD/EMD market place nor as a pseudo "proficiency and experience" qualification where there are no client assets at risk. We note that the levels of FIBs required appear to be activity or risk based calculations whereas the "excess working capital" requirement does not appear to be related to an LMD/EMD's business model or the risk associated to the investor where an LMD/EMD does not hold client assets. The "excess working capital" requirement should take similar factors into consideration when determining whether an LMD/EMD actually holds client assets that may be at risk and an exemption provided where the LMD/EMD does not hold client assets (iv) We note that pursuant to s. 4.17 of Proposed NI 31-103,[6] "advisors" who do "not hold, handle or have access to client's cash or assets" are not required to comply with the higher FIB requirements of section 4.16 of Proposed NI 31-103.[7] Since a significant number of LMD/EMDs also do not hold or have access to client assets, the LMDA proposes that if a solvency requirement is imposed on LMD/EMDs it should be $25,000 (the same level as "advisors").

The LMDA would like to draw to the CSA's attention that the CSA has not identified any significant risks to issuers, investors or other market participants in capital markets serviced by the LMD/EMD industry, such as the CSA did with Investment Fund Managers.[8] This provision of Proposed NI 31-103 as drafted over-regulates a non-existent situation for a significant number of LMD/EMDs. The LMDA believes this provision of Proposed NI 31-103 is incongruent with the stated propose of reducing regulatory burden and increasing regulatory efficiency and an exemption from this provision should be provided for LMD/EMD registrants.

Ultimate Designated Person ("UDP") and Chief Compliance Officer ("CCO")

Question #4: Registration of the UDP and CCO is proposed. As well, we propose that the UDP be the senior officer in charge of the activity carried on by a firm that requires the firm to register. What issues or concerns, if any, would your firm have with these registration requirements? Do you think the registration of the UDP and CCO contributes to or detracts from a firm wide culture of compliance? Please explain.

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[5] *Ibid*, Companion Policy, s. 4.1(3), p 76.

[6] *Ibid*, s. 4.17, p. 37.

[7] *Ibid*, s. 4.16, p 36.

[8] *Ibid*, p. 8

Requirement	Current Requirement	Comment
Proficiency Requirements for an Exempt market dealer – Chief Compliance Officer (i) The Canadian Securities Exam, and the Partners, Directors and Senior Officers Exam; or (ii) The Series 7 Exam and the New Entrants Exam.	None	(i) The "relevant experience" guidance contained in s. 4.4 of the Companion Policy[9] states that the regulator may grant an exemption based on qualifications or relevant experience equivalent to, or more appropriate in the circumstances than, the prescribed proficiency requirements. This guidance should be codified in Proposed NI 31-103 to ensure that LMD/EMDs are granted an exemption from the CCO proficiency requirements based on their relevant experience in the LMD/EMD industry. The exemptions should include an exemption for professionals and other LMD/EMD industry participants (i.e. lawyers, accountants, real estate brokers) possessing qualifications and/or experience relevant to the position of CCO

Insurance

Question #8: The Rule requires dealers, advisors and fund managers to have Financial Institution Bonds. In cases where the owners of the firm also carry out the operations and registerable activity of the firm, usually in small firms, are these bonds prohibitively costly to obtain and will the bonds provide coverage if they are obtained in these situations?

Requirement	Current Requirement	Comment
LMD/EMDs will be required to maintain a Financial Institutional Bond with clauses A to E in the greater of: (i) (i) $50,000 per employee or $200,000, whichever is less; (ii) 1% of the client assets the dealer handles, holds or has access to, or $25,000,000 whichever is less; or (iii) 1% of the dealers total assets or $25,000,000, whichever is less.	None	(i) The levels of FIBs required appear to be activity or risk based calculations but do not appear to be related to an LMD/EMD's business model or the risk associated to the investor where an LMD/EMD does not hold client assets. The FIB requirement should take into consideration whether an LMD/EMD actually holds client assets that may be at risk and an exemption should be provided from the FIB requirement where the LMD/EMD does not hold client assets.

Additional Comments

Financial Reporting Requirements

Requirement	Current Requirement	Comment
(i) LMD/EMDs will be required to deliver to their respective Commission annual audited statements and a calculation of excess working capital, within 90 days after their	None	(i) Because of greater demand for audit services in recent years, the cost of audit services has become significantly higher. Given the simple business models of most LMD/EMDs, their low capital requirements and the fact that that a significant number of LMD/EMDs do not hold client assets or property in trust (which LMD/EMDs will therefore not have ongoing capital requirements to meet demands of counterparties or to any need to hold additional capital to protect their clients against

[9] *Supra.*

fiscal year-end. (ii) LMD/EMDs will also be required to file with the regulator 30 days after the end of each of the first, second and third quarter of its fiscal year, its financial statements for the quarter, and also a calculation of working capital for each of these quarters.		loss when the LMD/EMD winds down its business), imposing an audit requirement for all LMD/EMDs, will provide little or no additional regulatory protection for the investing public while placing a significant capital burden on LMD/EMDs. (ii) Section 3.1 of the OSC Rule 31.503 *Limited Market Dealers* provides an exemption for LMDs with respect to providing audited financial statements to the regulator with the filing of an application or renewal of application to register as a LMD. A similar exemption from the requirement to supply audited financial statements to the regulator should be included in S. 4.22 of Proposed NI 31-103 for LMD/EMDs. (iii) We draw the CSA's attention to the relevant provisions of the *Income Tax Act* (Canada) pursuant to which a declaration that the financial information contained in the filer's return is true and accurate provides adequate comfort for Canada Revenue. If the Government of Canada, which derives income from these filings, finds sufficient comfort in such a declaration, we submit that such a declaration should provide sufficient comfort to the regulator, pending a legitimate reason to request an audit of an LMD/EMD's financial statements. We also note that pursuant to s. 4.21 the Proposed NI 31-103,[10] each LMD/EMD grants the regulator the right to request the LMD/EMD's appointed auditor[11] to provide the regulator with an audit or review should one be required. (iv) We also note that pursuant to s. 4.23 of Proposed NI 31-103, an "advisor" only has to file financial statements and Form 31-103 F1 *Calculation of Excess Working Capital* at the end of the year. Since a significant number of LMD/EMDs also do not hold client cash or assets, these LMD/EMDs should be provided with an exemption to the statement filings requirement such that these statements are unaudited and that they are only required to be filed on a yearly basis, rather than quarterly.

Imposing this audit requirement on LMD/EMDs will only serve to increase the cost of capital as these additional transaction costs will ultimately be transferred on to the issuers. This audit requirement derives its genesis from the working capital requirement referred to above. LMD/EMDs that do not hold client assets do not have counterparty obligations and are not in possession of property that has to be distributed back to clients should an LMD/EMD elect to wind up its operations. Moreover, the removal of the working capital requirement for LMD/EMDs would make the requirement for this provision redundant. The LMDA would also like to draw the CSA's attention to s. 4.20 and s. 4.21 of Proposed NI 31-103,[12] which gives the regulator the authority to cause an audit to be conducted on a registrant should the regulators so require. The LMDA believes that this provision provides the regulatory authorities with sufficient power to address situations of concern to the regulators as they occur, without imposing excessive audit requirements on LMD/EMD's universally, which requirements will cause LMD/EMDs to incur significant cost increases and drastically increase their regulatory burden. Moreover, the auditing of LMD/EMDs operating statements, especially where LMD/EMDs do not hold client assets, will provide limited additional security to capital market participants.

[10] *Ibid*, s. 4.23, p 38.

[11] *Ibid*, s. 4.20, p. 37.

[12] *Supra.*

Statements of Accounts

Requirement	Current Requirement	Comment
(i) An LMD/EMD must send a statement of account to each client not less than once every three months. (ii) The statement must show any debit or credit money balances and, the details of securities held for or owned by the client, unless otherwise requested by the client.	None	(i) Because a significant number of LMD/EMDs do not hold client assets and because many LMD/EMD transactions are one-off exempt market financings it serves no useful purpose to require LMD/EMDs to provide investor clients with account balance statements of $0.00 on a regular basis as contemplated in the Proposed NI 31-103. Therefore the CSA should provide an exemption to this provision of Proposed NI 31-103 for those LMD/EMDs that do not hold client assets. To do otherwise is to regulate a situation that does not exist. (ii) Other industry participants such as SRO participants are only able to provide these statements through the acquisition of expensive accounting software programs. An LMD/EMD holding no client assets and limited amounts of working capital should not be compelled to incur unnecessary transaction costs where there is no rational connection to their business model.

Complaints – Dispute Resolution Services

Requirement	Current Requirement	Comment
A registered firm must allow clients the option of resolving their complaint through a dispute resolution service. Upon receipt of a client compliant, the registered firm must (i) Notify the person or company that a dispute resolution service is available to mediate the compliant, and (ii) Inform the complainant on how to use the service. Proposed NI 31-103 further requires that a registered firm have (i) written policies and procedures for documenting investigating, and resolving a complaint; and (ii) Within two months after the end of it's fiscal year (or on any other specific date mandated by the applicable securities regulatory authority), each LMD/EMD must file a	None	(i) S 5.12 of the Companion Policy[13] differentiates between an "expression of dissatisfaction" and a "complaint". These definitions need to be codified in Proposed NI 31-103 as many "expressions of dissatisfaction" can, we submit, be resolved before they become "complaints". (ii) Additionally, a complaint in the companion policy is "an unresolved expression of dissatisfaction" that has been referred to the LMD/EMD's compliance staff. In a small LMD/EMD, this could mean that all "expressions of dissatisfaction" are "complaints" because the person fulfilling the role of CCO may also be the UDP, the dealing representative and the person ultimately responsible for resolving the "expression of dissatisfaction" at the outset. (iii) A dispute resolution service should not be required for LMD/EMDs as their investor clients are by definition sophisticated individuals or institutions (i.e. accredited investors) that have the financial means to litigate where no reasonable resolution to a dispute appears possible. Many smaller LMD/EMDs will have fewer resources for dispute resolution services than the investors they serve. Moreover, LMD/EMDs do not have a financial advantage over their investor clients possessed by SROs; therefore a dispute resolution service requirement is not only an inequitable requirement for LMD/EMDs, it is prohibitively expensive and unnecessary.

[13] *Ibid*, Companion Policy, s. 5.12, p. 83.

report with the Regulator explaining its complaint handling policies and, the number and type of the complaints received during the reporting period.		

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The above comments are respectfully submitted by the Board of Directors of the Limited Market Dealers Association of Canada on behalf of its membership. While the submission of the Board of Directors of the LMDA addresses the most egregious issues of Proposed NI 31-103, some individual members of the LMDA have additional concerns. The concerns outlined in their individual comment letters reflect the diversity of the LMD/EMD industry as well as the absence of consultation by the CSA with the LMD/EMD industry prior to releasing Proposed NI 31-103 for comment.

The Board of Directors of the Limited Market Dealers Association of Canada wishes to thank you for this opportunity to comment on Proposed NI 31-103.. If you have any questions, please direct them to Brian Prill, Chairman of the Limited Market Dealers NI 31-103 Comment Committee (461) 362-5632, bprill@lmdacanada.com

Yours very truly,

Board of Directors
Limited Market Dealers Association
BLP/sh