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May 29, 2008

Via Email

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Authorité des marches financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

c/o John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
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Fax: (416) 593-2318
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- and -

c/o Anne-Marie Beaudoin
Secrétaire de l'Autorité
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Dear Sirs and Mesdames:

RE: NOTICE AND REQUEST FOR COMMENT ON PROPOSED NATIONAL INSTRUMENT 31-103 *REGISTRATION REQUIREMENTS*

This letter is provided in response to the Canadian Securities Administrators ("CSA") notice and request for comment dated February 29, 2008 in relation to proposed National Instrument 31-103 *Registration Requirements* ("NI 31-103").

We act for, and are providing these comments on behalf of, a market participant who engages in the distribution of securities to investors across Canada, primarily in reliance on exemptions from the prospectus and registration requirements of applicable securities laws.

General Comments on Exempt Market Dealer Registration

Increased Cost Without a Corresponding Benefit

As an initial comment, our client would like to express its general objection to the introduction of rules that will impose registration requirements on exempt market dealers. Our client submits that the increased cost to capital that will result upon implementation of the proposed rules will have little corresponding benefit, namely increased investor protection. Our client is not alone in its objection noting the following:

- of the comment letters submitted on the first publication of the proposed rules, over 95% of the letters that discussed the exempt market dealer registration requirements objected to the requirements[1]; and
- the British Columbia Securities Commission and the Manitoba Securities Commission have opted out of the regime concluding that, based on their internal analysis and consultations, the increased regulatory burden does not provide a corresponding benefit to their capital markets.

Based on our client's experience raising capital in the exempt market across Canada, our client knows that the cost for it to raise capital in Ontario under the limited market dealer model is much higher than raising the same capital in other provinces due to the infrastructure our client requires in Ontario. Under the proposed exempt market dealer model, these costs will only be higher because of the additional requirements that will be imposed. But it is not the increased cost of compliance that is of primary concern to our client. It is the fact that the CSA has not demonstrated that there will be a corresponding benefit outweighing these costs. Given that Ontario has had the limited market dealer model since 1987, the Ontario Securities Commission (the "OSC"), in particular, should be able to demonstrate that this model has been more effective at protecting investors in Ontario compared to investors in other provinces and territories. Our understanding, based on OSC Staff Notice 11-758, is that this is not the case.

The costs of the requirements are not insignificant. Our client estimates it incurred approximately $200,000 to establish a limited market dealer in Ontario. Limited market dealers are required to comply with a subset of the proposed exempt market dealer requirements, in particular, the know-your-client obligation and to ensure that all trades are suitable for clients. Our client estimates it will incur another $50,000 to $75,000 primarily for legal, accounting and IT fees to enhance its systems to ensure they will comply with the additional exempt market dealer requirements and approximately $150,000 to $200,000 per year to operate each regional office. These costs are required to (i) maintain minimum working capital of $50,000; (ii) maintain minimum levels of insurance; (iii) develop relationship disclosure; (iv) provide clients with quarterly account reporting, (v) maintain certain books and records; (vi) establish systems to prepare and file quarterly and audited annual financial statements; (vii) update and implement new compliance policies and procedures; (viii) establish and maintain a complaint handling system; (ix) develop conflicts of interest policies and procedures; and (x) train all of its employees in connection with the new policies and procedures. Our client believes that the regulators will need to increase their operations to provide the necessary oversight of exempt market dealers. Our client is concerned that annual fees levied by the regulators on exempt market dealers may be significantly increased in the future as a result. Ultimately, we are concerned that the requirements for registering and operating as an exempt

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[1] ASC's power point for the Exempt Market Participant Information Sessions held in April 2008.

market dealer will be prohibitive to many smaller dealers. Given the significant costs of the requirement, we submit that the corresponding benefit, namely investor protection, should also be significant.

Our client also believes that its investors are not seeking the protections that registration affords. From its experience in Ontario, our client has found that investors typically resist giving the limited market dealer salesperson the information about their finances, taxes, other investment portfolio holdings and employment earnings that is necessary to perform a suitability review and assess risk tolerance. The investors do not understand why a salesperson is required to, in effect, "second guess" the investor when those same investors are deemed to be sophisticated enough to be able to make their own investment decisions without the benefit of a prospectus. Our client believes that investors outside of Ontario who do not have to be accredited investors if they are purchasing under the offering memorandum exemption will also resist this "second guessing" even more because, based on our client's experience, these investors are generally investing smaller amounts and are only dealing with the salesperson for a specific securities product and not for investment advice regarding their portfolio.

Based on our client's data regarding the capital it raised across the county last year, twice as much was raised in Alberta than in Ontario from four times as many investors whose size of investment was about half the size of an Ontario investor's. Similarly, in British Columbia, Saskatchewan and Manitoba, the average size of the investment is also approximately half that of an Ontario investor's. In *The Alberta Capital Market: Exempt Market Study March 2004,* the Alberta Securities Commission (the "ASC") considered this phenomenon of increased numbers of investors investing smaller amounts to be an indication of the success of the exemptions implemented in 2002 and now brought into NI 45-106. From that study, the ASC concluded that:

> [t]he MI 45-103 Exemptions seem to have been effective in increasing access to equity capital by small and medium sized issuers and allowing more investors to participate while providing appropriate investor protection.

Due to the increased costs to meet the exempt market dealer requirements, our client believes that many small investors and small operations will likely be squeezed out of the market. An exempt market dealer may need to increase the average size of the investor's investment to merit the administrative costs of account management, recording and reporting. Many smaller entities who provide exempt market investment opportunities to investors and who do not have access to significant deal flow, may not be able to continue to participate in the exempt market. Rather than increasing investor protection, the exempt market dealer requirements may have the corresponding unintended result of reducing investor choice and decreasing access to equity capital.

No Identifiable Market Harm

In 2002, the members of the CSA (other than the OSC), made a deliberate decision to significantly expand the exempt market by adopting the "accredited investor" and "offering memorandum" prospectus exemptions and were, at that time, satisfied that registration as a dealer was not required for anyone who traded in securities in reliance on these exemptions. Dealers in this expanded exempt market outside of Ontario have been unregistered for more than six years.

We would respectfully request the members of the CSA (other than the OSC) to clearly articulate what their specific experiences have been in overseeing the exempt market since 2002 that led these jurisdictions to take a completely opposite view and conclude that dealers in the exempt market must now be fully registered. In particular, we would respectfully request that the members of the CSA (other than the OSC) clearly identify the harm to the capital markets in their respective jurisdictions that will be perpetuated or created if exempt market dealers remain unregistered.

It is submitted that the proposed instrument will not stop fraud (e.g., the deliberate effort to improperly rely on prospectus exemptions). Instead, it will simply increase the compliance burden on those market participants who are already inclined to comply. In this respect, to the extent that the proposed registration of exempt market dealers is meant to permit regulators to assert jurisdiction over participants and maintain effective oversight of the exempt market, there are a number of ways that this can be accomplished in a manner that is far less intrusive and burdensome than the proposed registration regime, for example, a notice and submission to jurisdiction filing.

No Harmonization

One of the stated goals and benefits of NI 31-103 is to achieve the harmonization of securities laws across Canada. In this respect, we note that as it relates to the registration of exempt market dealers, Canada will be no further ahead after the implementation of NI 31-103. Prior to NI 31-103, two provinces had rules that were different from the rest of Canada (Ontario and Newfoundland required the registration of market intermediaries who were dealing in the exempt market). And after NI 31-103, two provinces will still have rules different from the rest of Canada because British Columbia and Manitoba will opt out of the exempt market dealer registration requirements as they relate to their local markets. The result is that the rules that apply to the sales of securities in the exempt market across Canada will continue to be determined by the residency of the investor and the location of the dealer.

Specific Comments on Exempt Market Dealer Registration

Handling Client Funds

NI 31-103 provides exempt market dealers with certain exemptions provided that they do not "handle, hold or have access to client assets, including cheques and other similar instruments". In this circumstance, exempt market dealers will not be required to meet the minimum capital requirement, the minimum insurance requirement, the audited annual financial statement filing requirement and the account activity reporting requirement. While there is no definition of handling client assets, the companion policy provides guidance indicating that a registrant will be handling client assets if, among other things, it "handles client cheques in transit (e.g., a cheque made payable to a third-party issuer)".

We would submit that this interpretation of handling client assets is overly broad and essentially will result in the nullification of the exemption. We believe that almost all exempt market dealers, including those who act solely as M&A advisors, will at some point in time act as a courier and facilitate the delivery of funds from an investor to an issuer.

We are also of the view that registrants who only ever act as a delivery service in respect of client funds (i.e., collect and deliver funds payable directly to the issuer in lieu of having the investor courier funds to the issuer directly) should not be required to comply with the minimum capital requirement, the audited financial statement filing requirement and the account activity reporting requirement. We believe it would be prudent for such registrants to maintain appropriate modified minimum levels of insurance to protect investors from loss of the funds (in transit or otherwise) and dishonest or fraudulent acts of employees.

The minimum capital requirement is, as described in the companion policy, "intended to ensure a registered firm can meet the demands of its counterparties and, if necessary, wind down its business in an orderly fashion without loss to its clients." To the extent that an investor's funds never flow through the accounts of the registrant and the registrant only acts as a delivery service, investors will likely not suffer any harm resulting from the collapse of the registrant (since the registrant will not have the ability to access or misuse the investors' funds). Upon the collapse of a registrant, the potential harm to the investor is that his or her funds are lost in transit, which concern can be covered by insurance.

Furthermore, we submit that an annual audit of a registrant's financial statements is not required in circumstances where client funds are not reflected on the accounts of the registrant, particularly in circumstances where the regulator can request an audit at any time.

Finally, in circumstances where investors' funds and securities are not held on behalf of an investor in an account maintained by the registrant for such purposes (i.e., funds are provided directly to the issuer and the securities are held directly by the investor), we submit that regular account reporting is not necessary, since there will be nothing to report.

Delivery of Quarterly Account Statements

NI 31-103 requires registrants to provide clients with quarterly account statements. A number of securities products sold in the exempt market are limited partnership units in respect of long term investments (i.e., 5 to 10 year investment return time horizon) that are reported at book value until a future liquidity event. In these circumstances, clients who purchase these types of securities will be provided with up to 40 statements (assuming a 10 year investment) showing that they hold, for example, 10,000 units with a value of $10,000 ($1 per unit). This is a costly and administratively burdensome requirement that does not provide clients with any valuable information. We would suggest that either (a) clients be permitted to opt out of the quarterly account reporting obligation; or (b) that an exemption from the account reporting requirement be provided to exempt market dealers in circumstances where there is no account activity and the security does not trade and is a type that is customarily reported at book value.

Canadian Securities Course

All sales representatives of exempt market dealers must pass the Canadian Securities Course ("CSC"). Unfortunately this course does not address the concerns of the exempt market and any person who passes this course has no greater understanding of (i) how the exempt market works; (ii) how to sell products in compliance with the applicable prospectus exemptions; or (iii) what duties an exempt market sales representative owes to clients. Arguably, there is no additional investor protection afforded to exempt market investors by virtue of having sales representatives of an exempt market dealer pass the CSC. We respectfully submit that this proficiency requirement should be deleted and, if the regulators remain concerned about proficiency, a specific course should be developed for exempt market dealers.

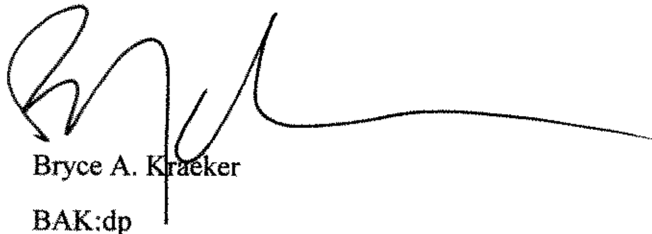
Distribution of Prospectus Qualified Securities

Under section 2.1(1)(d)(i)(B), an exempt market dealer is permitted to trade in securities that are distributed under a prospectus if the distribution may have been made under an exemption from the prospectus requirement. The companion policy gives, as an example, that the exempt market dealer may sell prospectus qualified securities to accredited investors. The companion policy should clarify how this provision could be applied in respect of an exempt market dealer who sells prospectus qualified securities in reliance on the offering memorandum exemption outside of Ontario. We recommend that such securities could be sold to the same prospective investors who would be eligible to purchase securities under the offering memorandum exemption but, in lieu of providing such prospective investors an offering memorandum prepared in accordance with National Instrument 45-106, the exempt market dealer could provide the prospectus.

We thank you for this opportunity to comment on NI 31-103.

Sincerely,

GOWLING LAFLEUR HENDERSON LLP



Bryce A. Kraeker

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