

**1.1.4 CSA Staff Notice 31-327 – Broker-Dealer Registration in the Exempt Market Dealer Category**

**CSA STAFF NOTICE 31-327**

**BROKER-DEALER REGISTRATION IN THE EXEMPT MARKET DEALER CATEGORY**

**September 2, 2011**

**Purpose**

Staff of the Canadian Securities Administrators (**CSA** or **we**) have recently learned that there are a number of firms registered as exempt market dealers (**EMD**) that are carrying out brokerage activities (trading securities listed on an exchange in foreign or Canadian markets) for accredited investors. We understand that these are primarily broker-dealer firms registered in the United States that are members of the Financial Industry Regulatory Authority (**FINRA**). CSA staff have also received applications from firms seeking registration in the EMD category for the same purpose.

CSA staff do not believe that the EMD category of registration was intended for firms that conduct brokerage activities. This raises serious policy issues that regulators and the industry need to consider. The purpose of this Notice is to outline our concerns and our interim response to this problem and to advise that we will be examining these activities in a wider consultation and review process.

**Background – the EMD Category**

National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103)* became effective September 28, 2009 and introduced the EMD category of registration, which was a new category to most CSA jurisdictions and represented a significant change to the pre-existing limited market dealer category in Ontario and Newfoundland and Labrador.

The EMD category was designed to allow increased oversight and regulation of market participants in the exempt market. The category permits trading in securities distributed under prospectus exemptions. We did not envision that EMDs would be involved in brokerage activities, including trading securities on an exchange, or entering into arrangements similar to introducing-carrying broker activities.

Firms providing brokerage activities have historically been categorized as investment dealers, which are subject to the Investment Industry Regulatory Organization of Canada (**IIROC**) requirements and supervision.

**Applications by Firms Seeking Registration in the EMD Category**

The current applicants seek to rely on section 7.1(2)(d) of NI 31-103 combined with the prospectus exemption provided in section 2.3 of National Instrument 45-106 *Prospectus and Registration Exemptions* that exempts distributions to accredited investors. Some of the applicants

also seek an exemption from section 13.12 of NI 31-103 to allow lending or providing margin to clients. Therefore, an EMD could technically trade in any securities for an accredited investor, including securities listed on an exchange.

**Issues**

We have concerns with firms applying for registration in the EMD category and with firms already registered in the category because we do not think the EMD category was intended to allow firms to engage in brokerage activities.

IIROC monitors brokerage activities and it has developed rules and an oversight infrastructure to supervise this activity. If EMDs are conducting brokerage activities which would otherwise be carried out by Canadian investment dealers who are members of IIROC, similar activities would be regulated within Canada differently, resulting in differences in regulatory oversight depending on whether the activity is carried out by an EMD or an IIROC member.

**Interim Action**

In view of these regulatory concerns, we will consider registering these broker-dealers in the restricted dealer category with terms and conditions. One condition is that these broker-dealers only deal with permitted clients. The registration will be limited in time. This interim registration will allow applicants to engage in limited activities while we engage in a consultation process.

**Consultation**

We will be examining these issues in a consultation and review process to allow all interested stakeholders an opportunity to comment. Our goal is to ensure appropriate regulatory requirements apply to all firms that engage in brokerage activities in Canada. The securities industry should be aware that the outcome of these consultations is likely to result in changes to our rules.

**Questions**

If you have questions regarding this notice please direct them to any of:

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