

## CSA Staff Notice 31-324

### **Exempt market dealers and account statement requirements in National Instrument 31-103 *Registration Requirements and Exemptions***

**June 22, 2011**

Exempt Market Dealer (**EMD**) is a new registration category introduced with National Instrument 31-103 *Registration Requirements and Exemptions* (**NI 31-103**). This Staff Notice:

- sets out our expectations for EMDs' compliance with the account statement requirements in NI 31-103
- notes that we will focus attention on EMDs distributing securities of related or connected issuers
- draws attention to guidance we have published on the valuation of securities

#### **Account statement requirements**

As registered firms, EMDs are required to deliver client statements, also referred to as "account statements". EMDs must deliver account statements to their clients at least once every three months (**quarterly account statements**) and may also be required to deliver a monthly account statement if a transaction is effected in the account during that month, other than transactions made under an automatic withdrawal/payment plan (**end-of-month account statements**).

Account statements have two main components:

- **transaction information** relating to transactions the registered firm has effected for its client during the reporting period, and
- **account balance information** relating to cash and all securities that are in the client's account as at the end of the reporting period

The account statement requirements are found in section 14.14 of NI 31-103. The requirement for quarterly account statements of a registered dealer is found in subsection 14.14(1). The requirement for end-of-month account statements of a registered dealer is found in paragraph 14.14(2)(b). Transaction information is prescribed in subsection 14.14(4). Account balance information for cash and securities that are in the client's account is prescribed in subsection 14.14(5).

The requirement to deliver quarterly account statements applies to all registered firms. These statements must include transaction information for all transactions made for the client during the period. However, the requirements to send an end-of-month account statement and provide account balance information are connected to transactions, cash or securities that are "in the account" of the client.

NI 31-103 does not specify what securities the Canadian Securities Administrators (the **CSA** or we) consider to be in the account and, so far, we have not published guidance on how we would interpret those words. As firms registered in a new category, EMDs have

no established industry practice in this regard, unlike advisers or dealers registered in other categories.

Securities of a client which a registered firm holds or controls are in the client's account, and the established practice of registered dealers and advisers is to provide account balance information on securities they hold or control. In many cases, they also provide account balance information on securities that they have sold to clients, but do not hold or control. Examples of securities of a client not held or controlled by their dealer or adviser include those registered in a client's name on a third-party issuer's books ("client name" securities), or securities issued in certificate form that are kept in the possession of the client. For firms that are members of the *Investment Industry Regulatory Organization of Canada (IIROC)* or the *Mutual Fund Dealers Association of Canada (MFDA)*, what securities must be included in account statements is set out in rules of their self-regulatory organization (**SRO**).

### **Staff expectations for contents of account statements**

We acknowledge that it may be difficult for EMDs to develop systems to provide their clients with account balance information without having a requirement or guidance specifying which securities of a client should be considered to be in the account for those purposes.

CSA staff are currently developing proposals for further requirements or guidance on the content of account statements. In the meantime, until we publish new guidance, or new requirements come into effect, we will *not* expect an EMD to:

- deliver end-of-month account statements, or
- include account balance information in quarterly account statements,

in connection with securities of a client that are not held or controlled by the EMD.

We *will* expect an EMD to deliver quarterly account statements containing:

- transaction information covering each transaction it made for a client during the quarter, and
- account balance information for all cash and securities of the client that it holds or controls

If an EMD does not hold or control any cash or securities of a client, and it makes no transactions for the client during a quarter, we will not expect the EMD to send an account statement for that quarter to the client.

Where an EMD is also registered in another dealer category or as an adviser, we will expect it to provide all of its clients with account statements that are consistent with its practices under the other category of registration. An EMD that is also registered in a category that requires membership in IIROC or the MFDA must comply with applicable SRO rules.

We encourage EMDs that have adopted the practice of delivering account statements that include account balance information about securities that they do not hold and control to continue to do so.

### **Transitional relief in Ontario and Newfoundland and Labrador**

In Ontario and Newfoundland and Labrador, there is transitional relief from the account statement requirement (i.e., section 14.14) for EMDs that had been registered under the former registration category of limited market dealer (referred to as “mapped-over” EMDs). This transitional relief remains available until its scheduled expiry on September 28, 2011. After that date, mapped-over EMDs will be expected to deliver account statements that are, at a minimum, consistent with the guidance in this Notice.

### **Securities of related or connected issuers**

We have identified a disproportionate rate of compliance deficiencies among EMDs that distribute the securities of related or connected issuers where the same individuals form the management of both the EMD and the issuer. Specific instances include failure to adequately discharge the EMD’s know-your-client obligation and obligation to make a determination that an investment is suitable for its client. We have also found cases of such EMDs failing to deal fairly, honestly and in good faith with their clients by using investor proceeds raised by them for their related or connected issuers for purposes other than those disclosed and marketed to investors.

Staff will focus compliance attention in this area, including monitoring client reporting by such EMDs. We will take enforcement action or other regulatory action where they are found to be acting contrary to securities law.

For guidance on when we will consider an issuer to be related or connected to an EMD, see the definitions in National Instrument 33-105 *Underwriting Conflicts* and its Companion Policy.

### **Valuation of securities**

With respect to the requirement to include market valuations of clients’ securities in account balance information, we draw attention to the guidance on the market value of securities in our proposed amendments to the companion policy to NI 31-103 that were published today as part of our proposals for cost disclosure and performance reporting by registrants. This guidance is consistent with what we previously published in the NI 31-103 “frequently asked questions” (FAQ). The proposed amendments and FAQ are available on CSA websites, including:

[www.albertasecurities.com](http://www.albertasecurities.com)

[www.lautorite.qc.ca](http://www.lautorite.qc.ca)

[www.bcsc.bc.ca](http://www.bcsc.bc.ca)

[www.msc.gov.mb.ca](http://www.msc.gov.mb.ca)

[www.gov.ns.ca/nssc](http://www.gov.ns.ca/nssc)

[www.nbsc-cvmnb.ca](http://www.nbsc-cvmnb.ca)

[www.osc.gov.on.ca](http://www.osc.gov.on.ca)

### **Questions**

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