ALBERTA SECURITIES COMMISSION

STAFF NOTICE 33-704

Review of Exempt Market Dealers

January 12, 2012

Introduction

The exempt market dealer (**EMD**) category of registration was introduced with the implementation of National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) on September 28, 2009. Alberta Securities Commission (**ASC**) staff recently completed initial compliance reviews of a number of firms that are registered in the EMD category. The purposes of this Staff Notice are to:

1. provide a summary of the initial compliance reviews and highlight certain key issues;

2. provide information with respect to common issues that were identified during the reviews and provide guidance with respect to suggested practices in the form of "Appendix A"; and

3. provide information with respect to compliance activities that ASC staff will perform in the future.

Summary of Initial Compliance Reviews

During 2011, ASC staff conducted initial compliance reviews of a number of EMDs in Alberta. We focused on registrants that are new to the regulatory environment. The goals of the reviews were to raise general awareness among registrants of their ongoing registrant obligations and to better understand how EMDs are operating in the Alberta marketplace. During the reviews, ASC staff identified a number of different business models, including:

1. distributing prospectus-exempt securities on behalf of related issuers and entities that are not related issuers;

2. providing underwriting services in relation to prospectus-exempt securities; and

3. distributing prospectus-exempt securities that EMDs manufacture themselves – for example, mortgage investment corporations that distribute units of their own investment funds.

The ASC staff reviews consisted of reviewing filings made with the ASC, interviewing representatives of the registrants, and assessing the information received in conjunction with the requirements of NI 31-103. In particular, our reviews focused on the operational aspects of each EMD's business and the associated regulatory obligations, including, but not limited to, compliance and supervision structure, know your client and suitability, know your product, disclosure, custody of assets and financial obligations. We concluded our reviews by sending letters to each EMD highlighting specific areas of concern and common industry issues. In some cases, we requested that certain EMDs provide additional information for our further consideration.

Overall, we learned that EMDs have a general understanding of their regulatory obligations but would benefit from further information and guidance to assist them in meeting these obligations. For example, many registrants have not yet fully developed effective compliance systems.

Issues Identified During the Reviews

The enclosed "Appendix A" provides information with respect to common issues that were identified during the reviews and provides guidance with respect to suggested practices. The Staff Notice also highlights certain key issues.

Compliance System

Registrants are required to maintain and apply policies and procedures that establish a system of controls and supervision to ensure compliance with securities law requirements and to manage day-to-day business risks. Common issues we identified are that the policies and procedures either do not reflect the EMD's actual business practices or do not fully address how an EMD's regulatory obligations will be satisfied. Some EMDs have established only rudimentary monitoring and supervisions systems that do not adequately ensure compliance or manage risks.

Know Your Client

NI 31-103 requires registrants to satisfy certain know your client (**KYC**) requirements. Among other things, collecting KYC information allows registrants to determine whether securities are suitable for clients.

A common issue we identified during our reviews is an inconsistency between clients' tolerance for risk and the types of securities that EMDs are selling. For example, EMDs are selling securities that are described as "speculative" or "risky" in the disclosure documents to clients who they have identified as having a low or medium tolerance for risk.

Suitability

NI 31-103 requires registrants to satisfy certain suitability requirements. In particular, registrants are required to ensure that sales of securities are suitable for their clients. A common issue we identified during our reviews is that some EMDs are unable to demonstrate having conducted an appropriate level of due diligence to satisfy the suitability requirement.

Disclosure of Information

NI 31-103 requires registrants to satisfy certain disclosure of information requirements. A common issue we identified during our reviews is that EMDs do not always adequately disclose relationships to clients with respect to issuers, ownership of securities, outside business activities, and risks related to borrowing money for the purposes of making financial investments. Further, it is not sufficient for EMDs to satisfy information disclosure requirements by providing clients with disclosure documents they receive from issuers.

Future Activities

As part of our ongoing oversight program, ASC staff will be conducting detailed compliance reviews of registrants. These reviews will include, among other things, reviewing registrants' books and records,

testing internal policies, procedures and controls and issuing detailed reports outlining deficiencies that may need to be rectified.

ASC staff have also been conducting initial assessments of firms that may be carrying out registerable activities without being properly registered. We will be taking further actions as deemed to be appropriate in the circumstances.

Lastly, ASC staff remain committed to offering educational opportunities to assist registrants and other market participants to better understand existing security law requirements. We will be providing further information with respect to such initiatives in early 2012.

Conclusion
The enclosed "Appendix A" provides information with respect to common issues that were identified during the reviews and provides guidance with respect to suggested practices for registrants. In the future, ASC staff intends to use the information in "Appendix A" as the basis for developing a compliance tool to assist all registrants in meeting regulatory obligations.

Questions
Please refer your questions with respect to this Staff Notice to either of:

Jamie Hood
Regulatory Analyst
Alberta Securities Commission
Tel. 403-297-4890
jamie.hood@asc.ca

Connor Irving
Regulatory Analyst
Alberta Securities Commission
Tel: 403-297-7266
connor.irving@asc.ca

Appendix A
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Explanatory Notes

1. This appendix to the Staff Notice is directed at firms conducting registerable activities in Alberta and in particular exempt market dealers (EMDs). Many firms are registered in multiple categories, such as EMD, Investment Fund Manager and/or Portfolio Manager. Firms registered in multiple categories should ensure they are meeting the regulatory requirements associated with all categories of registration.

2. This appendix to the Staff Notice is not directed at dealers who are members of Self-Regulatory Organizations (SROs), where additional requirements may be in place or at dealers conducting registerable activities in jurisdictions other than Alberta.

3. This appendix to the Staff Notice is intended to provide dealers with general information regarding their regulatory obligations and is not exhaustive. Firms must refer to the applicable legislation for complete information. Firms are expected to develop the necessary elements of an effective compliance system to ensure the fulfillment of regulatory obligations.

4. This appendix to the Staff Notice is not intended to provide information regarding the regulatory obligations of issuers of prospectus-exempt securities. The Corporate Finance division of the ASC intends to provide information relating to issuers of prospectus-exempt securities in the near future.

Glossary

NI 31-103 refers to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*
31-103CP refers to Companion Policy 31-103CP – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*
NI 33-109 refers to National Instrument 33-109 – *Registration Information*
33-109CP refers to Companion Policy 33-109CP – *Registration Information*
NI 45-106 refers to National Instrument 45-106 – *Prospectus and Registration Exemptions*
45-106CP refers to Companion Policy 45-106CP – *Prospectus and Registration Exemptions*
NI 52-107 refers to National Instrument 52-107 – *Acceptable Accounting Principles and Auditing Standards*
52-107CP refers to Companion Policy 52-107CP - *Acceptable Accounting Principles and Auditing Standards*
NI 31-102 refers to National Instrument 31-102 – *National Registration Database*

The term 'MIE' refers to Mortgage Investment Entities as defined in the Canadian Securities Administrators (CSA) Staff Notice 31-323 *Guidance Relating to the Registration Obligations of Mortgage Investment Entities*, dated February 25, 2011.

The term "firm" refers to firms that are "registrants" as defined in the *Securities Act* (Alberta).

Note: References to Division 1 and Division 5 of Part 13 – *Dealing with Clients – Individuals and Firms* and Part 14 – *Handling Client Accounts – Firms*, other than 14.6, 14.12(5) and 14.14, of NI 31-103 do not apply to an Investment Fund Manager in respect of its activities as an Investment Fund Manager.

1. Registration			
Changes to Registered Firm Information and Changes to Registered Individual and Permitted Individual Information			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A registered firm must notify the regulator of a change to information previously submitted in Form 33-109F6 – *Firm Registration.* With respect to changes to Section 3 of Form 33-109F6, including a firm's business activities, the notification must be provided within 30 days. With respect to all other changes to Form 33-109F6, the notification must be provided within 10 days. For changes to Registered Individual and Permitted Individual information, firms must ensure filings are done electronically through the National Registration Database (**NRD**) within the prescribed period.	Failure to notify the regulator of changes such as a change in the firm's financial year end and a change in auditor. Failure to notify the regulator within the time limits specified. Failure to fully explain the change in the filing.	Firms should ensure a Form 33-109F5 – *Change of Registration Information* is filed when appropriate. For changes to firm information, firms should ensure the Form 33-109F5 contains an explanation of the change as well as a new document containing current information. For example, when filing changes to the firm's capital structure, include a new capital structure chart and an explanation of the changes. Certain changes to Form 33-109F6 do not require a change notice, e.g. business documents such as a business plan and a policies and procedures manual. Please review Section 3.1 of NI 33-109 to determine when a Form 33-109F5 is required to be filed. For changes to firm information, file Form 33-109F5 using the email address registration@asc.ca. For changes to Registered Individual and Permitted Individual information, firms must make the submission in NRD format.	Parts 2 – 8 of NI 31-103 Sections 3 and Section 4 of 33-109CP, Appendix A: this appendix outlines the types of changes requiring notification, the notice period and the method of submission. Part 3 of NI 33-109 – *Changes to Registered Firm Information* Part 4 of NI 33-109 – *Changes to Registered Individual and Permitted Individual Information* NI 31-102 - *National Registration Database* www.nrd-info.ca

2. Internal Controls and Systems			
Compliance System			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
The firm must establish, maintain and apply policies and procedures that establish a system of controls and supervision to (a) provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation, and (b) manage the risks associated with its business in accordance with prudent business practices.	Many firms purchased a template compliance manual that identifies general policies, procedures and obligations but does not reflect the firm's actual business practices and internal procedures. Some firms do not follow the policies and procedures outlined in their policies and procedures manual. Some firms do not have supervision and training programs in place. The CCO does not appropriately monitor the operations and activities of the firm and its dealing representatives. Many firms do not have a business continuity plan in place.	Elements of an effective compliance system include the appointment of qualified compliance personnel, relevant policies and procedures, internal controls, day to day and systemic monitoring and supervision systems. Firms should review their compliance manual on an ongoing basis and ensure it is reflective of actual business practices. Firms should develop written policies and procedures to supervise the activities of their dealing representatives on an ongoing basis, which may include procedures such as contacting clients. Firms should conduct initial and ongoing compliance training sessions. Firms should consider controls like regular reminders to representatives of their ongoing obligations and obtaining periodic written acknowledgements of a representative's understanding of and compliance with their obligations; for example, on an annual basis. This may include requiring representatives to review the firm's policies and procedures manual on a regular basis and provide sign-off that they have reviewed and understood the material.	Section 11.1 of NI 31-103 - *Compliance System* Section 11.1 of 31-103CP – *Compliance System*

Compliance System ***Cont'd***			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
Firms utilizing the principal/agent model have the same supervision, training and monitoring obligations as firms utilizing the employer/employee model.	Some firms have limited involvement in or awareness of the business activities of their dealing representatives. Many firms do not have an effective system of controls and supervision over the business activities of their dealing representatives. Some firms do not monitor the marketing and advertising activities of their dealing representatives.	Firms should develop written policies and procedures to supervise the activities of their dealing representatives on an ongoing basis, which may include procedures such as contacting clients. Firms should develop written policies and procedures regarding the preparation and content of branding and marketing materials and how the firm reviews and approves these materials. Firms should have processes in place to review, supervise, retrieve and retain marketing materials on social media websites. A firm's client disclosure document should clearly highlight the relationship between the dealer and the dealing representative and the role of the dealing representative's personal company if any. Firms should consider using a representative disclosure document clearly highlighting the individual registrant's outside business activities, including the use of other business names. See the Marketing section below.	Section 11.1 of NI 31-103 - *Compliance System* Section 11.1 of 31-103CP – *Compliance System* CSA Staff Notice 31-325 – *Marketing Practices of Portfolio Managers*, published July 5, 2011

Books and Records			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A firm must maintain records that accurately reflect its business activities, financial affairs and client transactions and demonstrate the extent of the firm's compliance with the applicable requirements of securities legislation.	The firm is not able to evidence its compliance with applicable requirements.	Firms should be able to evidence compliance with all books and records requirements. Firms may find it useful to develop checklists of their obligations and associated daily, weekly, monthly and ongoing activities in order to guide their oversight and to provide evidence of ongoing review and sign-off of their obligations.	Part 11, Division 2 – *Books and Records* – of NI 31-103 Sections 11.1 and 11.5 of NI 31-103CP – *Compliance System*

3. Financial Condition			
Working capital			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A firm must notify the regulator as soon as possible if its working capital is less than zero. A firm's working capital must not be less than zero for two consecutive days.	Some firms review the activity in its corporate bank account as a substitute for calculating working capital. Some firms are not accurately calculating their working capital; for example, by not including the market risk component, by not including the insurance deductible, by incorrectly including assets that are not readily convertible to cash or by excluding related party debt without filing a subordinated loan agreement with the ASC. Some firms do not include the management certification which forms part of Form 31-103F1 – *Calculation of Excess Working Capital* - in their filings with the ASC. Some firms do not use the correct prior financial period as required on Form 31-103F1.	Firms should calculate working capital using the prescribed Form 31-103F1. Firms should calculate working capital as frequently as required to ensure that it does not fall to less than zero. At a minimum, a firm should perform the calculation on a monthly basis. Firms should ensure they review, sign and date the management certification section of Form 31-103F1 and retain evidence of review.	Section 12.1(1) and Section 12.1(2) of NI 31-103 - *Capital Requirements* Section 12.1 of 31-103CP – *Capital Requirements* Form 31-103F1 *Calculation of Excess Working Capital*

Subordinated Loans			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
Firms who wish to rely on the capital relief available with respect to long-term related party debt must execute a subordination agreement in the form set out in Appendix B of NI 31-103 and deliver a copy of the agreement to the ASC. Firms cannot rely on the capital relief provided with respect to the subordination of long-term related party debt unless they have filed the subordination agreement with the ASC.	Some firms do not execute a subordination agreement or file a subordination agreement with the ASC before relying on the capital relief provided with respect to the subordination of long-term related party debt. Some firms do not file the subordination agreement within the time lines specified. Some firms file an incorrectly completed subordination agreement with the ASC; for example: • the amount being subordinated is incorrect; • the amount being subordinated has been added together with the previously subordinated amount rather than creating a new subordination agreement which reflects only the incremental amount being subordinated; • the lender's name is incorrect. Some firms repay or terminate the agreement without providing notice or provide late notice to the ASC.	If a firm repays any part of the loan or terminates the agreement, it must notify the ASC 10 days prior to repayment or termination. This notification should include the filing of unaudited financial statements for the most recent period and a corresponding Form 31-103F1 evidencing the firm's ability to repay or terminate the subordinated loan without causing a capital deficiency. If a firm wishes to increase the amount of related party debt and rely on capital relief, it must execute a new subordination agreement reflecting only the additional amount. If a firm wishes to amend the terms of a subordinated loan, other than increasing the amount, it should consider terminating the original subordination agreement and issuing a new subordination agreement. The firm must file a notice of termination and a copy of the new subordination agreement with the ASC 10 days prior to termination. The reasons for terminating the existing agreement and issuing a new agreement should be provided. Interest can be paid provided the payment does not cause a capital deficiency. Note: any interest owed on the subordinated loan is automatically subordinated to the claims of other creditors and a new subordination agreement is not required with respect to interest accruals.	Section 12.2 of NI 31-103 - *Notifying the Regulator of a Subordination Agreement* Appendix B of NI 31-103– *Subordination Agreement* Form 31-103F1 – *Calculation of Excess Working Capital*

Financial Reporting			
With the recent implementation of IFRS, financial reporting requirements vary for financial years beginning on or after January 1, 2011 and those beginning prior to Jan. 1, 2011			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
Firms must file audited financial statements with the ASC on an annual basis and within 90 days of their financial year-end. The financial statements must include a statement of comprehensive income, a statement of changes in equity and a statement of cash flows, each prepared for the most recently completed financial year and the financial year immediately preceding the most recently completed financial year. The financial statements must also include a statement of financial position, signed by at least one director, as at the end of the most recently completed financial year and the financial year immediately preceding the most recently completed financial year. Where applicable, firms that are required to file unaudited interim financial information must file on a quarterly basis and within 30 days after the end of the first, second and third quarter periods of their financial year.	Late filing of financial information. The statement of financial position is not signed by at least one director. Financial statements are not accompanied by a completed Form 31-103F1. Some firms fail to file Form 33-109F5s to reflect any changes which may have come out of the audit; for example, a change in the firm's insurance policy. Some firms are not aware of their filing requirements; for example, some investment fund managers do not file interim financial information. Some firms do include information on the correct prior period.	Firms should diarize the timelines for financial filings. Firms should include all documents required, ensuring that they are properly executed and complete, at the time of filing. Firms should file any necessary Form 33-109F5s for changes to the firm's financial reporting information; for example, a change to the firm's year end.	Section 12.10 of NI 31-103 - *Annual financial statements* Section 12.11 of NI 31-103- *Interim financial information* Section 12.12 of NI 31-103 - *Delivering Financial Information – Dealer* Section 12.13 of NI 31-103 – *Delivering Financial Information – Adviser* Section 12.14 of NI 31-103 *Delivering Financial Information – Investment Fund Manager* NI 52-107 - *Acceptable Accounting Principles and Auditing Standards* 52-107CP - *Acceptable Accounting Principles and Auditing Standards*

4. Dealing with Clients			
Know your Client (KYC)			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A registrant must ensure it can establish the identity of the client. A registrant must ensure it has sufficient and current information to meet its suitability obligations under Section 13.3 of NI 31-103, such as the client's (1) investment needs and objectives; (2) financial circumstances and (3) risk tolerance. A registrant must take reasonable steps to keep the information current.	Registrants are not always obtaining sufficient KYC information; for example, the client's net worth is not always obtained. Registrants are not always updating KYC information as material changes occur and at a minimum annually.	Registrants should ensure that they are collecting and documenting sufficient KYC information so they can properly determine the suitability of recommended products. Firms should implement controls to ensure all KYC information is obtained and is accurate; for example, controls such as completeness checks and client sign-off of KYC forms. Registrants should ensure that they have a process for updating KYC information as material changes occur and consider practices such as annual client meetings to review KYC information. Firms should consider the appropriate level of compliance oversight and review of KYC information for their firm; for example, review and approval of transactions by compliance staff. All KYC reviews and updates should be documented and retained centrally.	Section 13.2 of NI 31-103 - *Know your client* Section 13.3 of NI 31-103 – *Suitability* Section 13.2 and Section 13.3 of 31-103CP CSA Staff Notice 33-315 – *Suitability Obligation and Know Your Produc*t, published September 9, 2009.

Know your Client (KYC) ***Cont'd***			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
Prospectus-exempt securities may be considered high risk products for a variety of reasons. For example, there is often limited availability of information regarding the issuer and the security, less recourse for the investor, no secondary market and long or indefinite investment horizons. In addition, investments purchased under a prospectus exemption are subject to restrictions on transfer, which may never expire. The firm must ensure that the level of risk associated with an exempt product, for example, as outlined in a security's offering memorandum or term sheet, is consistent with the client's tolerance for that level of risk.	The risk tolerance documented on a client's KYC form is inconsistent with the risk profile of the product. Many MIEs and their clients have indicated that they consider investments in mortgages to be low risk. This perspective is often inconsistent with the information contained in an associated offering memorandum and with the experiences of MIEs over the last several years with respect to mortgage impairments. Typically these private mortgages are structured at interest rates higher than those offered by traditional lenders, in part reflecting the higher degree of risk for these securities.	Firms must ensure the KYC information collected from the client, such as risk tolerance, net worth and age, is consistent with the risk profile of the security being sold. Firms should have clear guidelines regarding the recording of investment objectives including a client's tolerance for risk. For example, a firm may require that a client's risk tolerance be recorded with respect to a client's entire investment portfolio, often with percentages allocated to low, medium and high risk, or with respect to a specific security only.	Section 13.2 of NI 31-103 - *Know your client* Section 13.3 of NI 31-103 – *Suitability* NI 45-106 – *Prospectus and Registration Exemptions* (Note that the Registration Exemptions contained under Section 3 of NI 45-106 were revoked effective on March 27, 2010) CSA Staff Notice 33-315 – *Suitability Obligation and Know Your Product,* published September 9, 2009.
Firms must determine if the client meets the appropriate prospectus exemption requirements being used to purchase the security; for example, purchases made under the "accredited investor" exemption of NI 45-106.	Some firms do not collect sufficient KYC information to reasonably determine whether an investor qualifies for the exemption being utilized or the KYC information collected does not support the use of the exemption; for example, the client has insufficient financial assets, net assets or net income. The investor's financial assets are incorrectly calculated to include the investor's personal residence and other real estate.	A firm should ensure that sufficient KYC information is obtained and documented and that the information is consistent with the exemption being utilized.	NI 45-106 – *Prospectus and Registration Exemptions* (Note that the Registration Exemptions contained under Section 3 of NI 45-106 were revoked effective on March 27, 2010) Section 1.1 of NI 45-106 - *Definitions*

Know your Client (KYC) ***Cont'd***			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
Clients of firms or related firms operating prior to the introduction of NI 31-103: The firm, if it has an ongoing relationship with these clients, has an obligation to ensure it has sufficient information to meet its suitability obligations.	Many firms have not yet collected KYC information on clients who dealt with the firm or related firms operating prior to the introduction of NI 31-103.	The firm should collect sufficient KYC information for these clients and provide them with a current disclosure document. The firm should consider conducting a suitability assessment on the products previously sold to the client by the firm, a predecessor firm or related firm, to determine suitability of the product given the client's current situation.	Section 13.2 of NI 31-103 - *Know your client*
Suitability			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A registrant must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a client to buy or sell a security, or makes a purchase or sale of a security for a client's managed account, the purchase or sale is suitable for the client. The registrant must not buy or sell a security that it deems unsuitable unless the client instructs the registrant to proceed nonetheless.	In addition to common issues regarding the collection of KYC information detailed above, some firms could not demonstrate a reasonable level of due diligence with respect to the issuers and the securities available for sale. Some firms rely on issuers to provide product training to their representatives and do not supplement this training with training provided by the dealer. CSA staff previously raised concern about the failure of EMDs to adequately discharge their KYC and suitability obligations where the securities being distributed are those of a related or connected issuer and the same individuals form the mind and management of the EMD and issuer.	A firm must have an appropriate due diligence process in place with respect to issuers and their securities to document its initial and ongoing assessment of all products and investments. Process steps could include a detailed analysis, formal approval, internal training, suitability guidelines, ongoing due diligence and documentation of the due diligence conducted. Firms should provide sufficient product training, in addition to any training provided by the product issuer, to satisfy the firm's and the representative's know your product obligations. Once a firm approves a product for sale, registrants must ensure the product is suitable for a client before they recommend the product. A suitability assessment must be completed at the time of each transaction.	Section 13.3 of NI 31-103 – *Suitability* Section 3.4 of NI 31-103 *Proficiency – Initial and Ongoing* CSA Staff Notice 33-315 – *Suitability Obligation and Know Your Product* CSA Staff Notice 31-324– *Exempt Market Dealers and Account Statement Requirements in National Instrument 31-103 Registration Requirements and Exemptions,* published June 22, 2011. The definition of permitted client can be found in Section 1.1 of NI 31-103 - *Definitions of terms used throughout this Instrument*.

Suitability *Cont'd*			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
	MIEs are often related or connected to issuers, where many of the same individuals form the mind and management of the EMD and issuer.	Firms related or connected to issuers should consider implementing controls such as separation of duties, different reporting lines and independent product review. Note: Only a "permitted" client can waive a registrant's requirement to ensure a product is suitable.	
Conflicts of Interest			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A firm must take reasonable steps to identify, respond to and disclose existing and potential material conflicts of interest. If a registered individual recommends a security that they own, this may constitute a material conflict which should be disclosed to the client before or at the time of the recommendation.	Some firms have not progressed beyond documenting the principals governing conflicts of interest to implementing effective policies and procedures to identify, avoid, control and disclose potential conflicts of interest. Many MIEs engage in mortgage brokerage activities or operate a related mortgage broker firm. However, most firms have not identified potential conflicts of interest and established policies and procedures for addressing them.	Firms should implement policies and procedures that ensure they identify, avoid, control and disclose conflicts of interest; for example, potential conflicts associated with outside business activities. Firms should consider a registrant disclosure document which clearly discloses potential conflicts of interest; for example, outside business activities.	Section 13.4 of NI 31-103 - *Identifying and responding to conflicts of interest* CSA Staff Notice 31-326 – *Outside Business Activities* Section 13.4 of 31-103CP
Disclosure when Recommending Related or Connected Securities			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
The firm must not make a recommendation with respect to the securities of related or connected issuers without disclosing the extent of the relationship.	Some firms rely on the issuer's disclosure information to fulfill the firm's dealer obligations, for example, the disclosure as contained in the issuer's offering memorandum. Some firms provide insufficient disclosure with respect to the extent of the relationship and potential conflicts of interest associated with the relationship.	Firms must to be able to demonstrate that these disclosure obligations are being met. Firm should include written disclosure explaining the nature and extent of the relationship with the related or connected issuer in all materials distributed or provided to clients. This disclosure should include existing or potential conflicts of interest, including fees and payments to related parties.	Section 13.6 of NI 31-103 - *Disclosure when recommending related or connected securities*

Disclosure when Recommending Related or Connected Securities *Cont'd*			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
		Firm may maintain a list of the related issuers for which it acts as a dealer or adviser. It may make the list available to clients by: posting the list on its website and keeping it updated; providing the list to the client at the time of account opening, or explaining to the client at the time of account opening how to contact the firm to request a copy of the list free of charge.	
Referral Arrangements			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A registrant must not participate in a referral arrangement unless the terms of the referral arrangement are set out in a written agreement between the registered firm and person or company receiving or giving the referral. The registrant must ensure that the information prescribed by subsection 13.10(1) of NI 31-103 is provided to the client in writing before the party receiving the referral either opens an account for the client or provides services to the client. The prescribed information includes, but is not limited to, the name of each party to the agreement, the purpose and material terms, including the nature of the services to be provided by each party and any conflicts of interest.	Some firms cannot evidence their compliance with the regulatory obligations regarding referral arrangements. Some firms do not have a written agreement in place for their referral arrangements. All required details of the referral arrangement are not outlined in the agreement. Some clients do not receive the information regarding the referral arrangement at the appropriate time. Changes to the referral arrangement are not properly disclosed to clients and within the required time frame. Some firms have not properly verified the qualifications of the person or company to whom the client will be referred.	Firms should ensure that appropriate written agreements for all referral arrangements that the firm and/or individuals have entered into are in place and that sufficient information is provided to clients at the appropriate time. Firms should implement policies and procedures outlining how the firm will review potential referral arrangements, how existing referral arrangements will be monitored and how any changes to referral arrangements will be communicated to clients. Firms should ensure that firms and individuals to whom clients are referred and who are performing registerable activities are appropriately registered.	Part 13, Division 3- *Referral arrangements* of NI 31-103 Part 13, Division 3 – *Referral arrangements* of 31-103CP

Disclosure when Recommending the use of Borrowed Money			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
If a registrant recommends that clients use borrowed money to finance any part of a purchase of a security, the registrant must, before the purchase, provide the client with a written statement outlining the risks associated with using borrowed money An example of a written statement can be found under Section 13.13 of NI 31-103.	Some firms recommend consideration of the use of leverage but do not provide clients with a written statement outlining the risks prior to purchase.	A firm must provide to all clients, prior to purchase, a written statement outlining the risks associated with using borrowed money to purchase securities.	Section 13.13 of NI 31-103 – *Disclosure when recommending the use of borrowed money*
Complaints			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A registered firm must document and, in a manner that a reasonable investor would consider fair and effective, respond to each complaint made to the registered firm about any product or service offered by the firm or a representative of the firm.	Some firms do not have a clearly defined definition of a client complaint. Some firms do not document client complaints. Some individuals do not know how to intake complaints and to whom to report client complaints.	Firms should consider using a complaint log and a complaint handling form for individuals to document the intake, details and resolution of each complaint. Firms should have clear complaint handling policies and processes for monitoring, reporting to an identified party and responding to both verbal and written complaints. Firms should provide communication to clients that clearly outlines where complaints can be directed.	Part 13, Division 5 of NI 31-103 – *Complaints*

5. Handling Client Accounts - Firms			
Disclosure			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A registered firm must deliver to a client all information that a reasonable investor would consider important about the client's relationship with the registrant. The firm must deliver the information to the client as outlined under Section 14.2 of NI 31-103; for example, information regarding the products and services offered by the registered firm, risks associated with investing, risks of using of borrowed money, conflicts of interest, etc. The information must be delivered before the firm first purchases or sells a security for a client or advises the client to purchase, sell or hold a security.	Some firms are not providing any disclosure document or are not able to evidence the provision of a disclosure document. Some firms rely on the issuer's disclosure information to fulfill the firm's disclosure obligations, for example, reliance on the disclosure as contained in the issuer's offering memorandum. There is inadequate disclosure to the client. Some MIEs are not providing adequate disclosure regarding mortgage impairments.	Firms should provide, and be able to evidence the provision of, a relationship disclosure document clearly highlighting the information required under Section 14.2 of NI 31-103 and any other information a client would consider important. Firms must disclose information regarding the outside business activities of their dealing representatives which create a potential conflict of interest. Some firms use an individual registrant disclosure document which highlights the representative's outside business activities; for example, the business entity through which the dealing representative markets his or her services, the services provided through each entity associated with the representative, the compensation received for each activity, the regulators overseeing the activity, how complaints can be addressed and the dealer's non-involvement in these other activities. MIEs should review their disclosure practices regarding impairments and ensure that adequate information is provided. Consideration should be given to including a definition of impairment, the current status of mortgages under administration with respect to any impairments and general information on how the firm handles mortgages in various stages of impairment.	Section 14.2 of NI 31-103 - *Relationship Disclosure Information*

Fair Allocation of Investment Opportunities			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
This obligation is applicable to firms who are also registered in the advisor category as Portfolio Manager or Restricted Portfolio Manager. A registered adviser must ensure fairness in allocating investment opportunities among his or her clients. A registered adviser must deliver to a client a summary of the policies required under Section 11.1 of NI 31-103 - C*ompliance system* - that provide reasonable assurance that the firm and each individual acting on its behalf complies with section 14.10 of NI 31-103 - A*llocating investment opportunities fairly* - and that summary must be delivered (a) when the adviser opens an account for the client, and (b) if there is a significant change to the summary last delivered to the client, in a timely manner, and, if possible, before the firm next (i) purchases or sells a security of the client, or advises the client to purchase, sell or hold a security.	Some firms do not have a policy governing how they ensure fair allocation of investment opportunities, including the circumstances under which investment opportunities are allocated to staff of the firm. Some firms are not providing their clients with a summary of their policies regarding fair allocation. Some firms do not follow their fair allocation policies and procedures.	Registered advisers must implement the necessary policies and procedures to ensure fairness in allocating investment opportunities among their clients. Registered advisers must deliver a summary of their policies and procedures regarding fair allocation to clients upon account opening and at the time of any significant change. Registered advisers must be able to demonstrate that investment opportunities have been fairly allocated amongst their clients.	Section 11.1 of NI 31-103 – *Compliance system* Section 14.3 of NI 31-103 - *Disclosure to clients about the fair allocation of investment opportunities* Section 14.10 of NI 31-103 - *Allocating investment opportunities fairly*

Holding Client Assets in Trust			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A registered firm that holds client assets must hold the assets (a) separate and apart from its own property, (b) in trust for the client, and (c) in the case of cash, in a designated trust account at a Canadian financial institution, a Schedule III bank, or a member of IIROC.	For some firms that do hold cash, the cash is not held in a designated trust account. Some firms are commingling corporate assets with client assets.	Firms must ensure that all client assets are held separate and apart from the firm's own corporate assets. Firm must ensure that client cash is held in a designated trust account at Canadian financial institution, a Schedule III bank, or a member of IIROC.	Section 14.6 of NI 31-103 – *Holding client Assets in trust*
Account Activity Reporting			
Trade Confirmations			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
A registered dealer that has acted on behalf of a client in connection with a purchase or sale of a security must deliver to a client a written confirmation of the transaction which contains the details of the transaction. If the transaction is with a related or connected issuer, the registered dealer must disclose that the security is a security of a related or connected issuer on the trade confirmation.	Some firms are not sending written confirmations of transactions to clients. Some firms are relying on the trade confirmation delivered by the issuer to meet their obligations as a dealer to deliver a written confirmation of the transaction to the client. Some firms are not ensuring all the required information is included in the trade confirmation. For example, MIEs may send documents relating to the mortgage investment to an investor upon the completion of a deal; however these documents may not meet the requirements of a trade confirmation.	Firms should provide clients with a single page trade confirmation summary which includes all required information.	Section 14.12 of NI 31-103 - *Content and Delivery of Trade Confirmation* CSA Staff Notice 31-324– *Exempt Market Dealers and Account Statement Requirements in National Instrument 31-103 Registration Requirements and Exemptions*, published June 22, 2011.

Statements			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
Account statements have two main components: transaction information and account balance information. EMDs are expected to deliver account statements, at least quarterly, 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 client securities are not held or controlled by the EMD, EMDs are not expected to send out end-of-month account statements or include account balance information in quarterly statements.	Some firms are not sending account statements. Some firms are relying on account statements delivered by the issuer or custodian to meet their obligations as a dealer. Some firms are not ensuring that the account statements delivered meet the regulatory requirements. For example, MIEs typically make regular distributions of income to investors and provide information about these distributions; however, the information provided may not meet all the requirements of account statements.	Firms should ensure that they are delivering account statements which meet the regulatory requirements. Firms registered in multiple categories should ensure that they have policies and procedures in place to meet the regulatory requirements applicable to all categories of registration.	Section 14.14 of NI 31-103 – *Account statements* CSA Staff Notice 31-324– *Exempt Market Dealers and Account Statement Requirements in National Instrument 31-103 Registration Requirements and Exemptions*, published June 22, 2011.

6. Marketing			
Summary of Obligation	*Common Issues*	*Suggested Practices*	*Reference*
Registered firms and individuals are obligated to deal fairly, honestly and in good faith with their clients in the preparation, review and use of marketing materials Registered firms and individuals must ensure that materials or statements disseminated to investors are fair and not misleading.	Marketing materials contain: • unsubstantiated claims • the use of misleading or confusing titles, trade or business names • disclosure which is not adequate, accurate, meaningful or up-to-date • an ASC endorsement, direct or implied • information regarding the firm's registration with the ASC without including the category of registration • incorrect or inappropriate use of hypothetical performance data • information that refers simply to the benefits of various investments without including information with respect to the associated and/or potential risks Some firms do not have adequate written policies and procedures that govern marketing activities. Some firms do not adequately oversee the marketing activities of individual representatives; for example, by not requiring firm sign-off of individual web sites and other client communications such as those involving social media web sites like Facebook.	Firms should implement policies and procedures for preparing, reviewing and using marketing materials, including approval prior to dissemination. Firms should implement processes that allow them to effectively monitor and supervise the marketing practices of their dealing representatives to ensure they comply with securities legislation. Firms should ensure their marketing materials contain adequate disclosure and explanations. Firms must ensure that their marketing materials are free of false or misleading information, including unsubstantiated claims. Fox example, marketing should be free of statements that indicate that the ASC or any other securities regulator has endorsed the firm or individual associated with the firm.	Section 75.2 of the *Securities Act* (Alberta) – *Duty of Care* Section 100 of the *Securities Act* (Alberta) – *Representation or holding out of registration* Section 101 of the *Securities Act* (Alberta) - *Representations* CSA Staff Notice 31-325 – *Marketing Practices of Portfolio Managers,* published July 5, 2011