

Looking for Registration in all the Wrong Places: Tips and Traps when joining an EMD

“A drowning man will grab, even the tip of a sword”

Tsun Tsu

National Instrument 31-103 and the recent CSA staff notice 31-323 regarding mortgage funds have mandated a dealer registration for a large number of existing businesses and salespersons that were previously free to operate without registration.

This has understandably created an unhealthy amount of fear and confusion. It has also encouraged certain businesses and salespersons to address the new registration requirement by joining third party Exempt Market Dealers (EMDs).

In this article, we will review what you need to consider before joining an existing dealer, and introduce the option of creating and operating your own independent registered EMD.

Moving in with your EMD

When confronted with new registration obligations, many new industry participants focus on the ticket price for entry to the securities industry (e.g. proficiency, capital, etc.) and, don't fully appreciate that registration is the beginning of one's regulatory obligation - not the end of it.

Joining an EMD is like moving in with a new spouse or partner. It can be a positive and fulfilling experience if you and your EMD are compatible. However, it can also be a source of tension and conflict, and even a messy divorce, if you two are not in sync.

An EMD can provide a range of services in addition to a regulatory platform, including:

1. Product Due Diligence
2. Training
3. General Marketing Support
4. Compliance Support
5. Administrative Support

As a first step, you should review your business needs against the type and quality of services the EMD can reasonably provide.

It is important to pick an EMD appropriate to your requirement. If the purpose of joining is primarily to address compliance issues, then registering with a firm that has sparse compliance and registration experience in a multi-branch dealer may not be helpful.

Your compatibility with the EMD management's style is also important. Salespersons who are used to operating independently can find it frustrating to work under someone else's direction and control. This problem is magnified if EMD management has a different outlook, or has objectives that are not in alignment with the salesperson. Conflicts can often arise over matters such as product due diligence and acceptance.

Prior to joining any EMD, you should carefully review its internal policies. Discuss your obligations and management's involvement/oversight of your business. For example, it is required that management execute agreements relevant to your business, pre-approve any products sold through the dealer, and handle any referral payments. However, management may have other restrictions and controls that you need to be aware of, such as restrictions on the use of trade names, or restrictions on dealing with out-of-province clients.

Management's reputation and prior regulatory difficulties are also important considerations. However, it should be recognized that many prior regulatory problems are not a matter of public record and can remain hidden. Management's fundamental orientation toward regulatory and control matters is often a better indicator of potential future problems.

For example, if the firm's compliance manual appears disorganized, misses key topics, discusses principles in lieu of specific procedures, and/or appears to be pieced together from other manuals - run away. A poorly defined compliance manual is often a prime indicator that management may not appreciate the challenges or seriousness of operating a multi-branch securities registered firm.

Finally, you need to consider who else will be joining the EMD. If regulators sanction a firm, or the financial press publishes a distasteful article against a dealer, it tarnishes the reputation of everyone operating under that firm.

Salespersons don't fully appreciate that when joining another EMD, they are also placing their reputation in the same boat as other registered persons who may operate under different branches or divisions of the EMD. Your business can be affected by actions of other salespersons over which you have little or no influence, or oversight.

Hence, you should also interview management on their criteria and due diligence process when accepting new businesses and salespersons.

Build your own

Given the above considerations, it would be wise to also think about creating your own EMD.

An EMD is a relatively easy category of registration for which to qualify, on the basis of proficiency, capital, regulatory insurance, etc. However, as noted above, obtaining registration is only the beginning of one's obligations, not the end of it.

The real barrier may be uncertainty about whether you have adequate time, attention and/or knowledge to manage compliance issues for your own registered firm.

Ara recognized this hidden “barrier to entry” several years ago while NI 31-103 was in contemplation. We anticipated that independent firms would need access to the same level of professional compliance support as the national and major regional distributors. As a result, we created a compliance support program to address this obstacle. The ongoing compliance program effectively provides a firm’s CCO with access to a functioning compliance department.

The program has been in operation for four years and currently provides ongoing compliance support to about 25 independent businesses.

If you are interested in exploring the creation of your own EMD, we would be pleased to provide you with an outline of the ongoing compliance support program, and a complimentary task list, budget and timeline for registering your own EMD.

We would also be pleased to introduce you to EMDs that offer a regulatory platform, for whom Ara provides ongoing compliance support.

Please contact us at info@aracompliance.com for more information.