Kicking Off 2015

Bulletin

January 30, 2015

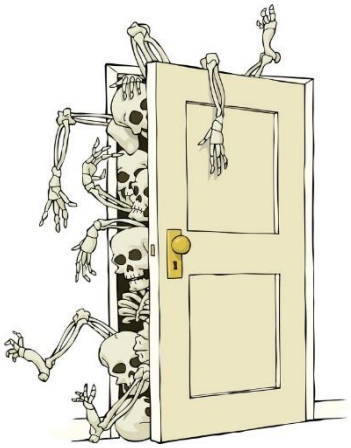
AUM Law primarily serves the asset management sector, with specific expertise in the regulatory space. We strive to provide the most practical, forward-thinking advice and services, using a business model geared to efficiency, responsiveness and excellence.

We are pleased to send you this summary of new developments that may affect your business. Please contact a member of our Regulatory Compliance Group to ask a question, submit a comment or request more information. Please contact communications@aumlaw.com to subscribe or unsubscribe.

With the beginning of a new year, you may have resolved to break a habit, get into better shape or turn over a new leaf in some way. Along with those aspirations, you will also want to remain aware of the following new developments and requirements for registered firms:

1. Late Fee Amnesty for Certain Outside Business Activities
2. Registered Firms that Distribute Products Through Third-Party Dealers
3. Trustees as Permitted Individuals
4. Extension of Certain CRM2 Timelines

1. Late Fee Amnesty for Certain Outside Business Activities



We all have skeletons in our closets. For one of them – outside business activities* (OBAs) that you may not have previously reported on time – the Ontario Securities Commission (OSC) is offering a one-time late filing fee reduction.

In its recent staff notice, the OSC announces that registered firms with registered or permitted individuals (Representatives) may apply for late fee relief for changes to OBAs that were previously reported on item 10 of Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals*.

The eligibility period of the changes is October 16, 2014 to March 27, 2015. Representatives must update each OBA change via the National Registration Database (NRD), and the deadline to submit the application for consideration of late fee relief is **March 27, 2015**.

Outside business activity disclosure is not a new requirement. The amnesty program offered by the OSC simply enables market participants to "catch up" with overdue filings related to previously existing OBAs. Normally, the late fees payable are $100 per business day late, subject to a maximum aggregate late fee of $5,000 per calendar year for all documents required to be filed or delivered by a firm. Registered firms that meet the above criteria (and continue to be deemed suitable for registration) will be considered for a **reduced late fee of only $100 per OBA** for each late notice of a change. There is no fee for the application itself.

*These include individuals' roles as directors, officers, trustees, shareholders and other roles. If you are unsure what is considered an outside business activity, please contact us for further analysis.

2. Registered Firms that Distribute Securities Through Third-Party Dealers

As discussed in our previous bulletin, on January 11, 2015, a number of important amendments to the following National Instruments, related rules, companion policies and forms came into force:

- National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103); the amendments are found here
- National Instrument 33-109 *Registration Information* (NI 33-109); the amendments are found here

The amendments to NI 31-103 include, among other things, a new restriction on registered dealers (in s. 8.0.1 of NI 31-103) and registered advisers (in s. 8.22.2 of NI 31-103) from relying on an exemption in Part 8 of NI 31-103 (the exemption removal provisions), in order to conduct an activity if the firm could otherwise perform the activity under its category of registration. In other words, if a firm is registered as a dealer or adviser, it must conduct all registrable dealing or advising activities in the capacity of a registered dealer or adviser, and must comply with all registrant obligations when conducting such activities. It cannot remove its registrant "hat" and conduct certain registrable activities in reliance on a registration exemption and without complying with registrant obligations for those activities. For example, an exempt market dealer (EMD) can no longer rely on the international dealer exemption.

Potential Implications for Registered Firms that Distribute Securities Through Third-Party Dealers

Although there may be legitimate policy concerns underlying the introduction of the exemption removal provisions (e.g., concerns about the potential for client confusion or concerns about the regulators' jurisdiction to regulate certain activities by registered firms), these provisions may have an impact on certain existing market practices and could result in an unnecessary duplication of compliance obligations.

For example, an investment fund manager that manages an investment fund may obtain EMD registration because the fund manager, from time to time, distributes units of the fund through its own efforts. The fund manager may also distribute units of the fund through third-party dealers and/or may make the securities available through the facilities of FundSERV Inc. In these circumstances, the fund manager is solely acting in the capacity of fund manager and is not "wearing its EMD hat." Rather, it is making the distribution solely through the third-party registered dealer, and may not have any contact with the ultimate investors who are purchasing the units.

Prior to the introduction of the exemption removal provisions, where a fund manager distributed units of a fund through third-party dealers, to the extent these activities could be considered "trading" by the fund manager, it could take the position that it was able to rely on the dealer registration exemption in section 8.5 [Trades through or to a registered dealer]. The fact that the fund manager was also registered as an EMD for other purposes was not relevant since it was not "wearing its EMD hat" when conducting these activities.

However, with the introduction of the exemption removal provisions, it appears that the fund manager can no longer take this position. This would raise the question whether the fund manager is now also required to comply with dealer obligations, such as know-your-client (KYC) and suitability obligations, when distributing units of the fund to these investors.

We have raised this concern with OSC staff, asking whether a fund manager that is registered as an EMD and that distributes securities of a fund to an investor through a third-party dealer can take the position that the investor is not its "client" with the result that the fund manager does not have to comply with KYC, suitability or other obligations to this investor. In view of the fact that the third-party dealer will be required to comply with these obligations, we believe this would be a reasonable position to take and would not result in an unnecessary duplication of these obligations.

We have asked that OSC staff consider issuing an FAQ or other clarification to address this concern. We will advise if we obtain further information on this issue.

3. Trustees as Permitted Individuals

As a result of the amendments to NI 33-109, including to the definition of "permitted individual", there may now be a requirement for each trustee of a family trust (or other trust) holding 10% or more of the voting securities of a registered firm to file a Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals* (Form 33-109F4) via the NRD.

We believe this may be an unintended consequence of the recent amendments and have raised this issue with OSC staff.

However, until the Canadian Securities Administrators (CSA) clarify their position, we would recommend that all trustees of a trust, in this situation, review their trust documents and the new definition of permitted individual: "permitted individual" includes trustees, executors, administrators and other personal or legal representatives who have a direct or indirect "control or direction" over 10% or more of the voting securities of a firm. This means that if a family trust holds 10% or more of the voting securities of a firm, *each trustee* may now be considered a permitted individual and *each trustee* may be required to file a Form 33-109F4.

Generally, for the purposes of securities law, a person has "control or direction" over securities if the person *has or shares* voting or investment power over the securities. Under most trust indentures or agreements, no single trustee has "control or direction" over the assets held by the trust. Decisions are usually made by either a majority of the trustees or unanimously. Accordingly, under most trust indentures or agreements, it would appear that the trustees each share "control or direction" over the securities.

Please note that this new requirement applies to firms that are already registered. If a family trust holding 10% or more of the voting securities of the firm has three trustees (e.g., A, B and C), and Trustee A has already filed a Form 33-109F4, Trustees B and C may now also be required to file a Form 33-109F4.

4. Extension of Certain CRM2 Timelines

The CSA published their decisions about certain CRM2 requirements in Bill Rice's letter of January 28, 2015, as follows:

- The July 15, 2015 CRM2 requirements applicable to registered dealers and advisers are extended to December 31, 2015. This means that the new disclosure requirements required in quarterly account statements (or monthly in certain prescribed circumstances), including position cost information, will come into force at the end of 2015.

- There will be no changes to the requirement to provide cost disclosure and performance reporting information to investors, as it still comes into effect on July 15, 2016.
- There will be no requirement to include comparative data from 2015 in investment performance reports by firms that will report performance for the calendar year 2016. Those firms will be able to base their first investment performance reports on 2016 information alone.
- In spite of recent industry concerns, there will be no change to the definition of “book cost”. Firms that wish to provide tax-adjusted cost information to their clients can do so as supplementary information, affirming that the definition of “book cost” will not change and will remain as currently reflected in NI 31-103 and the CRM2 rules.

The CSA’s letter was in response to a request by the Investment Industry Association of Canada to modify certain dates associated with the CRM2 initiative, to grant dealers more time to implement and test. The CSA have noted that they will prepare the necessary instruments to give effect to these decisions soon.

Please contact a member of our Regulatory Compliance Group for guidance on any of the topics in this bulletin.