Marching Forward

Bulletin

March 30, 2015

With the warmer weather, a few important developments have sprung up:

1. CSA Amendments to NI 45-106 are Coming: Contact Us for a Fixed Fee Quote
2. CASL Fulfills its Promise with $1.1 Million Penalty
3. Marketing Materials Review
4. Decision in *Stradiotto V. BMO Nesbitt Burns Inc.* Provides Guidance to Registrants on Negligence and Breach of Suitability

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1. CSA Amendments to NI 45-106 are Coming: Contact Us for a Fixed Fee Quote

As discussed in our recent bulletin, the Canadian Securities Administrators (CSA) recently announced their adoption of important changes to National Instrument 45-106 *Prospectus and Registration Exemptions* (to be renamed National Instrument 45-106 *Prospectus Exemptions*) (NI 45-106). Please be reminded that these changes may affect your operations and they are expected to take effect on **May 5, 2015**, subject to ministerial approvals.

2. CASL Fulfills its Promise with $1.1 Million Penalty

If you have not recently assessed your firm's relevant policies, procedures and compliance with *Canada's Anti-Spam Legislation* (CASL), now is the time to do so.

Earlier this month, the Canadian Radio-television and Telecommunications Commission (CRTC) issued its first CASL Notice of Violation. The Notice included a penalty of $1.1 million to a Quebec-based corporate training company for allegedly sending commercial electronic messages without the recipients' consent and without including a properly functioning unsubscribe mechanism.

In addition, the CRTC announced on March 25, 2015 that an online dating site provider has entered into an undertaking with the CRTC for allegedly sending commercial emails to registered users of its site without including a clear and prominent unsubscribe mechanism that could be readily performed. As a result, the company has reportedly paid $48,000, and it will develop and implement a CASL compliance program that includes staff training.

These cases demonstrate the CRTC's commitment to crack down on flagrant violations of CASL, which came into force on July 1, 2014. You may wish to review our bulletin summarizing the CASL requirements.

3. Marketing Materials Review

Many firms regularly send newsletters and other marketing materials to clients and other subscribers, promoting their business and investment performance, and/or providing their commentary on the state of the investment industry.

We have found that a common deficiency of firms (particularly newer firms) is the publication of marketing materials that could be considered by the provincial securities regulators to be misleading. We regularly remind our clients to review their materials and the relevant guidance, such as the best practices set out in CSA Staff Notice 31-325, before sending out these materials to subscribers.

AUM Law receives communications from a number of our client firms by virtue of being on their mailing lists, but we do not necessarily review the materials to ensure their compliance with regulatory obligations. If you would like us to review your materials in advance of their external release, please contact us.

4. Decision in *Stradiotto v. BMO Nesbitt Burns Inc.* Provides Guidance to Registrants on Negligence and Breach of Suitability

In November 2014, the Ontario Superior Court released its decision in *Stradiotto v. BMO Nesbitt Burns Inc.* This case dealt with a claim against a registered investment dealer and certain of its registered representatives for, among other things, negligence based on breach of suitability obligations.

The following is a brief summary of the Court's treatment of the suitability issue:

Key Points

- A failure to update "know your client" (KYC) documentation after a client informs a registrant of a significant change (e.g., retirement), even if the changes were contemplated in the design of the portfolio, is not a "technical breach", but may be considered negligence.
- The asset class of a security should be determined based on a full review of its attributes, rather than simply the name or type of security. While preferred shares are often considered fixed income securities, circumstances and certain attributes may support classifying them as equity securities. Misclassifying a security may have a significant impact on an asset allocation and may result in a portfolio being unsuitable.
- Client approval of a portfolio does not necessarily offer a defence to registrants, as the client is relying on the firm and its representative's experience.

Facts in Brief

The plaintiff hired a registered individual (the Representative) to provide investment advice in preparation for his retirement. Approximately one year later, the plaintiff retired and informed the Representative of this fact. The Representative did not do any formal update of the client's KYC documentation.

In 2008, the market experienced a significant downturn and the plaintiff's portfolio began to decline. The plaintiff was particularly concerned about one of his positions – preferred shares that were linked to a note. When constructing the plaintiff's asset allocation, the Representative had classified this security as a fixed income security. If the security had been classified as an equity security, the portfolio would have held more than what was allowable under the agreed asset allocation.

The Court found that the preferred shares should have been classified as an equity security because it had stopped paying dividends while the client held it and because the underlying note created a higher risk profile than traditional preferred shares. The Court found in favour of the plaintiff for an amount of $128,000 in damages, as

1. the asset allocation, even without considering the preferred shares, was constantly at the upper limit of the agreed asset allocation; with the re-classification of the preferred shares, the equity allocation was in excess of what was agreed upon; and
2. the asset allocation appeared to be aggressive when considering the circumstances of the retired plaintiff; objectively, the Court concluded that the Representative failed to meet its standard of care when not updating the plaintiff's KYC documentation when the plaintiff retired.

This case is an important reminder that a failure to comply with KYC and suitability obligations can result in significant civil and regulatory consequences to registrants.