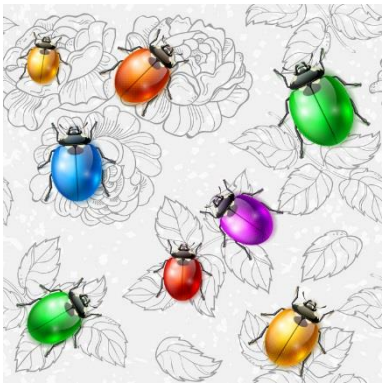
June Bugs

Bulletin

June 30, 2015

There are a number of developments that we're putting bugs in your ear about this month. Please contact your usual lawyer at AUM Law if you would like to discuss any of these topics.



1. Use of Holding Companies

The British Columbia Securities Commission (BCSC) published its *2015 Annual Compliance Report Card* in May and noted that it is continuing to see many instances where dealing and advising representatives direct their firms to pay commissions or management fees to personal corporations. The report states, "We [the BCSC] understand this is tax efficient, but it is not allowed. A personal corporation that receives commissions or management fees from trading in, or advising on, securities is acting in furtherance of trades in securities."

Only firms and individuals registered appropriately under provincial securities legislation are permitted to receive compensation for conducting registrable trading and advising activities, although in 2014, the BCSC noted that "this does not apply to corporations of approved persons of mutual fund dealers, which we have exempted from this registration requirement for historical reasons."

This is a tricky and pitfall-loaded area of the law. Please speak with us about a review of your current compensation structures to avoid this potential deficiency.

2. Finalized! Offering Memorandum Wrapper Relief for Offering of Foreign Securities to Permitted Clients

The Canadian Securities Administrators have finalized amendments to eliminate the need to prepare a "wrapper" when foreign issuers offer securities in Canada to permitted clients under a prospectus exemption. The amendments to National Instrument 33-105 *Underwriting Conflicts*, Multilateral Instrument 45-107 *Listing Representation and Right of Action Disclosure Exemptions*, Ontario Securities Commission (OSC) Rule 45-501 *Ontario Prospectus and Registration Exemptions* and an Ontario-specific amendment to Form 45-106F1 *Report of Exempt Distribution* are expected to be effective on September 8, 2015.

The amendments codify and expand the relief previously granted to several investment dealers to prevent the additional disclosure requirements under Canadian securities law from acting as a deterrent for foreign issuers to make offerings available to Canadian institutional investors. Although the required disclosure is generally boilerplate and provided through the use of a short addendum or "wrapper" to the foreign disclosure document, the additional disclosure is seen as limiting opportunities for Canadian institutional investors. Given the presumed sophistication of permitted clients, the justification for the disclosure is generally not considered to be significant.

The relief is limited only to offerings to permitted clients of certain foreign securities. Accordingly, wrappers will still be necessary if foreign offerings are extended to other classes of investors, such as accredited investors. In addition, the required disclosure will still be required for offerings by Canadian issuers, regardless of whether the investors are permitted clients.

3. Expanded Insider Trading and Tipping Prohibitions

Recent amendments to the *Securities Act* (Ontario) have expanded the scope of the insider trading and tipping prohibitions. In addition to "reporting issuers", these provisions now apply to any "other issuer whose securities are publicly traded."

The changes resolve a potential gap in the insider trading provisions that arise from the fact that a public issuer with securities traded by Ontario market participants may not be a reporting issuer in Ontario.

A 2010 amendment had already extended the scope of the insider trading and tipping prohibitions to any issuer listed on the TSX Venture Exchange that has a real and substantial connection to Ontario. With the recent change, it is now clear that the prohibitions can apply to any issuer with securities listed or traded on a public market in any jurisdiction, whether in Canada or abroad.

Prior to these amendments, it was clear that improper trading in securities of issuers that were not reporting issuers in Ontario could lead to sanctions under the Act. For example, in decisions such as *Re Talawdekar and Hariharan* in 2015 and *Re Suman and Rahman* in 2012, the OSC addressed such improper trading as conduct contrary to the public interest. With the expanded scope of the insider trading and tipping provisions, such conduct would now constitute a direct breach of the Act.

Since there is no definition of what constitutes "an issuer whose securities are publicly traded," there is the potential for the new language to be interpreted broadly. For example, consider whether a non-reporting issuer that has distributed securities widely in reliance on exemptions to the prospectus requirement could be considered to have securities that are publicly traded.

Given that the OSC and other members of the CSA are currently considering expanding the scope of the prospectus exempt market through additional exemptions, such as a new crowdfunding exemption and an expanded offering memorandum exemption, there is a greater potential for:

- "quasi-public" non-reporting issuers with large numbers of retail investors; and
- increased secondary trading in the exempt market, including through crowdfunding portals and other platforms, such as TSX Private Markets.

We expect that the full scope of the expanded insider trading and tipping prohibitions will become clear as these provisions are interpreted in future decisions. However, in the interim, registrants and issuers should update their policies and procedures to reflect the expanded scope of the insider trading and tipping prohibitions.

4. Proposal for ETF Facts Requirement

On June 18, 2015, the CSA released their well-anticipated proposal that will require exchange-traded funds (ETFs) to produce and file a summary disclosure document, the *ETF Facts*.

The *ETF Facts* will look very similar to the *Fund Facts* document that is currently required to be prepared for retail mutual funds. However, the *ETF Facts* document will contain additional detail that reflects the unique nature of the products, including the trading and pricing information related to an ETF, such as market price, bid-ask spread, and the premium or discount to net asset value.

Dealers that receive orders for ETF securities will likewise be required to deliver the document instead of a prospectus within two days of purchase. Similar to the *Fund Facts*, the *ETF Facts* document must be made available on the website of the ETF or its manager.

The *ETF Facts* is intended to provide investors with important information about the fund in a comprehensible format that is easily comparable to other funds. It will also help ensure consistency between the disclosure requirements for mutual funds and ETFs. The proposal will replace the exemptive relief that has already been granted to a number of specific dealers that act as agents for the purchaser of an ETF security, which requires them to deliver a summary document within two days.

The CSA are seeking comments on a number of aspects of the proposal, including on the proposed two-phase transition periods, the content of the form as it relates to trading of ETFs and on rights for withdrawal. Comments will be accepted until September 16, 2015.

5. In Effect: Amendments to Privacy Legislation

As of June 18, 2015, amendments to the *Personal Information Protection and Electronic Documents Act in* Bill S-4 are in effect, including the following:

- Broadened regulatory powers of the Privacy Commissioner of Canada, including the ability to enter into compliance agreements with organizations
- A clarified concept of “valid consent” for the collection, use and disclosure of personal information
- Permitted disclosure of information in a business transaction under certain circumstances
- Exceptions to the consent requirement, including for certain investigations

A breach notification and recordkeeping requirement is expected to come into effect at a later date. When it does, organizations will be required to notify affected individuals and the Office of the Privacy Commissioner of Canada in case of a security breach if it is “reasonable in the circumstances to believe that the breach creates a real risk of significant harm to an individual.” Organizations will also be required to notify any other organization that can reduce the risk or mitigate the harm from the breach.

We invite you to take this opportunity to review your policies and procedures that deal with the protection of personal information.

6. Report on Virtual Currencies Released by Senate Standing Committee on Banking, Trade and Commerce

The 2014 omnibus federal budget bill (Bill C-31) saw the introduction of legislation that would regulate dealers in virtual currencies as "money services businesses" under Canada's *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*. The implementing regulations are not yet published; however, June did see the release of *Digital Currency: You Can't Flip this Coin!*, a report by the Senate Standing Committee on Banking, Trade and Commerce.

In the report, the senators recommend that "the federal government, in considering any legislation… create an environment that fosters innovation for digital currencies and their associated technologies." The report also urges government to use a regulatory "light touch" to minimize "stifling" the development of payment, value storage and transmission technologies.

The report contains a concise and up-to-date overview of the principal issues, and has been welcomed as farsighted and forward-thinking by the digital currency (Bitcoin) community. It is worth paying attention to what is happening in the payments area, of which cryptocurrencies and blockchain technologies are a part.

7. Registration Exemption for US-Registered Firms

On May 28, 2015, the Ontario Securities Commission published OSC Rule 32-505 *Conditional Exemption from Registration for United States Broker-Dealers and Advisers Servicing U.S. Clients from Ontario*. The Rule provides exemptions from the dealer and adviser registration requirements for US registered broker-dealers and advisers that have offices or employees in Ontario, and are trading to, with or on behalf of clients that are resident in the United States, or acting as advisers to US clients – provided these firms do not have any Ontario resident clients.

Firms that wish to make use of this exemption must complete and file Form 32-505F1 with the OSC **by August 31, 2015.**

Outside of Ontario, the other provincial securities regulators issued parallel orders in March 2015 granting the same exemption from the requirement to register as a dealer or adviser to U.S registered firms provided the firms do not trade for or advise Canadian clients.

8. Our Cybersecurity Services

Did you know that 78% of organizations have experienced a data breach over the past two years? (Source: TrendMicro.)

Pursuant to section 11.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, registered firms are required to establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to manage the risks associated with their businesses, in accordance with prudent business practices. As highlighted in the OSC's June 24 outreach seminar and as mentioned in our May bulletin, cybersecurity is becoming an area of increasing focus for securities regulators.

To help registrants (and other entities) meet their internal control obligations and stay ahead of cybersecurity risks, we recently launched a fixed-fee cybersecurity services module. The module involves a review of the following:

- governance structure and risk management
- risk assessment
- technical controls
- incident response planning
- vendor management
- staff training
- cyber intelligence and information sharing
- cyber insurance
- continuous assessment

We would be pleased to set up a preliminary assessment to evaluate your needs. Please contact us.