Fall Fever

Bulletin

September 2015

The 1992 Toronto Blue Jays made history by becoming the first non-U.S. team to win the World Series. It has been a long 23-year wait, but Canada's team is once again poised to become World Champions!

We humbly accept that our September bulletin may not be quite as exciting, but hope you find it useful as you come to bat amidst the curve-balls of developments and requirements in the regulatory landscape.

Please contact your usual lawyer at AUM Law if you would like to discuss any of these topics.

1. Online Advice Models

In CSA Staff Notice 31-342 *Guidance for Portfolio Managers Regarding Online Advice*, staff of the Canadian Securities Administrators (CSA) reiterated that portfolio managers that operate as online advisors are subject to the same obligations as traditional "bricks and mortar" advisors, including know-your-client (KYC) and suitability requirements.

The CSA notice indicates that no truly automated "robo-advisors" have been registered in Canada. To date, all online advisors that have been approved, operate under a "hybrid model" where individual advising representatives remain actively involved in, and responsible for, all decisions regarding a client's portfolio. Typically, an individual advising representative initiates contact with all clients or prospective clients. However, the CSA notice does acknowledge that some advisors operating under the hybrid model will only initiate direct contact with clients if the advising representative has questions or concerns about the information gathered through the online portal. In the latter case, CSA staff may consider imposing terms and conditions to limit the advisor to relatively simple products.

As part of the registration process, CSA staff will review an online advisor's KYC and suitability processes to ensure that they are designed and conducted in a manner that amounts to a meaningful discussion between the firm and client, notwithstanding the online nature of the interaction. Clients should also have the option to initiate live contact with an advising representative of the firm.

Although the CSA notice focuses on portfolio managers (PMs), it does indicate that the same considerations apply to dealers that operate through online portals.

If you would like to discuss this topic, please contact your usual lawyer at AUM Law.

2. 2015 OSC Compliance and Registrant Regulation Report

As many market participants know, every year the Ontario Securities Commission (OSC) publishes an Annual Summary Report for Dealers, Advisers and Investment Fund Managers covering the activities of the Compliance and Registrant Regulation branch. This year's report was released in the form of OSC Staff Notice 33-746.

Among the more salient topics covered in the report are sneak previews of the final forms of the offering memorandum exemption and the crowdfunding regime the report indicates are soon coming to Ontario. These new developments were initially published for comment in March 2014 for a period of three months and the OSC intends to publish them in final form later this fall, with a coming-into-force date to follow soon thereafter.

As alluded to above, the report also discusses deficiencies identified by the OSC during the past year's compliance reviews (as well as repeat deficiencies), along with regulatory guidance on accepted practices. Some of the deficiencies include:

- Inadequate referral arrangements
- Incomplete and/or inadequate books and records
- Failure to complete adequate KYC, KYP and suitability assessment
- Inadequate update of clients' KYC and suitability information
- Inappropriate practice of "renting out" a firm's registration
- Inadequate supervision of dealing representatives
- Failure to provide adequate disclosure of underwriting conflicts
- Failure to provide adequate relationship information
- Inadequate written policies and procedures on portfolio management
- No collection of clients' insider status
- Commingling of client assets
- Prohibited inter-fund trading

Outside Business Activities

The report also continues to remind registrants of one of the OSC's recent hot button topics – the obligation to report outside business activities (OBAs) and late fees resulting from failures to disclose on time. More specifically, the report discusses amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* that came into force in January 2015, along with related changes to its companion policy that have added guidance regarding conflicts of interest in connection with registrants and permitted individuals serving on boards or having other OBAs. The report provides examples of the types of activities that the OSC would expect individuals to report:

- **Employment** – all employment activities with the sponsoring firm and outside of the sponsoring firm.
- **Officer and director positions** – all officer and director positions with the sponsoring firm and outside of the sponsoring firm (regardless of whether the individual is in a position of power or influence), including positions with hospitals, charities, cultural and religious organizations and general partnerships.
- **Equivalent positions to an officer or director** – these include positions where the individual is in a position of power or influence over clients or potential clients, but also non-leadership roles, such as:
  - Roles handling investments or monies of an organization, such as being on a charity's investment or finance committee (as these roles are similar to activities performed by registrants)
  - Acting as a pastor (as this role places the individual in a position of influence over his or her congregation)

  - Mentoring youth through an organization (as it places the individual in a position of influence over potential clients, including family members of the youth)
- **OBAs** – these include activities where the individual is in a position of power, position of influence or position that places the individual in contact with clients or potentially vulnerable clients (e.g., seniors), such as teachers (elementary, secondary and college), registered nurses, early childhood educators, volunteer ministers and support workers working with clients with mental health issues, abused women or the elderly.
- **Holding companies** – ownership stakes in holding companies require disclosure as they allow a person to perform, control or influence a business activity indirectly. However, *de minimis* ownership interest of 1% or 2% do not generally require disclosure.

If you have any questions regarding the above, please contact your usual lawyer at AUM Law.

3. Foreign Clients

Investment fund managers interested in accepting foreign investment into their Canadian funds will want to ensure they are asking the right questions before accepting subscriptions from foreign clients. Some questions include:

- Will the transaction trigger securities laws or other obligations in the foreign jurisdiction?
- Are there any additional or elevated anti-money laundering obligations based on the specific foreign jurisdiction?
- Does the inclusion of foreign investment change the tax treatment of the Canadian fund?

Before accepting any foreign investment, we encourage you to contact us to address the above questions and discuss your specific circumstances.

4. Securities Regulators' Mystery Shopping Report

In a first of its kind, the OSC, IIROC and MFDA recently published the results of a mystery shop of Ontario advisors, including investment dealers, mutual fund dealers, exempt market dealers (EMDs) and PMs, for the purpose of assessing retail investors' experiences and to evaluate the investment advice process. The report concludes that while most registrants play by the rules, some are still struggling to fulfil basic regulatory obligations.

The review was conducted between July and November 2014, and involved individuals meeting with advisors and purporting to have funds to invest.

Some numbers:

- A total of 105 meetings were conducted
- 11 EMD reviews
- 13 PM reviews
- 63% of shops met or exceeded all regulatory expectations and there were no instances of serious misconduct requiring regulatory action
- In almost 80% of the shops, the undercover investors were told about investment products the advisor could sell
- In almost 90% of the cases, the advisors asked about their investment objectives

The news was not all good, however, as unsuitable recommendations were made in 14% of the 24 shops that made specific investment recommendations. A further 21% of shops making recommendations did not collect thorough KYC information and 29% did not discuss fees appropriately. It is important to note that none of the 24 shops that made recommendations were PMs.

As a next step, the regulators plan to focus on the enhancement of advisory practices, setting out clear expectations and using the findings of the mystery shop to inform policy-making. For further details please see OSC Staff Notice 31-715, released on September 17, 2015.

Please contact us if you would like to discuss further.

5. CRTC's New Guidance on Implied Consent

On September 4, 2015, the Canadian Radio-Television and Telecommunications Commission (CRTC) released an Enforcement Advisory to remind certain businesses in Canada of the requirements under Canada's Anti-Spam Legislation (CASL) with respect to "implied consent". In connection with the Enforcement Advisory, the CRTC has also published an updated Guidance on Implied Consent (the Guidance).

The Enforcement Advisory indicates that CRTC staff observed that some businesses are sending commercial electronic messages (CEMs) to lists of email addresses gathered from public websites. The Guidance explains the circumstances pursuant to which a CEM can be sent to email addresses found online, and also addresses:

- The difference between express and implied consent
- Circumstances where a purchaser of a business can rely on previously obtained consent
- Existing business relationships and examples of how an existing business relationship can or cannot be used as implied consent
- How to prove that you have consent
- The importance of good recordkeeping practices

In light of this Enforcement Advisory and new Guidance, and given the CRTC's commitment to crack down on flagrant violations of CASL (see our March and July bulletins for examples of recent enforcement actions), we encourage you to review your CASL compliance program and assess how you are protecting your firm against regulatory action or civil lawsuits. Please call us if you would like to discuss further.

For an overview of requirements under CASL, see our In a Nutshell on the topic.

6. Anti-Money Laundering Reminder

We continue to identify significant gaps in the anti-money laundering and counter-terrorist financing (AML/CTF) compliance programs of EMDs, PMs and investment fund managers (IFMs). The most common gaps we observe are:

- Inadequate/insufficiently documented risk assessments (risk assessments that are pro forma or "boilerplate")
- Failure to perform an independent effectiveness review every two years, or inadequate documentation of the review
- Incomplete client identification information and documentation (e.g., expired ID and missing prescribed information for beneficial owners of corporate or other entity clients)
- Documentation to determine whether a client is acting on behalf of a third party (Third Party Determination) is particularly problematic and poorly understood
- Policies and procedures have not been properly updated to reflect the Risk Based Approach and incorporate required customer due diligence, ongoing monitoring and enhanced measures to be applied to identified high risk business relationships

As it happens, these are the very things that pop up frequently when FINTRAC imposes administrative monetary penalties.

This is a gentle reminder that the unofficial "grace period" to allow for reporting entities to bring their AML/CTF financing into full compliance with the amendments which took effect last year has expired. During its examinations, FINTRAC expects to see a robust and up-to-date AML/CTF program. In particular, there is an expectation that reporting entities have understood and implemented the Risk Based Approach.

If your AML/CTF compliance program needs some refreshing or renovation, please contact your usual lawyer at AUM Law.

7. Extension of Quebec Derivatives Blanket Exemption

On August 27, 2015, the Autorité des marchés financiers published Decision No. 2015-PDG-0132 (the Extension Decision) that postpones the effective date of the revocation of the blanket derivatives exemption under the *Quebec Derivatives Act* (QDA) (the Blanket Order) by nine months, from September 5, 2015 (see our August bulletin) to June 5, 2016.

The Extension Decision provides entities who wish to continue dealing in listed options and futures derivatives (for which an exemption was available in the Blanket Order) with a nine-month window to apply for registration as derivatives dealers under the QDA. The Extension Decision also provides transitional relief for exempted entities trading in derivatives under the Blanket Order from having to obtain these derivatives from accredited investors using the new risk acknowledgement form (Form 45-106F9) required by National Instrument 45-106 *Prospectus Exemptions* (NI 45-106). This transitional relief will end on June 5, 2016.

Please contact us if you would like to discuss further.

8. New Rights Offering Exemption

Under the current legislation, an issuer planning to conduct a prospectus-exempt rights offering in Canada may use the rights offering prospectus exemption in section 2.1 of NI 45-106, which in turn requires compliance with National Instrument 45-101 *Rights Offerings*. The CSA have finalized significant changes to the rights offering regime in an effort to address the fact that issuers rarely use prospectus-exempt rights offerings to raise capital due to the associated time and cost. The CSA announced that the amendments and policy changes will come into force on December 8, 2015.

The amendments create a streamlined prospectus exemption available only to reporting issuers (excluding investment funds subject to National Instrument 81-102 *Mutual Funds*). The main features of this new rights offering exemption include the following:

- NI 45-101 rights offerings will be repealed
- Securities regulatory authorities will no longer review rights offering circulars
- A new form of notice (Form 45-106F14) will have to be filed and sent to security holders, containing information about accessing the rights offering circular electronically
- A new form of simplified rights offering circular (Form 45-106F15) will be introduced and presented in a question and answer format
- Reporting issuers will no longer be restricted to issuing more than 25% of their securities under the exemption in any 12-month period; the new dilution limit will be 100%

Please contact us if you would like to discuss this development.

9. Participation Fees

In mid-September the OSC's Registrant Outreach held a seminar that provided registrants, unregistered capital markets participants and other industry participants with a refresher on the calculation and filing of participation fees in advance of the December 1, 2015 filing deadline.

During the seminar, OSC staff highlighted changes to OSC Rule 13-502 *Fees* applicable to registrants and unregistered capital markets participants, which came into effect on April 6, 2015. These changes include:

- Removal of the use of the reference "fiscal year" (for 2015, all registrants and unregistered capital markets participants should calculate fees based on the firm's financial year ending in 2015)
- Change in the definition of "capital markets activities" (meant to address the common error made by firms that deduct all non-Ontario revenues even if they are considered capital markets activities, and to reflect that IFMs are required to be registered)
- Change in the definition of "Ontario percentage" (meant to simplify and clarify the term by removing references to various tax legislation tied to its previous definition)
- Amendments to filing and payment deadline for unregistered IFMs (meant to align the fee calculation and payment time with registrants and exempt international firms)
- Requirement for the CCO (or person acting in a similar capacity, in the case of unregistered capital markets participants) to attest to completeness and accuracy of the Form 13-502F4 calculation
- Late fee amendments (including increase in late fee cap for all forms or documents to be filed from $5,000 to $10,000 for the three largest categories of registrants with Ontario revenues over $500M)
- No refunds (clarifies that, absent exceptional circumstances, the OSC will not issue a refund if the request is made later than 90 days after the fee was required to be paid)
- Indirect avoidance of Rule (clarifies the OSC's views with respect to fee avoidance)
- Participation fee rates (will be kept at the 2014 level until 2016)

Staff reviewed filing requirements for the capital markets participation fee calculation, led participants through Form 13-502F4 and provided examples of common errors related to the calculation and filing of the participation fees. Please contact your usual lawyer if you have any questions relating to the above, or the calculation of fees in general.

10. Help Us, Help You

As we have previously discussed, registered firms have ongoing obligations under securities legislation to inform the OSC of the following changes to a firm or a registered individual's information. Failure to notify the OSC within 10 calendar days of most of these changes may lead to a $100 late fee per day, up-to a maximum of $5,000 per year (and in some instances $10,000 per year – see Participation Fees above):

Changes to Firm	Changes to Registered and Permitted Individuals	Changes to Operations
• Operations (e.g., organizational structure, officers and directors) • Ownership or anticipated acquisition of securities of another entity • Insurance, auditors and constating documents (e.g., articles of amendment)	• Individual Forms 33-109F4 • Outside activities*	• Offering of new products/business lines

*The OSC has been imposing late filing fees for failure to disclose all outside activities of individuals (e.g., directors, officers, trustees, shareholders and other roles). If you are unsure what to disclose, please contact us for further analysis and potential filing.

An ounce of prevention is worth a pound of cure. Contact a member of our Regulatory Compliance Group to ensure that you are compliant.

AUM Law(yers) in the News

David Surat, Senior Legal Counsel in our Regulatory Compliance Group, was recently interviewed by Tali Folkins of *Law Times* and quoted in "Common securities regulator moves forward", an article published in their September 7, 2015 issue.

LAW TIMES

As mentioned in our August bulletin, the jurisdictions participating in the Cooperative Capital Markets Regulatory System took an important step in the system's transition by releasing for public comment a revised consultation draft of the uniform provincial/territorial *Capital Markets Act*, and a draft of the initial regulations. The proposed framework represents a significant advance towards harmonization by eliminating several of the carve-outs and local variations from the current patchwork of national and multilateral instruments, local rules, policies and forms.

Please contact David if you would like to discuss this development.

Announcements

The head of our Montreal practice, **Pierre-Yves Châtillon**, has been named as a top mutual funds lawyer in *The Best Lawyers in Canada 2016.*

Stay Tuned…

… for our upcoming "In a Nutshell" piece focusing on features of **mortgage investment entities** and **syndicated mortgages**.