Mysteries Solved

Did you know… Murder, She Wrote made its television debut on this day in 1984? Angela Lansbury, as everyone's favorite mystery writer turned sleuth J.B. Fletcher, solved crimes from Cabot Cove to Moscow in this suspenseful (and highly realistic) tv series.

The suspense is over, however, with respect to the much anticipated Financial Action Task Force (FATF) Mutual Evaluation Report on Canada's anti-money laundering regime. **Spoiler Alert:** Results are mixed.

We will take the mystery out of the FATF Report as well as other key regulatory developments in this month's AUM Law bulletin.

In this bulletin

In Brief: OSC Investor Office Launches Multi-lingual Investment Resource Website ● Two-Year AML Reporting and Review Requirements

1. FATF Releases Mutual Evaluation Report on Canada's AML/CTF Measures

On September 15, 2016, the Financial Action Task Force (FATF) released its highly anticipated Mutual Evaluation Report (the Report) on Canada's anti-money laundering and counter-terrorism financing (AML/CTF) measures. The FATF is the inter-governmental body that develops global anti-money laundering policies and sets standards for member countries. In 2015, a FATF evaluation team assessed Canada's AML/CTF regime against FATF's global standards and has now released its findings.

While the Report acknowledges that the Canadian regime has a good grasp of the risks the country faces from money laundering and terrorist financing, it

In Brief

OSC Investment Resources

In hopes to better engage with Ontario's increasingly diverse investor base, the OSC's Investor Office has just launched InvestingIntroduction.ca, a platform providing investment resources in 19 different languages. The website serves as a primer for new investors, covering topics such as fraud, how to check the registration of an advisor or firm, and complaint reporting.

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AML Two-Year Review

We would like to remind our clients that, in most circumstances, registrants are required to perform an independent review of their anti-money laundering

identifies a number of areas requiring improvement. Notably, the fact that lawyers and law firms are not subject to the federal AML/CTF regime was identified as a "significant loophole" (a Supreme Court of Canada decision severely limited the application of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* to the legal profession). Real estate brokers and dealers in precious metals and stones were also singled out for attention as high risk sectors in need of "more intensive supervisory measures".

In general, securities dealers were assessed to have "a good understanding of their AML/CFT obligations, although supervisory findings highlight that the level of understanding is weaker in more simplified structures and that internal controls are a recurring area of weakness".

In Brief cont'd

program **every two years**. If you are unsure of whether you have met this obligation or wish to inquire about our services in this area, please contact your usual lawyer at AUM Law

The Report also notes that certain securities dealers, particularly those not involved in cross-border activities, tend to underestimate their vulnerability to money laundering and terrorist financing. Further, FINTRAC data indicates an uneven level of compliance among non-Federally Regulated Financial Institutions (FRFIs). Some of these non-FRFIs (including securities dealers) exhibit "incomplete or not updated policies and procedures, limited scope of controls, a lack of comprehensive assessment of effectiveness, and no communication to senior management".

The Report is currently being reviewed by industry and policy makers, and we can expect further regulatory initiatives to address the findings.

Please contact a member of our Regulatory Compliance Group if you would like to discuss this Report or your AML/CTF obligations generally.

2. Highlights From OSC's September 2016 Investment Funds Practitioner

The Investment Funds and Structured Products Branch of the OSC just released the latest edition of its Investment Funds Practitioner (the Practitioner), which provides an overview of recent issues arising from applications for discretionary relief, prospectuses, and continuous disclosure documents that investment funds file with the OSC.

We have highlighted the following key issues from the Practitioner for your convenience.

Prospectuses – Investment Funds Offering Currency Hedged Class or Series

The OSC is currently reviewing and monitoring developments relating to currency hedging strategies used by investment funds and is considering whether additional guidance or rule-making is needed. OSC Staff is particularly concerned about whether a class or series of an investment fund established for the purpose of using currency hedging strategies (a Hedged Series) should be a separate investment fund. This concern is based on subsection 1.3(1) of NI 81-102 – *Investment Funds*, which states that each class or series of an investment fund that is referable to a separate portfolio of assets is considered to be a separate fund.

Filers are encouraged to consult with OSC Staff in structuring a Hedged Series. Filers should also expect additional questions with respect to their Hedged Series, in particular for a class or series where a portfolio manager hedges anywhere from 0% to 100% of the Hedged Series' foreign currency exposure. Though historically OSC Staff has been comfortable with the hedging of all or substantially all of the foreign currency exposure for a Hedged Series, the deviation to a more variable hedging approach has resulted in their questioning of how to treat these variable Hedged Series, and whether such classes should be their own investment fund.

OSC Staff will also request as part of their prospectus review that a fund with a Hedged Series include in its prospectus disclosure that the prior approval of security holders will be obtained before the currency hedging strategy of the Hedged Series is changed.

Continuous Disclosure – Review of Fund-of Funds Disclosure of Fees and Expenses

OSC Staff conducted an issue-oriented continuous disclosure review of the disclosure of fees and expenses for fund-of-funds. Of note, OSC Staff emphasized that:

1. Fund managers have to "look-through" expenses in fund-of-fund structures when calculating the management expense ratio (MER) and total expense ratio (TER) for top funds, including top funds that invest in third party conventional mutual funds and exchange traded funds (ETFs). Fund managers should use reasonable estimates when determining the expenses of underlying funds managed by third parties. The OSC has found that a number of top funds that invested in underlying ETFs did not include the expenses of the ETFs in the calculation of the MER and TER. Many of those funds disclosed MER and TER which were materially understated and were required to refile.
2. Management fee disclosure provided by top funds, particularly for new funds without historical MERs, may be misleading if there is no prospectus disclosure explaining that the underlying funds may have higher management fees. OSC Staff expects the top fund to provide sufficient disclosure to clearly explain the impact of the expected management fees of the underlying funds on the top fund's MER. Staff has found that funds with the investment objective to invest in underlying funds often disclose only the management fee at the top fund level, even if the underlying fund(s) have higher management fees.

Independent Review Committees (IRCs) – IRC Reporting Under Section 4.5 of NI 81-107

OSC Staff affirmed its view is that there is no materiality threshold when applying the IRC's reporting requirement under section 4.5 of NI 81-107. This provision requires an IRC to provide written notice to the principal regulator when the IRC becomes aware of any instance in which the fund manager acted in certain conflict of interest matters**,** namely (i) interfund trading, (ii) purchases of securities of a related issuer, or (iii) investment in securities offerings underwritten by a related party; but did not comply with a condition imposed by securities legislation, or any IRC approval or exemptive relief decisions.

Please contact a member of our Investment Funds Group to further discuss any of these topics.

3. No Double Dipping – A Reminder Regarding Fees

On July 29, 2016, the OSC approved a no-contest Settlement Agreement with respect to Scotia Capital Inc., Scotia Securities Inc., and HollisWealth Advisory Services Inc. (together, the Scotia Dealers) in response to allegations by OSC Staff of inadequacies in the Scotia Dealers controls and supervision systems, resulting in a failure to detect or correct the charging of excess account fees to clients.

This case hinged on the alleged "double dipping" of client fees. In particular, the OSC alleged that the Scotia Dealers incorrectly classified a number of client accounts for fee billing purposes, and as a consequence, clients that had purchased structured products in fee-based accounts were paying account fees to Scotia Dealers, who were additionally receiving trailer fees from the issuer. As a result, these clients paid excessive fees because the fee calculation for the structured products did not exclude the trailer fee component received on the managed accounts.

This has proven to be costly for the Scotia Dealers, as under an OSC-approved compensation plan there is an anticipated compensation payment to affected clients of approximately $20 million, in addition to a voluntary payment of $850,000.

In addition to the above compensation payments, the Scotia Dealers agreed to terms and conditions including close supervision by the OSC and a timeframe under which to remedy any remaining issues with their policies and procedures.

The Scotia Dealers case highlights the importance of reviewing one's compliance systems to ensure adequate measures are in place to avoid control and supervision inadequacies. It is also important for funds charging trailer fees to ensure that the possibility of double dipping is examined closely, as a failure to do so could be a costly affair.

Please contact us to discuss how we can help you ensure that your supervisory policies are adequate.

4. New TSX DRIP Plan Rules

On September 1, 2016, the Toronto Stock Exchange (TSX) adopted (and the OSC approved) amendments to the rules governing dividend/distribution reinvestment plans (DRIPs). The new rules, which can be found at Section 617.1 of the TSX Company Manual (New DRIP Rules), provide a complete set of standards and practices applicable to DRIPs for their listed issuers. For your convenience, we have highlighted the New Drip Rules related to implementing and amending a DRIP below.

Under the New DRIP Rules, all new DRIPs (other than DRIPs providing for the payment of dividends or distributions solely with securities purchased on the secondary market) must be pre-cleared with the TSX at least five business days prior to the effective date of the DRIP. Once a DRIP has been pre-cleared by the TSX and approved by the board of directors of the listed issuer, the issuer must file certain prescribed documents with the TSX and pay a listing fee. Any amendment to an existing DRIP must also be pre-cleared by the TSX at least five (5) business days prior to the effective date of the amendment.

The TSX also sets out parameters for their listed issuer's DRIPs. Under the New DRIP Rules, the price per listed security at which securities will be issued under a DRIP cannot be lower than the market price less a 5% discount. The listed issuers must also make some provision for fractional security interests that may result from the DRIP. All security holders must be eligible to participate in the DRIP, though listed issuers may limit the participation of security holders residing outside of Canada. Finally, the DRIP must state that all amendments to the DRIP must be pre-cleared by the TSX.

Please note that the TSX confirmed that listed issuers with DRIPs in effect prior to September 1, 2016, will be grandfathered and will not be required to comply with the New DRIP Rules until such time as those DRIPs are amended and require TSX approval.

Please contact a member of our Investment Funds Group to further discuss this topic.

5. CSA Publishes Notice on Cyber Security for Market Participants

On September 27, 2016, the CSA published an updated cyber security notice (the Notice) for financial market participants. The Notice emphasizes that as the cyber security landscape has evolved and cyber attacks have become more frequent and complex, it is vital for market participants to adhere to guidance issued by self-regulatory organizations such as IIROC and the MFDA, and take meaningful steps to protect themselves against cyber threats.

In particular, the CSA expects Issuers, Registrants and Regulated Entities to do the following:

- **Issuers**: Provide detailed and entity specific cyber risk disclosure, and maintain a cyber-attack remediation plan that outlines how the materiality of an attack is assessed to determine "whether and what, as well as when and how, to disclose in the event of an attack." When assessing materiality, issuers should consider factors such as "impact on the company's operations and reputation, its customers, employees and investors."

- **Registrants**: Continue to remain vigilant in developing, implementing and updating their approach to security hygiene and management, and review and follow the aforementioned guidance from self-regulatory organizations such as IIROC and the MFDA.

- **Regulated Entities**: Examine and review their compliance with ongoing requirements outlined in securities legislation and terms of recognition, registration or exemption orders, including the need to have internal controls over their systems and to report security breaches. As well, adopt a cyber security framework provided by a regulatory authority or standard-setting body tailored to their size and scale – one size does not fit all.

Though this Notice is not binding, it would be unwise to disregard the guidance contained therein, especially given the significant liability and reputational damage that can result from having an inadequate cyber risk management program. Further, as cyber security has been identified as a priority area for the CSA going forward, you can be sure that the sufficiency of market participants' cyber programs will be under increased scrutiny.

Please contact our Regulatory Compliance Group to discuss the issue of cyber security further.

6. CSA Publishes Notice on Consideration of Concerns Regarding Report of Exempt Distribution

On September 29, 2016, the CSA issued revised guidance (the Guidance) on the new 2016 Exempt Distribution Report (the Report), in order to address ongoing concerns that certification requirements in the Report exclude Canadian institutional investors from foreign offerings. In particular, concerns have been raised that Canadian institutional investors have been excluded from participating in foreign offerings as a result of a "perceived change in the risk of personal liability in the 2016 Report, as well as the more extensive information required in the 2016 Report."

Though the CSA initially took steps to remedy these concerns with regulatory relief from the requirement to disclose whether a purchaser is a registrant or an insider of the issuer in certain circumstances, it acknowledges these issues still have not been satisfactorily resolved. As such, though the Guidance provides further clarification regarding issues such as the certification of the Report, the CSA is continuing to seek input on this issue and is considering additional steps to address the concerns.

Please contact us if you have any questions regarding this Guidance or would like assistance with providing input to the CSA.

7. Think of Us When Conducting a Capital Raise

AUM Law can act as an extension of your dealer's compliance team. From initial marketing to post-closing matters, whether it be in relation to a number of transactions or one specific deal, we provide valuable advice on processing documentation to ensure that your transaction(s) align with regulatory expectations.

We can assist by:

- Developing tailored and practical transaction-related policies and procedures that align with regulatory expectations
- Preparing offering documents, subscription agreements, client and product onboarding documents and reviewing marketing materials in connection with a capital raise
- Assisting in real time on transactions by providing back-office support.

AUM Law can also provide an extra set of hands and eyes to process the following work:

- Review completed subscription agreements
- Review evidence of compliance with regulatory expectations relative to a particular product
- Filing reports of exempt distribution in connection with a distribution.

Don't wait until the eleventh hour, please contact our Regulatory Compliance Group to help with your next capital raise.

Frequently Asked Questions

> Can the business cards and other marketing materials of a registrant reflect its registered trade name instead of its full legal name?

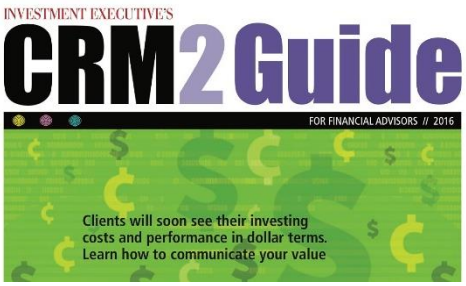
Yes (but keep reading). Regulatory guidance indicates that a registrant may use its registered trade name when marketing its activities (which includes using business cards), so long as the trade name is not misleading or confusing to investors, and provided the marketing materials have been reviewed and approved in accordance with the registrant's policies and procedures. Please note that certain documents, including legal contracts and confirmation and account statements, among other documents, must contain the registrant's full legal name.

Registrants are required to register a trade name under applicable corporate legislation. Once the trade name is registered, the registrant must notify the OSC of its use within 30 days.

News & Events

Investment Executive CRM2 Guide

Erez Blumberger was recently interviewed by Investment Executive senior editor Patricia Chisholm for the 2016 edition of the CRM2 Guide, published concurrently with their October 2016 issue.



In the Q&A session, Erez gives his thoughts about educating clients on CRM2, and managing client expectations.

Read the full interview here.

Dialogue on New Capital Markets Regulatory Authority

Ahead of the 2018 proposed launch of a new cooperative regulatory system, the Capital Markets Authority Implementation Organization (CMAIO) is opening a dialogue with select individuals in the securities regulatory sphere to relate their plans and receive feedback on how best to move forward. **Erez Blumberger** has accepted an invitation to attend the October luncheon to share his views.

Recent Speaking Engagements

Alan Sinclair joined a panel of speakers at this year's Portfolio Management Association of Canada's (PMAC) Compliance Forum, sharing insights on the top 10 things portfolio managers should have on their "compliance radar".

The World Alternative Investment Summit Canada (WAISC) hosted **Erez Blumberger** to speak on a variety of topics buzzing in the asset management industry.

TDSI COO Summit

TD Securities is hosting their second annual COO Summit on October 19. The agenda includes a "Fireside Chat with the OSC", and three breakout sessions on topics relevant to COOs. **Erez Blumberger** will host a session entitled "Shelter from the regulatory storm: hot topics in Canadian securities regulation".