Weapon of Choice

Did you know… Cult icon Christopher Walken was born on this day in 1943? Known for his diverse range of roles in classics such as Pulp Fiction and The Deer Hunter, perhaps Walken's most famous role remains record producer Bruce Dickinson in SNL's VH1 "More Cowbell" skit. Continuing with the musical theme, Walken famously danced his way through the iconic Weapon of Choice music video, which VH1 anointed Best Video of All Time.

In this month's Bulletin we will explore the OSC's current "weapon of choice", or no contest settlements. We will also take a look at the OSC's Statement of Priorities, highlights from the 2017 Federal Budget, and much more!

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1. OSC No-Contest Settlements: To Settle or Not to Settle

Back in March of 2014, the Ontario Securities Commission (OSC) published Staff Notice 15-702 – Revised Credit for Cooperation Program (the Program) in order to encourage market participants to "self-police, self-report and self-correct" matters that might be contrary to securities law. Under this Program, cooperation with the regulator could result in settlements where the market participant does not make any admission of fact or admit to a violation of securities law. Under such settlements, known as "no-contest" settlements, Staff of the OSC lays out the facts resulting from their investigation, which are neither admitted nor denied by the market participant.

In Brief

OBSI's Expanding Powers and Increasing Complaints

The Joint Regulators Committee (JRC) released its annual report last week, discussing its oversight of the Ombudsman for Banking Services and Investments (OBSI), and the potential to increase the ombudservice's power. An independent reviewer concluded last year that OBSI should be given the power to make their monetary recommendations binding, a conclusion that the JRC is supporting. OBSI currently works under a "name and shame" model, without enforcement power.

Staff of the OSC set out certain eligibility criteria for no-contest settlements, including:

- the timeliness of self-reporting;
- the degree of investor harm, and compensation to investors;
- the degree of cooperation with the OSC;
- any remedial steps taken by the person/company; and
- agreement to pay monetary amounts, if any.

No-contest settlements are not available in instances of fraudulent conduct, criminal activity, or when the person or company has misled or obstructed Staff's investigation.

To date, there have been six no-contest settlements entered into between market participants and the OSC, generally relating to compliance system failures. Under these settlements, market participants have agreed to compensate investors from $8 million to as high as $156 million, made voluntary payments to the OSC ranging from $250,000 to $8 million, with costs ranging from $20,000 to $2.1 million.

In approving these settlements, the OSC has touted the efficiencies gained by resolving enforcement proceedings more quickly and at a reduced cost, in addition to freeing up staff resources to pursue other enforcement matters. No-contest settlements can also give market participants an incentive to settle matters expeditiously, offer compensation to investors where appropriate.

Notably, the resolution of a matter by way of a no-contest settlement may also result in less reputational damage for market participants than would otherwise occur in respect of a contested public hearing. No-contest settlements may also limit the exposure of market participants to civil suits, often in the form of class actions, arising from any admissions of liability.

The U.S. Securities and Exchange Commission (SEC) has a long history of settling most enforcement actions without requiring admissions, though this practice has come under fire recently. Opponents to no-contest settlements take the position that they are harmful to public policy as they lessen the deterrent effects of regulatory proceedings.

Whatever your views on these kinds of settlements, they appear to be here to stay. It is also important to note that the OSC commends market participants that self-report and self-correct compliance issues upon completion of internal compliance reviews.

Please contact a member of our Regulatory Compliance Group if you would like to discuss further.

2. 2017 Federal Budget and Mutual Fund Corporations

On March 22, 2017, the federal government released its 2017 budget to mixed reviews. The Investment Industry Association of Canada (IIAC) was critical of the budget's failure to include an investor tax credit to counter current weak economic conditions, similar to the U.K.'s Enterprise Investment Scheme program.

On a more positive note, the federal budget proposes to allow mutual funds organized as corporations to convert to trusts without a negative tax impact to investors. We reported last year on changes to the *Income Tax Act* (Canada) involving mutual fund corporations with multiple share classes, where typically each class is its own fund. These changes had the result of discontinuing the tax

In Brief cont'd

The JRC's report is timely, as OBSI's own annual report details an increase in the number of complaints filed against investment management firms and banks in 2016. For cases processed last year involving investment firms, the amount of compensation OSBI recommended be given to complainants totaled $2.4 million. If the JRC's proposal to expand OBSI's powers comes to fruition, firms may see themselves obligated to pay compensation to aggrieved investors.

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Climate Change on the CSA's Agenda

Given the mounting concern surrounding climate change, the Canadian Securities Administrators (CSA) have announced a research project that will look at disclosure on climate-related risks and financial impacts by large, public companies. The review will look at issuers' mandatory material-risk disclosure, as well as any voluntary reporting on climate change.

The regulators' project, set to last through spring and summer, will also include a review of existing climate-related disclosure requirements in other countries, an online poll to issuers on their current disclosure practices, and focus groups with firms and investors on the topic.

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deferral for share exchanges between different share classes (see our March 2016 Bulletin). The 2017 budget proposes to extend existing mutual fund merger rules, which will allow mutual fund corporations to reorganize, on a tax-deferred basis, into separate mutual fund trusts. These rules will apply to transactions occurring on or after budget day. Similar to any mutual fund merger, these reorganizations will be subject to a myriad of rules in the Income Tax Act and remain subject to securities laws regarding fund mergers.

If you have a mutual fund corporation or other mutual fund and are considering the benefits of a reorganization, please contact our Investment Funds Group.

3. Waverley – The Long Awaited Commission Decision

On March 1, 2017, the Panel of Commissioners of the OSC (Panel) issued its much anticipated decision with respect to Waverley Corporate Financial Services Ltd. (Waverley), an exempt market dealer (EMD), and Don McDonald, Waverley's Ultimate Designated Person (UDP) and Chief Compliance Officer (CCO). This decision arose from an appeal of the decision of the Director of the Compliance and Registrant Regulation (CRR) branch, issued in late 2016, which found, amongst other things, that Waverley's "Issuer-Connected DR Model" (described below), contravened subsection 25(1)(b) of the Ontario *Securities Act*, which requires dealing representatives to act on behalf of their sponsoring firms.

The Panel's decision is noteworthy as it provides important clarity on the OSC's view of Waverley's Issuer-Connected DR Model, which in the OSC's words relies "primarily upon marketing its services to issuers (Sponsoring Issuers), who introduce dealing representatives (Representatives, or DRs) to Waverley in order to market their securities." In the OSC's further view, Waverley markets its services to issuers as a way of helping issuers avoid the financial costs and compliance responsibilities that would be required of issuers if they were to register as dealers themselves ("captive dealers").

In its decision, the Panel *did not* prohibit outright Waverley's business model or practice of sourcing Representatives from Sponsoring Issuers, as had been requested by CRR Staff. Instead, the Panel concluded that the Waverley DRs were acting on behalf of Waverley and not in contravention of subsection 25(1)(b).

However, the Panel also concluded that Waverley did not properly manage conflicts of interest, and did not have adequate systems of control and supervision, particularly with respect to referral arrangements.

The Panel further found that Mr. McDonald did not fully understand his responsibilities as a registrant and did not demonstrate the proficiency necessary to establish and maintain policies and procedures that reasonably ensured compliance with Ontario securities legislation by Waverley and its representatives in a manner that was attuned to Waverley's business and compliance risks. In particular, the Panel found the Mr. McDonald failed with respect to his understanding, identification and proper management of conflicts of interests, and failed to implement a system of control and supervision that adequately responded to the close alignment of interests between Waverley's Representatives and their Sponsoring Issuers.

Accordingly, the Panel imposed terms and conditions to address these deficiencies by means of improved disclosure, more robust supervisory controls and procedures relating to Waverley's oversight of its Representatives' interactions with customers, and a prohibition on certain roles that Representatives can perform for their Sponsoring Issuers and their affiliates. One Term and Condition we find particularly curious requires all Waverley DRs' "telephonic" communications with customers, potential customers and others to be recorded, monitored and stored by Waverley. This would include all cell phone calls. We will leave it to you to decide how feasible and practical this is!

As mentioned, this decision is instructive as it provides express support of Waverley's Issuer-Connect DR Model. It should also serve as a cautionary tale, however, that compliance programs are not a "one size

In Brief cont'd

Blockchain-Based Models May Trigger Registration Requirements

Firms participating in blockchain-based activities, or utilizing other types of distributed ledger technology, are being advised by the OSC to contact its fintech team, OSC LaunchPad, to determine whether these activities may require the firm to register with securities regulators, or issue a prospectus. Products or other assets tracked and traded as part of a distributed ledger may be considered securities, and thus may trip certain regulatory requirements.

fits all" affair, and must be established and implemented carefully. In our view, this decision is a "must-read" for compliance professionals as it contains Commission findings and views, particularly regarding addressing conflicts of interest, that are instructive to all registrant categories, not only to EMDs.

We plan to discuss this important decision in greater detail at our AUM Law Spring Conference (see below under News & Events). We hope to see you there!

4. OSC Releases its Draft Statement of Priorities

The OSC recently released its annual draft statement of priorities, and unsurprisingly, retail investor issues, including investor protection, featured prominently. Areas of continued focus include embedded commissions in the mutual fund industry and the best interest standard, with newer areas of focus including whistleblower outreach and fintech. The OSC also reiterated its continued commitment to streamlining the regulatory environment and making it less burdensome, while keeping pace with developments in innovations. Stay tuned…

5. New Compliance Guidance for CRS and FATCA

The Canada Revenue Agency (CRA) recently posted updated guidance relating to the implementation of (and intersection between) the Canadian Common Reporting Standard (CRS) and the U.S. Foreign Account Tax Compliance Act (FATCA).

The guidance is meant to streamline the tax information collection and exchange requirements of the two regimes, and is being heralded by industry participants as beneficial to both financial services institutions and clients. In particular, the IIAC has lauded the guidance for having the dual benefit of minimizing net new requirements and costs for financial services institutions, and reducing confusion faced by clients. As well, the new guidance provides useful standardized tax residency certification forms for both the CRS and FATCA that can be used by financial services institutions if they so choose.

Frequently Asked Questions

> Can a CCO collect KYC and assess suitability, or should the dealing representative carry these out?

The advising representative, not the CCO should collect KYC and assess suitability because there is a proficiency principle in section 3.4 of National Instrument 31-103 that raises issues if a CCO undertakes this registrable activity. The OSC has raised concerns in the past when CCOs have tried to carry out KYC and suitability assessments due to the CCOs not having the required proficiency. That is not to say that a CCO can never conduct the assessment. If the CCO has the appropriate proficiency, and the firm has policies and procedures that are not inconsistent with this practice, there may be an argument, if only on a temporary basis, to do it. However, at the very least, this will likely draw significant regulatory scrutiny and complicate certain documentation requirements (e.g., trade confirmation requires the name of the dealing representative). The better practice would be to avoid this.

News & Events

Registrant Regulation Summit

We are proudly sponsoring this year's **Annual Focus Event on Registrant Regulation Conduct & Compliance**, taking place May 2-3. Attendees will have the opportunity to connect with 100+ regulators, compliance executives, industry stakeholders and legal experts. The summit will delve into the proposed CSA best interest

standard, reform on mutual fund fees and changes in the fintech space, among other topics.

Visit the conference page for more details, or to register.

AUM Law Spring Conference

As announced last month, we are proud to be hosting our inaugural **AUM Law Spring Conference** on May 9.

Team Announcement

We are pleased to announce that **David Coultice** will be joining our Securities Group as Senior Legal Counsel on Monday, April 3. David's most recent experience comes from Dentons, where he has spent the past 10 years practicing in the areas of corporate finance, mergers and acquisitions and registration and regulatory matters. Prior to this role, David spent 5 years at the OSC in the role of Senior Legal Counsel in the Corporate Finance Branch and 11 years at Faskin Martineau LLP.

Welcome, David!