September 2018

AUM LAW

Bulletin

Movin' Out Edition

Like Billy Joel, AUM Law is moving out. On October 15, we are relocating downtown to Toronto's financial district. We will be steps away from the King subway station and connected to the PATH system, at the corner of Yonge Street and Adelaide Street. Our new contact details are:

AUM Law
110 Yonge Street, Suite 400
Toronto, ON M5C 1T4
Tel: 416-966-2004

In connection with our move, we are launching a new logo and updated colour scheme as part of the ongoing evolution of our brand. Our new logo appears at the top of this month's bulletin, and you'll see other visual elements of our brand incorporated into our communications, social media presence, and office throughout October.

In this bulletin:

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> News & Events

1. Jail Time for Mr. Tiffin

We wrote about the Tiffin case in May. Daniel Tiffin has just been sentenced to six months in jail for *Securities Act* offences.

2. Embedded Commissions: We Just Disagree Edition

On September 13, the Canadian Securities Administrators (CSA) published for comment the long-anticipated rules (Proposed Rules) that will prohibit certain embedded commissions currently allowed under National Instrument 81-105 *Mutual Fund Sales Practices* (NI 81-105). If the proposed changes are adopted, investment fund managers will be prohibited from paying dealers:

- upfront sales commissions for the sale of mutual funds offered under a prospectus; and
- trailing commissions where the dealer does do not make a suitability determination.

In Brief

Reminder: Revised Form 45-106F1 Report of Exempt Distributions Takes Effect on October 5

As we discussed in our July 2018 bulletin, the Canadian Securities Administrators (CSA) have finalized changes to Form 45-106F1 *Report of Exempt Distributions* (Form 45-106F1), and those changes will come into effect on October 5. The changes are intended primarily to address concerns that institutional investors are excluded from offerings by foreign dealers because of the headache-inducing nature of the information and certification requirements in Form 45-106F1. Please contact us if you would like assistance with filing Form 45-106F1.

The second prohibition will apply even for sales to permitted clients who have waived the suitability requirements. The CSA expects that the prohibition of upfront sales commissions will eliminate the deferred sales charge (DSC) option that certain fund managers offer their clients. The new rules, if adopted, likely will be subject to a one-year transition period.

Almost coincidentally with the release of the CSA's announcement, Ontario's Minister of Finance indicated that the government disagrees with the Proposed Rules as currently drafted. In a news release, Minister Fideli stated that the proposed amendments "result from a process initiated under the previous government and, if implemented, will discontinue a payment option for purchasing mutual funds that has enabled Ontario families and investors to save towards retirement and other goals." This statement implies that the governments is principally concerned with the potential elimination of DSC option for mutual fund purchases. The Minister then indicated that Ontario will work with other provinces, territories and stakeholders to explore other potential alternatives to ensure fair, efficient capital markets and strong investor protections.

It is not unheard of for a government in Canada to disagree with an initiative proposed by an independent securities regulator. But usually such differences of opinion are resolved either before a regulatory initiative is published for comment or through discussions once the comment period closes. It will be interesting to see whether and how the Ontario government, Ontario Securities Commission (OSC) and other CSA members reach consensus on a way forward, especially since the Proposed Rules reflect the results of over five years of research by securities regulators and consultation with stakeholders on this topic.

We will monitor and report on how this proposed initiative unfolds. If you would like to discuss the Proposed Rules and their implications for your business, please contact us.

3. Mind the Non-GAAP

On September 6, the Canadian Securities Administrators (CSA) published for comment Proposed National Instrument 52-112 *Non-GAAP and Other Financial Measures Disclosure* (NI 52-112) and a related companion policy. The new instrument will apply to all issuers (including investment funds), except for SEC foreign issuers, and will apply to all documents (including Management's Discussion and Analysis, press releases, annual information forms and prospectuses), as well as other written communications in websites and social media.

According to CSA staff, many issuers disclose a range of non-GAAP financial measures that are not standardized, lack context when disclosed outside the issuer's financial statements, lack transparency as to their calculation and/or vary significantly by issuer or industry. Examples include terms such as "adjusted earnings", "pro forma earnings", "cost per ounce", and "earnings before non-recurring items". To date, the CSA has been providing non-binding guidance on such measures through Staff Notice 52-306 (Revised) *Non-GAAP Financial Measures* (SN 52-306) and reports on disclosure practices. Despite this guidance, variability in disclosure practices has persisted. As well, there are some non-GAAP financial measures that fall outside the relevant definition in SN 52-306.

NI 52-112 is intended to provide regulators with a stronger tool to enforce standards for appropriate disclosure. However, it doesn't go as far as some people would like. According to the CSA, some stakeholders wanted the CSA to prohibit the disclosure of certain financial measures in some circumstances and develop industry-specific, disclosure requirements. The CSA is proposing a less prescriptive approach. Instead, NI 52-112 will require an issuer to provide certain types of disclosure if it chooses to disclose non-GAAP financial measures. For example, NI 52-112 will, among other things:

In Brief cont'd

IOSCO Publishes Guidance on Conflicts of Interest in the Equity Capital-Raising Process

On September 18, the International Organization of Securities Commissions (IOSCO) published its final report on *Conflicts of Interest and Associated Conduct Risks during the Equity Capital Raising Process* (Report). The Report provides guidance to securities regulators on policy measures to address potential conflicts of interest and conduct risks relating to, *e.g.*, pressure on analysts during the pre-offering phase, allocation of securities, pricing, and personal transactions by staff employed by firms managing a securities offering. IOSCO also plans to publish similar guidance focusing on the debt capital-raising process.

IOSCO's guidance isn't binding on its members. However, we expect the Ontario Securities Commission (OSC) and other Canadian securities regulators may assess whether their existing regime and outstanding regulatory proposals that affect registrant conduct meet the minimum standards reflected in IOSCO's guidance. IOSCO guidance also can serve as a useful framework against which market participants can assess regulatory proposals in Canada in order to determine whether a proposal exceeds or is otherwise out of line with international standards.

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IOSCO Issues Policy Measures on Retail, Leveraged OTC Products and Warns Public about Binary Options

On September 19, the International Organization of Securities Commissions (IOSCO) published its final Report on Retail OTC Leveraged Products (Report),

- Regulate how the non-GAAP financial measure is labelled;
- Regulate the non-GAAP financial measure's prominence;
- Require the presentation of non-GAAP financial measures for comparable periods; and
- Require disclosure of the fact that there is no standardized disclosure framework for the measure and that the measure may not be comparable to similar measures disclosed by other issuers.

Comments are due on the proposal by December 5, 2018. If you would like to discuss NI 52-112, please reach out to your usual AUM lawyer.

4. FINRA Publishes White Paper on RegTech for Comment

On September 10, the U.S. Financial Industry Regulatory Authority (FINRA) published Technology Based Innovations for Regulatory Compliance ("RegTech") in the Securities Industry for comment (White Paper). Although the White Paper is directed at FINRA-regulated broker-dealers, we believe that Canadian dealers, portfolio managers and investment fund managers also may find the discussion relevant as they assess the potential benefits and risks of implementing various RegTech tools to strengthen their compliance programs.

The White Paper discusses how RegTech tools are being applied in five areas within the securities industry:

- Surveillance and monitoring;
- Customer identification and anti-money laundering (AML) compliance;
- Regulatory intelligence;
- Reporting and risk assessment; and
- Investor risk assessment.

FINRA noted that RegTech innovations offer potential benefits in a number of areas including:

- **Risk management:** RegTech tools based on artificial intelligence (AI) and big-data analytics can help firms create alerts that facilitate more forward-looking compliance programs, as well as helping them look at data across the firm to conduct enterprise-level reviews.
- **Automation, effectiveness and efficiency:** Robotics process automation (RPA) can help firms minimize the need for humans to perform repetitive tasks, thereby speeding up processes, reducing errors and freeing up individuals to perform higher-level functions such as reviewing alerts and developing processes. One firm noted that it had adopted a tool that reduced false alerts by 80%, freeing up staff time to focus on alerts that warranted escalation. RegTech tools (such as tools that review compliance for specific rules before trade execution) also can potentially prevent non-compliant activities before they occur. Finally, some emerging tools have more intuitive, user-friendly and interactive interfaces, which can enable users without technology backgrounds to conduct more complex analyses to support compliance and supervisory functions.
- **Opportunities for enhanced industry collaboration:** Some firms are exploring how to leverage distributed ledger technology to create industry-wide utilities for sharing solutions for customer identification and AML compliance. These innovations may help reduce firms' compliance costs while increasing firms' ability to trace the relationship of transactions and related movement of funds across firms.

FINRA, however, also cautions firms to be aware of the challenges and regulatory implications that some of these tools pose and recommends steps that firms can take to address those issues. The report focuses on three key areas of implementation risk with respect to RegTech: supervisory control systems, outsourcing to RegTech vendors, and customer data privacy.

In Brief cont'd

focusing on binary options, contracts for difference, and rolling-spot forex contracts. At the same time, IOSCO also published a warning about the risks of binary options and included links to similar warnings issued by IOSCO members globally.

The Report, which is aimed primarily at regulators, includes "toolkits" with guidance on policy measures to address the risks arising from the marketing and sale of such products to retail investors, educating investors about these risks, and enforcement approaches to mitigate the risks posed by unlicensed firms that sell these products.

The Report does not require regulatory action by IOSCO members. However, we expect that the Ontario Securities Commission (OSC) and other Canadian securities regulators may consider the Report in developing policy, educational and enforcement responses to inappropriate marketing or sale of such products in Canada. Firms also might find the reference material in the Report relevant, especially with respect to educating investors, if they see a need to warn their clients about products like these being offered by unlicensed firms.

If you are developing or considering the acquisition of RegTech tools to enhance your compliance systems and practices, AUM Law can help you identify and assess the legal and regulatory compliance implications of using such tools.

5. Real Estate Investment Vehicles: Which Make and Model Suit You?

Are you interested in creating a vehicle to invest in real estate or mortgages secured by real estate, or are you currently managing one or more such vehicles? With our focus on serving the asset management sector and our expertise in regulatory compliance and investment funds, AUM Law is well-equipped to work seamlessly with real estate lawyers and tax advisers to help clients establish and operate real estate investment vehicles. To learn more about how we can support you, please contact us to receive our new brochure outlining the key legal, regulatory and compliance factors you may wish to consider in deciding how to structure, launch and operate such a vehicle.

6. Alternative Funds: Ready to Shake It up?

Alternative funds offer investors the potential for diversification of assets, attractive risk-adjusted returns, and downside risk mitigation. However, their frequently complex investment strategies as well as restrictions on redeemability of units have raised securities regulators' concerns about the appropriateness of letting retail investors buy and hold such funds. To date, therefore, the Canadian securities regulatory framework generally has prohibited the public offering of most alternative funds.

That regulatory framework is set to change, once the Canadian Securities Administrators (CSA) finalize their new rules for publicly offered alternative funds. In September 2016, they published a detailed rule proposal (Alternative Fund Rules) and have been considering comments and revising their approach since then. We believe that the final iteration of the rules is coming very soon.

AUM Law can help you start getting ready now to navigate the new regulatory framework. Please contact us to learn more about the proposed regime and how we can help.

News & Events

PMAC Toronto Regulatory and Compliance Forum

AUM Law was proud to sponsor PMAC's Regulatory and Compliance Forum in Toronto on September 27. Our very own Richard Roskies participated in a panel discussion of good practices and practical solutions for both novel and common compliance challenges.

Practical Advice. Efficient Service. Fixed-Fee Plans.

AUM Law focuses on serving the asset management sector in the areas of regulatory compliance and investment funds. We also support clients in this sector by providing legal advice and services for structuring entities, raising capital, business combinations, and compliance with reporting issuers' and investors' disclosure obligations. Our clients include investment fund managers, portfolio managers, dealers, public and private investment vehicles including real estate funds, alternative funds and private equity funds, investors, and private and public companies.

This bulletin is an overview only and it does not constitute legal advice. It is not intended to be a complete statement of the law or an opinion on any matter. No one should act upon the information in this bulletin without a thorough examination of the law as applied to the facts of a specific situation.