The "All Ears" Edition

This month, it seems like the regulators have taken Donna Summer's song "Stop, Look and Listen" to heart. Among other initiatives, the OSC is digesting and collecting additional feedback on ways to reduce regulatory burdens, and the OSC, CSA and IIROC have published various regulatory proposals for comment. In particular, we want to highlight the CSA's re-proposed changes to the regulatory framework for syndicated mortgages, because some of our clients are seeking further industry support for their comment letter and we can help you connect with them on this initiative.

In this bulletin:

1. OSC Pushes Forward with Regulatory Burden Reduction Initiative

In January, we reported that the Ontario Securities Commission (OSC) was seeking feedback on steps that it can take to reduce regulatory burdens and improve the investor experience. Its request for comment triggered a tsunami of comment letters, and now the OSC and its staff are focused on assessing that feedback, collecting additional feedback through further engagement, determining short, medium and long-term goals for reducing regulatory burdens, deciding on priorities, and establishing measurement criteria.

A. Our Takeaways from the Burden Reduction Roundtable

On March 27, AUM Law attended the OSC's first regulatory burden roundtable, where stakeholder representatives and regulators discussed regulatory burdens and their impact and considered how to measure, set priorities for and maximize the impact of burden reduction initiatives. The roundtable was more of a therapy session than a forum for generating new ideas beyond what was already set out in the comment letters. Nevertheless, we gleaned a few takeaways from the event including the following:

- The concerns about regulatory burdens affecting the asset management sector and participants in the exempt market got a good hearing. The regulators acknowledged that undue regulatory

In Brief

3iQ Asks OSC to Review Director's Decision Not to Issue Receipt for Its Bitcoin Fund

Last month, we reported that the Acting Director (Director) of the Ontario Securities Commission (OSC) declined to issue a receipt for a prospectus for 3iQ's planned bitcoin fund. On March 15, the fund manager applied to the OSC for a hearing and review of this decision. In its application to the OSC, the manager submitted, among other things, that the Director erred in applying more stringent requirements for custody, liquidity and valuation than those that apply to other public mutual funds. The hearing is scheduled for April 3. We'll keep you posted on the outcome.

IIROC Publishes Results of Consultation on Evolution of Advice in Canada

On March 20, the Investment Industry Regulatory Organization of Canada (IIROC) and Accenture published Enabling the Evolution of Advice in Canada, which focuses on how the Canadian wealth management industry is evolving to meet the changing demographics of investors, factors (including the regulatory environment) that hinder innovation, and potential changes in regulatory policies and approaches that could support innovation and improve the investor experience.

burdens adversely affect the investor experience, either by making products and services more costly and/or harder or impossible to access.

- Regulated market participants expressed their concern about reform proposals that take too long to get from concept to finalization, as they introduce too much uncertainty into firms' operations. Some panelists stressed that if regulators focus more attention on defining the regulatory problem and desired solution (in consultation with stakeholders) at the outset, they could move from proposed to final rules faster and with better outcomes.
- Panelists representing venture capital issuers and registrants reiterated that they want a stronger relationship with their regulator, where regulatory staff are willing to offer advice, deliver a consistent approach to regulatory issues, and facilitate cooperation with other regulators to reduce regulatory burdens (e.g. in the timing of audits).
- The OSC and other regulators at the event were pleasantly surprised that, in general, commenters aren't using this initiative as an opportunity to chip at investor protection.

B. The OSC's Next Steps

The OSC has two more roundtables scheduled for May. On May 6, the session will focus on regulatory burden issues relating to registration, compliance and investment funds. On May 27, the session will focus on trading, marketplaces, issuer requirements and derivatives. OSC staff also indicated that they are accepting additional submissions. If you would like AUM Law's help in making a submission, please contact us.

After OSC staff have collected and assessed the feedback that they receive from the submission process, roundtables and other discussions with stakeholders, they will publish a report to outline their action plan and analysis of expected impacts. There is no deadline set for this step, but given the progress they have made so far, we believe a report could be published as early as late summer.

2. OSC Releases Proposed Statement of Priorities

It's no surprise that regulatory burden reduction is one of the OSC's top priorities for 2019-20, as outlined in its proposed Statement of Priorities released on March 28.

Regulatory Burden Reduction: In addition to further engagement with and reporting to stakeholders on this subject, the OSC's planned actions and outcomes in the coming year include:

- Revising and modernizing National Instrument 33-109 *Registration Information*;
- Implementing the plan set out in the Canadian Securities Administrators (CSA) Staff Notice 81-329 *Reducing Regulatory Burden for Investment Fund Issuers*;

In brief cont'd

New OSFI Cyber Security Incident Reporting Guidelines: The Shape of Things to Come?

Recently, the Office of Superintendent of Financial Institutions (OSFI) published an Advisory on Technology and Cyber Security Incident Reporting, which comes into effect on March 31. Although this guidance is of primary relevance to federally regulated financial institutions, we think that it will be of interest to other, regulated financial services firms in Canada. You may wish to read it conjunction with guidance published the Canadian Securities Administrators (CSA) Staff Notice 33-321 Cybersecurity and Social Media, which we wrote about in our October 2017 bulletin. Given that cybersecurity threats are increasing in sophistication, frequency and persistence, we wouldn't be surprised to see the CSA incorporate elements of OSFI's cyber incident reporting regime into the Canadian securities regulatory framework sometime soon.

IIROC and the CSA Seek Feedback on Concerns about Internalization of Orders within the Canadian Equity Market

Canadian equity markets have evolved rapidly in recent years, with multiple competing marketplaces launching operations, new participants entering the

- Greater use of creative regulatory approaches (e.g. limited registration and other exemptive relief) to provide an environment for innovators to test their products, services and applications with a reduction in time-to-market for novel fintech businesses while maintaining appropriate investor safeguards; and
- Initiating an overhaul of the OSC's website to enhance searchability, usability, efficiency and accessibility.

The Statement of Priorities also identifies a number of other regulatory burden reduction initiatives that are planned or underway with the CSA, such as identifying opportunities to enhance electronic delivery of documents and identifying an alternative, streamlined offering regime for reporting issuers.

Additional Priorities: The Statement of Priorities also indicates that the OSC will prioritize further work on initiatives such as the following:

- The OSC will work with its CSA colleagues to develop and publish revised proposals relating to client-focused reforms to the registrant regulatory framework and mutual fund embedded commissions. (See our discussion of the earlier proposals in our June 2018 bulletin and our September 2018 bulletin, respectively.)
- The OSC will follow up on its March 2018 Seniors Strategy by publishing a staff notice and proposed rule amendments to address financial exploitation of seniors and vulnerable investors. (See our discussion of the OSC's Seniors Strategy in our March 2018 bulletin.)
- The OSC will continue working on its regulatory framework for over-the-counter (OTC) derivatives and will develop a compliance review program for derivatives markets participants. (See our discussion of the CSA's 2018 proposed registration framework for OTC derivatives in our April 2018 bulletin and proposed OTC derivatives business conduct rules in our June 2018 bulletin, respectively.)

AUM Law will monitor developments with respect to the OSC's priorities for the year and keep you informed.

3. CSA and IIROC Seek Input on Regulatory Framework for Crypto-Asset Trading Platforms

On March 14, the Canadian Securities Administrators (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC, and together with the CSA, Regulators) jointly published Consultation Paper 21-402 *Proposed Framework for Crypto-Asset Trading Platforms* (Consultation Paper). Platforms that facilitate the purchase, sale or transfer of crypto assets (Platforms) may be subject to securities and/or derivatives regulation, depending on how they operate and the assets they make available for trading. The Consultation Paper discusses this threshold issue, outlines the Regulators' understanding of the risks related to these Platforms for Canadian investors and capital markets, summarizes regulatory approaches in other jurisdictions, and then outlines the Regulators' concept proposal for a regulatory framework for Platforms, which

In brief cont'd

market and market participants interacting in different ways. This evolution has raised some concerns about certain trading practices, including internalization of orders (*i.e.*, where a trade is executed with the same dealer as both buyer and seller). The Canadian Securities Administrators (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC) have been studying these developments. On March 12, they published a consultation paper that provides data on the magnitude of internalization in the Canadian equity market, describes the existing regulatory framework, and seeks feedback on a range of issues and concerns (such as the segmentation of retail orders and the impact of broker preferencing) relating to these practices. The comment period closes on May 13, 2019.

they give the rather awkward name of "Proposed Platform Framework." The Proposed Platform Framework isn't fully developed and we won't describe it in detail. Instead, we are highlighting several issues that we think our clients might find interesting.

- **Does Securities or Derivatives Regulation Apply?** As we have discussed in prior editions of the bulletin, including our June 2018 bulletin, the CSA have found that most offerings of utility tokens involve a distribution of securities. Certain other kinds of crypto-assets that function as a form of payment or means of exchange on a decentralized network, such as bitcoin, are not in themselves securities or derivatives but are more like commodities such as currencies or metals. The Consultation Paper suggests, however, that securities legislation may still apply to Platforms that offer trading of crypto assets that are commodities because the investor's contractual right to the crypto asset may constitute a security or derivative. The Regulators outline the factors they're considering in their analysis and are seeking feedback on this scope issue.
- **Territorial Scope:** The Proposed Platform Framework will apply both to Platforms that operate in Canada and those that have Canadian participants. The CSA may consider exemptive relief for Platforms located outside Canada that are subject to similar regulation and oversight.
- **Hybrid Platforms Means Hybrid Regulation:** Some existing Platforms engage in functions typically performed by marketplaces including exchanges and alternative trading systems (ATSs), dealers, custodians, and/or clearing agencies. Given the hybrid nature of the Platforms, the Regulators intend that the Proposed Platform Framework will combine elements of the existing regulatory frameworks for marketplaces (including marketplaces that trade over-the-counter derivatives) and dealers, supplemented with additional requirements tailored to additional risks presented by the Platforms.
- **Shrink to Fit Regulation:** Depending on a Platform's specific activities, some elements of the Proposed Platform Framework may not apply. For example, an entity that trades crypto assets that are securities but always trades against its participants and does not facilitate trading between buyers and sellers may be regulated as a dealer only and won't be subject to marketplace rules. For example, exempt market dealers (EMDs) that are currently permitted under securities legislation to facilitate the sale of securities, including crypto assets, in the exempt market would be able to continue offering this service as long as they don't fall into the definition of "marketplace". Of course, registered firms that begin offering crypto asset products or services will be expected to report changes in their business to their principal regulator, and the proposed activities may be subject to review to assess whether there is adequate investor protection.
- **Risks, risks, risks:** A substantial part of the Consultation Paper focuses on the potential risks to investors and Canadian capital markets that Platforms may present, the kinds of rules that should be adopted to address those risks, and whether the existing and/or crypto asset-specific requirements that the Regulators are contemplating will be practicable and effective. For example, the Consultation Paper seeks feedback about regulatory approaches to:

- **Custody and verification of assets**, *e.g.* what standards should a Platform adopt to mitigate risks related to safeguarding investors' assets and how could auditors or other parties provide assurance to regulators that a Platform has adequate controls in place to protect investors' assets?
- **Price determination**, *e.g.* are there reliable pricing sources that could be used to determine fair prices?
- **Systems and business continuity planning**, *e.g.* what is the appropriate scope for an independent systems review (ISR) of a Platform's information technology and related internal controls?
- **Management and disclosure of conflicts of interest**, *e.g.* are there particular conflicts of interest that Platforms may not be able to manage appropriately, given their current business models and if so, how could those models be changed to manage such conflicts appropriate?
- **Insurance**, *e.g.* since some Platforms find it difficult to obtain insurance, are there alternative measures that address investor protection that could be considered equivalent to insurance coverage?
- **Clearing and settlement**, *e.g.* are there significant differences in risks between the traditional and decentralized models for clearing and settlement and how could those risks be mitigated?

AUM Law will monitor the developments in this area. In the meantime, if you would like to discuss how the existing regulatory framework may apply to your crypto-assets business, have any questions about the Consultation Paper or would like our assistance in making a submission to the CSA and IIROC, please contact us. The submission deadline for comments is May 15, 2019.

4. CSA Revises Its Proposed Changes to Regulatory Framework for Syndicated Mortgages

A year ago, we reported that the Canadian Securities Administrators (CSA) plan to amend the regulatory framework for syndicated mortgages (2018 Proposal). Just over a year later, the CSA published for comment a revised proposal (2019 Proposal), which takes into account feedback that CSA staff received on the 2018 Proposal. We compare and contrast the proposals below.

- **Mortgage exemptions removed:** Like the 2018 Proposal, the 2019 Proposal will, if adopted, remove the existing prospectus and registration exemptions for securities that are syndicated mortgages ("Mortgage Exemptions") in Ontario, Nova Scotia, Prince Edward Island (PEI), Newfoundland and Labrador, the Northwest Territories, Nunavut, and the Yukon.
- **Bye bye private issuer exemption:** Consistent with the 2018 Proposal, the private issuer prospectus exemption will be removed for syndicated mortgages if the 2019 Proposal is adopted.
- **Be like BC:** Regulators in several jurisdictions are proposing exemptions similar to those contained in BC Rule 45-501 Mortgages.
  - **Some jurisdictions to exempt "qualified, syndicated mortgages":** The regulators in Ontario, New Brunswick, Nova Scotia and Newfoundland plan to adopt prospectus and dealer registration exemptions for qualified, syndicated mortgages. The regulators in Alberta and Québec are proposing to adopt prospectus exemptions for qualified, syndicated mortgages.
  - **Permitted clients exemption:** Alberta is proposing a prospectus exemption for syndicated mortgages distributed to permitted clients.
- **Get ready to register soon:** The 2018 Proposal would have staggered the implementation dates for the removal of the Mortgage Exemptions, so that the amendments to the registration exemption would have come into effect twelve months after the amendments to the prospectus exemption.

The CSA has scratched that plan and now intends that all of the proposed amendments will come into effect on December 31, 2019. In Ontario and other jurisdictions where the Mortgage Exemptions currently apply to syndicated mortgages, market participants that are in the business of trading syndicated mortgages and aren't currently registered with the relevant authorities will need to determine whether another registration exemption is available to them or whether they need to become registered.

- **Distributions under the offering memorandum (OM) exemption:** The CSA have tweaked a few elements of their proposed changes to the OM exemption for syndicated mortgages. Like the 2018 Proposal, the amendments set out in the 2019 Proposal will require supplementary disclosure tailored to syndicated mortgages to be provided to investors in connection with distributions under the OM Exemption. Among other things, the issuer will have to deliver an appraisal, prepared by a qualified, independent appraiser, of the current fair market value of the property underlying the syndicated mortgage to prospective purchasers of the securities.
    - The 2018 Proposal would have permitted the appraisal to have been dated up to 12 months prior to the date it was delivered to prospectus purchasers. Taking into account comments that this was too long a period given rapidly changing real estate markets, the CSA has revised the requirement so that the appraisal date must be within six months preceding the date of its delivery to prospective purchasers.
    - The proposed mortgage broker certificate requirement has been removed.
    - Additional guidance on the identity of the issuer of a syndicated mortgage has been provided.

Raise Your Hand: The comment period closes on May 14. The 2019 Proposal is one of several initiatives affecting the regulatory landscape for syndicated mortgages in Ontario. AUM Law has been facilitating discussions between some of our clients in the syndicated mortgage market, on the one hand, and staff of the OSC, the Financial Services Regulatory Authority of Ontario (FSRA), and the Ministry of Finance, on the other, regarding their concerns about and potential changes to the 2019 Proposal. These clients are preparing a submission and seeking a critical mass for their comment letter. If you want to discuss how the 2019 Proposal or related initiatives might affect your business and/or be connected with our clients who are preparing that submission, please contact us.

5. FINTRAC Clarifies Comments Made at OSC Seminar

Last month, we reported that a FINTRAC staff member's comments at an OSC seminar created some uncertainty about what registrants should do when a document used for identification purposes at the time of account opening expires. On March 13, FINTRAC clarified its views as follows:

A. Keeping Client Information Up-to-Date

FINTRAC confirmed that a firm does not have to re-identify a client if the client identification (ID) information that it originally used has expired before conducting a transaction on the client's behalf. As part of ongoing monitoring, the firm must keep client information (e.g. name, address, date of birth, occupation) up-to-date, but it does not have to re-identify the client, provided that the firm has kept the relevant records and has no doubts about the information used.

B. Client Identification and Beneficial Ownership

FINTRAC also clarified that securities dealers have obligations relating to beneficial ownership only when they have to confirm the existence of an entity. These obligations include, in general terms:

- Obtaining information that describes the entity's ownership, control and structure (including the names and addresses of its beneficial owners);
- Taking reasonable measures to confirm the accuracy of information obtained; and
- Keeping records of the information obtained and measures used to confirm its accuracy.

Reasonable measures to confirm the accuracy of information obtained can include referring to official documentation or records and/or obtaining documentation signed by the client to confirm the veracity of the information. In some circumstances, a single document can be used to obtain the information and confirm its accuracy. If a firm is unable to obtain or confirm beneficial ownership of an entity, the firm must verify the identity of the entity's most senior managing director. FINTRAC recommends, but not does not require, firms to use one of the methods described in its guidance document, Methods to Identify Individuals and Confirm the Existence of Entities.

6. CSA Proposes Regulatory Framework for Benchmarks

On March 19, the Canadian Securities Administrators (CSA) published National Instrument 25-102 Designated Benchmarks and Benchmark Administrators (NI 25-102) for comment. The proposed regulatory framework is intended to mitigate the risks of manipulation, interruption and uncertainty in the use of benchmarks, such as the Canadian Dollar Offered Rate (CDOR) and the Canadian Overnight Repo Rate Average (CORRA). Proposed NI 25-102, if adopted, will regulate the benchmarks themselves, the companies that administer benchmarks, and certain firms that contribute to the calculation of the benchmarks. The instrument specifically provides for the designation of CDOR and CORRA, as well as their administrator Refinitiv Benchmarks Services (UK) Ltd. The CSA has indicated that it may seek to regulate other benchmarks and benchmark administrators under NI 25-102 if they become sufficiently important to Canadian markets, if CSA members become concerned about them, or if an administrator applies for designation.

The regime has been designed to be substantially equivalent to the European Union's *Regulation on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds* (EU BMR), so that designated Canadian benchmarks can be used by EU-regulated entities, such as financial institutions and investment funds, once the EU's restrictions on third-country benchmarks come into force in January 2022. The comment period closes on June 12, 2019.

News & Events

We are proudly sponsoring this year's annual **Registrant Regulation Conduct & Compliance Summit**, taking place May 14-15 in Toronto. Visit the conference page for more details, or to register.

AUM Law's very own Janet Holmes, a former Assistant Program Director for Osgoode Hall Law School's Master of Laws (LL.M.) Program in Securities Law, joined current and former Ontario Securities Commission (OSC) staff on March 28 for a panel discussion for this year's LL.M. class about the role of credit ratings and the evolution of the regulatory framework for rating agencies.

Janet Holmes also joined dozens of senior corporate, securities and litigation lawyers, judges, and OSC commissioners to judge students from thirteen Canadian law schools participating in the 29th edition of the Canadian Corporate/Securities Law Moot, hosted by Davies, on March 8-9. This year's problem, which

was set against the leafy backdrop of the growing Canadian cannabis industry, considered the circumstances in which an issuer may be liable to secondary market investors for failure to disclose material changes or to disclose that financial forecasts may no longer be realized.

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