AUM LAW

June 2019 | Bulletin

Canada Day Edition

It looks like we're finally going to have a sunny, summery long weekend. To help you get an early start on the holiday, we're publishing our bulletin a day early.

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1. CSA Publishes Suggested Practices for Engaging with Older or Vulnerable Clients

On June 21, the Canadian Securities Administrators (CSA) published Staff Notice 31-354 Suggested Practices for Engaging with Older or Vulnerable Clients (Notice). The Notice builds on prior work by the regulators, including the Ontario Securities Commission Seniors Strategy, which we wrote about in March 2018. It's also intended to complement senior-focused guidance published by the Investment Industry Regulatory Organization of Canada (IIROC) and the seniors webpage maintained by the Mutual Fund Dealers Association (MFDA).

Although the Notice doesn't break any new ground, it does provide registrants with more detailed guidance and suggestions for dealing with older and vulnerable clients. In particular, we noted the following:

- **Red Flags:** The Notice describes red flags for diminished mental capacity and financial exploitation, noting that registrants can be among the first to notice problems in these areas. CSA staff recommend that firms train their employees to recognize these warning signs and understand how the changes can affect clients' financial decision-making abilities.
- **Trusted Contact Person (TCP):** For some time, regulators have been encouraging registrants to ask their clients to identify one or more TCPs whom the registrant can contact if there is a concern about mental capacity or financial exploitation. Implementing a TCP protocol, however, presents

In Brief

Stop Presses! OSC Drops Requirement for Pooled Fund Managers to Get Approval to Act as Trustees

As part of its burden reduction initiative, the Ontario Securities Commission (OSC) announced on June 27 that it will no longer require investment fund managers (IFMs) of pooled fund to apply for approval to act as trustees. Prior to this change, IFMs had to pay a fee, file an application, have it reviewed by OSC staff and receive approval. The change is set out in Revised Approval 81-901 Mutual Fund Trusts: Approval of Trustees under Clause 213(3)(b) of the Loan and Trust Corporations Act and takes effect immediately.

ASC Publishes Checklist for EMD Compliance Manuals

On June 12, the Alberta Securities Commission (ASC) published Notice 33-706 *Policy and Procedures Manual – Reference Resource for Exempt Market Dealers* (SN 33-706). It lists, by topic, the national and local regulatory instruments that firms registered as, or thinking about registering as, exempt market dealers (EMDs) may wish to consider in developing their compliance manuals. Although SN 33-706 is directed primarily at Alberta firms, other Canadian firms may find the resource list useful as well.

challenges for registrants due to concerns about matters such as privacy laws, the risk of complaints or lawsuits arising from a delay in implementing a client's instruction pending a discussion with a TCP, and concerns about situations where a TCP might be perpetrating abuse of the client. Until legislation is enacted that provides a clear safe harbour for registrants that contact a TCP, registrants will continue to face risks in this area. The Notice, however, includes recommendations on steps that registrants can take to mitigate some of these risks. As we discuss in another article in this bulletin, the CSA are working on a TCP requirement and, ideally, it will incorporate a safe harbour.

- **Communications:** Registrants are encouraged to: (1) be aware of how issues relating to vision, hearing and mobility may affect how their clients communicate with them; (2) design written communications with the needs of older and vulnerable clients in mind; and (3) provide written summaries and follow-up information to older or vulnerable clients after conversations take place.
- **Know-Your-Client (KYC)**: The Notice describes the types of information to request and document. CSA staff also encourage firms to meet with older or vulnerable clients more frequently to remain informed of significant changes (such as the diagnosis of a medical condition) that may affect the clients' financial circumstances and/or indicate diminished financial capacity or increased risk of financial exploitation.
- **Supervision:** Registrants are encouraged to establish heightened supervision of accounts and transactions for older and vulnerable clients, including: (1) conducting more focused reviews of new account application forms and KYC updates for these clients; (2) establishing age-based heightened review criteria for certain investments or product concentrations; and (3) incorporating factors such as age and retirement status into criteria for conducting spot checks on client trades or portfolios.
- **Complaint-Handling:** Registrants are encouraged to be mindful that older or vulnerable clients may be particularly susceptible to abandoning a justified complaint because they find the firm's complaint-handling procedures too prolonged or complex.
- **POAs and LTAs:** The CSA encourages registrants to, among other things:
  - have policies and procedures (P&Ps) to identify accounts that have a power of attorney (POA) or limited trading authorizations (LTAs) or that are under public guardianship or trustee services;
  - develop P&Ps to ensure that any POAs on file are current and satisfy applicable requirements under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act, including requirements relating to third-party determinations;
  - consider how legislation that governs POAs in the jurisdiction where the client resides may affect the registrant's ability to take instructions from the designated attorney;

- keep in mind that the client's needs, objectives, financial circumstances and risk tolerance must still be considered in determining whether an investment is suitable, even when the registrant is taking instructions from someone appointed under a POA; and
- be mindful that POAs and LTAs can be abused, so that the firm should consider developing P&Ps and employee training to address potential abuses in this area.

- **Escalation P&Ps:** The CSA encourages registrants to establish P&Ps for employees to escalate concerns within the firm if they suspect a client is suffering from diminished mental capacity or is being financially exploited. They also encourage firms to have P&Ps that address when and how suspected abuse of a POA should be escalated to external authorities. The Notice outlines information that firms could collect in standardized forms to record and share (internally or externally, as appropriate) when concerns arise and also suggests that firms maintain and share with their employees up-to-date contact information for provincial support services and providers.

AUM Law can help you by drafting or reviewing your P&Ps for older and vulnerable clients, providing training to your employees, and/or conducting focused compliance risk assessments in this area. Please contact us if you have any questions about the Notice or for a quote on our services.

2. CSA Issues 2016-19 Report Card and 2019-2022 Business Plan

On June 13, the Canadian Securities Administrators (CSA) published a report card on their 2016-19 business plan as well as their 2019-2022 Business Plan (CSA Plan). The report card serves as a handy summary of recent regulatory developments at the national level. And although the CSA Plan doesn't include any timelines for action, it does provide insight into what CSA members have agreed to prioritize in the next three years.

Some initiatives are already under way or previously announced, such as the proposed regulatory framework for over-the-counter (OTC) derivatives, proposed rule changes relating to investment fund embedded commissions, and proposed client-focused reforms. We also noted the following action items of interest:

- **Older and vulnerable investors:** The CSA is developing a framework to address financial exploitation and cognitive impairment among older and vulnerable investors. This includes the staff guidance that we describe in more detail in this bulletin. In addition, the CSA intends to introduce a trusted contact person (TCP) requirement, as well as "direction for placing temporary holds on disbursements of funds or securities" where there is a reasonable belief of financial exploitation or cognitive impairment.
- **Promotional activities in venture market:** Recent developments in the venture market have raised concerns among the CSA that "stakeholder processes" for sharing relevant information and identifying regulatory issues relating to market oversight may not be working effectively. The CSA, therefore, plans to research the effectiveness of those processes, using the venture market as a case study. If the CSA concludes that further work is needed, a concept paper will be published.

The CSA also described initiatives to streamline regulation and reduce regulatory burdens, including the following:

- **Rationalize investment fund disclosure:** The CSA plans to remove redundant and ineffective disclosure and reporting requirements for investment funds to reduce the regulatory burden and provide more streamlined and useful disclosure to investors.
- **Registration information:** The CSA intends to modernize, streamline and improve the existing registration process to make it more efficient, make it less burdensome to apply for and maintain

registration, and increase transparency with respect to the collection and use of personal information.

- **Continuous disclosure:** The CSA plans to streamline disclosure requirements for public companies in their annual and interim filings, consider the frequency of reporting, and amend the Business Acquisition Report (BAR) requirements.
- **Improve access to capital for public companies:** The CSA has published a proposal to liberalize the framework for at-the-market (ATM) offerings. It also is planning to consult on an alternative and streamlined offering system for public companies.

AUM Law will monitor these CSA initiatives and update you when concrete proposals are published.

3. Canadian CEO Penalized for His Company's CASL Breaches

Earlier this spring the Canadian Radio-television and Telecommunications Commission (CRTC) fined the chief executive officer (CEO) of nCrowd, Inc. (nCrowd) $100,000 for his company's breaches of Canada's Anti-Spam Legislation (CASL). The CRTC decision is worth reading for a number of reasons including the following findings:

- nCrowd failed to prove that it took appropriate steps to ensure that it had consent to send commercial, electronic messages (CEMs) to more than one million email addresses that it had purchased from Couch Commerce.
- nCrowd's unsubscribe mechanism and its process for handling unsubscribe requests were inadequate.
- CEO Brian Conley acquiesced in nCrowd's CASL violations and therefore committed a violation of CASL, too.

This case serves as an important reminder that officers, directors and agents of a corporation can be found liable for the corporation's violations of legislation if they direct, authorize, participate in, or even **merely assent to or acquiesce in** the illegal activity. In this case, the CRTC analyzed whether Mr. Conley's actions met the definition of "acquiesce". In his defense, Mr. Conley asserted that:

- it was impossible for a company CEO to have first-hand knowledge of millions of email addresses or the functionality of an opt-out button;
- Couch Commerce had represented that its list was CASL-compliant; and
- an independent investigation into Couch Commerce's assets before the sale did not reveal any alleged violations of CASL.

According to the CRTC, however, Mr. Conley was experienced with email distribution platforms (having invented one) and knew how important this marketing method was to his business. He was familiar with the functionalities of CEMS and unsubscribe mechanisms and was personally involved with the acquisition of the email distribution lists from Couch Commerce.

Individuals acting on behalf of a company or tasked with directing or supervising its activities can reduce their risk of liability by taking steps, consistent with their role, to ensure that the company has implemented and complies with an effective set of internal controls reasonably designed to prevent violations of the law. AUM Law can assist you in this area by drafting or reviewing policies and procedures, conducting compliance risk assessments, and/or training you, your directors and your employees on the relevant legislative requirements.

4. Beleave It! Prompt, Remedial Action Can Take Enforcement Actions off the Table

Since late 2018, British Columbia Securities Commission (BCSC) staff have been investigating whether various firms and individuals (collectively, the BridgeMark Group) and issuers engaged in illegal distributions of securities and abusive conduct involving, among other things, inappropriate reliance upon the consultant exemption in National Instrument 45-106 *Prospectus Exemptions* (NI 45-106). On June 5, the BCSC discontinued its enforcement action against Beleave Inc. (Beleave), one of the issuers. We believe that settlement agreement (Settlement) provides useful information on steps that a company can take, in the face of allegations of securities misconduct, to avoid or narrow the scope of enforcement action that it might face.

The misconduct: According to the Settlement, between April and June 2018, Beleave announced that it had raised approximately $10 million through two private placements. In fact, Beleave retained only $2.5 million, returning $7.5 million through prepaid "consulting fees" to members of the BridgeMark Group, which did not provide any consulting services. Although the purchasers represented to Beleave that they were acquiring the shares for investment purposes only, they resold a majority of the shares into the market at an average price below the acquisition cost almost immediately after the acquisitions.

Although Beleave's board of directors approved the private placements, a majority of the directors did not know of the private placements' connection to the purported consulting arrangements. They became fully aware of these matters only when the BCSC's Executive Director issued a temporary order and notice of hearing in November 2018 regarding the BridgeMark Group and the issuers involved.

Beleave's remedial actions: According to the Settlement, Beleave acted promptly to address the misconduct by, among other things:

- Conducting a thorough, internal investigation;
- Ensuring that all individuals associated with the misconduct made no executive decisions during the investigation;
- Negotiating a separation of these individuals when the investigation concluded;
- Refreshing its management team and board of directors, including with the appointment of independent directors with experience in corporate governance and compliance;
- Creating dedicated audit, governance and compensation committees;
- Strengthening its internal control and management processes;
- Making early admissions to the Executive Director regarding its misconduct and fully cooperating with the BCSC's investigation; and
- Undertaking to correct its public disclosure regarding the private placements.

Beleave disclosed additional remedial actions in the news release it published on June 6.

Of course, it is preferable to avoid enforcement issues in the first place with robust governance, compliance systems and controls, and careful monitoring including compliance risk assessments. But if your firm becomes embroiled in an investigation, prompt and thorough remedial action as well as cooperation in good faith with the regulator can go a long way to minimize the risk of enforcement action. AUM Law can help you before or after the regulator comes knocking at your door. Please don't hesitate to contact us with questions or a request for assistance.

5. SEC Adopts Final Rules Governing Broker and Adviser Relationships with Investors

On both sides of the border, securities regulators have been working for several years to amend and clarify the obligations that broker-dealers and investment advisers owe to retail investors. In both countries, the regulators considered adoption of an over-arching, best interest standard.

As we reported in June 2018, the Canadian Securities Administrators (CSA) decided not to adopt such a standard. Instead, they proposed specific amendments (Client-Focused Reforms) to the know-your-client (KYC), suitability, conflicts of interest and relationship disclosure information (RDI) requirements in *National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103), as well as a new know-your-product (KYP) requirement.

The U.S. Securities and Exchange Commission (SEC) took the opposite approach by adopting, on June 5, 2019, Regulation Best Interest: The Broker-Dealer Standard of Conduct (Reg BI). Both approaches have their supporters and critics, and we think that Canadian market participants might find the US approach interesting, albeit of indirect relevance. In particular, the statements issued by individual SEC Commissioners and the SEC's Investor Advocate at the June 5 public hearing to consider Reg BI are worth reading because they contextualize the reforms and highlight some of the concerns about the final rules. We expect that CSA members will pay attention to Reg BI, how the SEC addressed the comments on its original proposal, and how Reg BI is implemented (and criticized) as the Client-Focused Reforms are finalized.

In addition to adopting Reg BI, the SEC adopted:

- Form CRS - Relationship Summary, which will require broker-dealers and investment advisers to provide retail investors with a short relationship summary document covering the relationships and services the firm offers, the fees, costs, conflicts of interest and required standard of conduct associated with those relationships and services, and whether the firm and its financial professionals have reportable legal or disciplinary history;
- An interpretation of the fiduciary duty that investment advisers owe to their clients under the Investment Advisers Act of 1940 (Advisers Act); and
- An interpretation of the "solely incidental" prong of the broker-dealer exclusion from the requirement to register under the Advisers Act.

As we mentioned above, the CSA's to-do list for 2019-22 includes adoption of the Client-Focused Reforms (or an amended version of them). We will continue to monitor this initiative and keep you informed. Please contact us if you'd like to discuss how the potential changes may affect your business.

6. OPC Reframes Its Consultation Paper on Trans-Border Data Flows

In May, we reported that the Office of the Privacy Commissioner of Canada (OPC) was consulting on proposed guidance (Consultation) about how the Personal Information Protection and Electronic Documents Act (PIPEDA) applies to transfers of personal information between organizations for data processing, including cross-border transfers. We also reported that the Government of Canada had launched a consultation on a proposed digital charter and published a discussion paper (Discussion Paper) outlining plans to modernize PIPEDA.

On June 11, the OPC announced that it was reframing the Consultation to take into account the proposed digital charter and the Discussion Paper. In particular, the OPC is now inviting feedback both on how the current law should be interpreted and applied to these kinds of data transfers and how a

future law should protect data privacy in this area. The deadline for comments has been extended to August 6, 2019.

Please contact AUM Law if you would like to discuss the potential impact of these developments on your business or if you are interested in making a submission.

News & Events

On June 19, AUM Law's very own Erez Blumberger and Kimberly Poster served as expert instructors on registrant regulation and investment funds for the Intensive Course in Canadian Securities Law and Practice offered through Osgoode Hall Law School's Professional Development program.