AUM LAW

May 2022 | Bulletin

Star Wars Edition

May is the month of many holidays and the unofficial start of summer/movie blockbuster season! May is also a significant month for Star Wars fans everywhere, as the original Star Wars: A New Hope premiered in May 1977.

Although the #StarWarsCelebration has ended, there's still a whole lot to be excited for in our galaxy, not so far away. This month we report on consolidating SROs, the new investor protection fund, FSRA's new whistle-blower program, outside activity reporting and more below.

In this bulletin:

1. Shining a Spotlight on Fees – Total Cost Reporting is Here

As noted in our April bulletin, the Canadian Securities Administrators (**CSA**) and the Canadian Council of Insurance Regulators (**CCIR**) released proposed amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**), 31-103CP and proposed a new CCIR Individual Variable Insurance Contract Ongoing Disclosure Guidance, all related to new total cost reporting (**TCR**) requirements for investment funds and segregated funds. The proposals were a joint committee effort involving members of the CSA, CCIR, Canadian Insurance Services Regulatory Organizations, the Investment Industry Regulatory Organization of Canada and the Mutual Fund Dealers Association of Canada.

The proposed insurance guidance would apply to all insurers offering segregated fund contracts and is intended to add new cost and performance reporting requirements for individual variable insurance contracts. The changes to the insurance guidance also seeks to improve awareness of

the rights of policy holders to guarantees and how their actions might affect their guarantees. The remainder of this update focuses on the changes proposed with respect to the disclosure of costs of holding investment funds.

The purpose of the enhanced cost disclosure is to enhance investor protection, by improving awareness of ongoing embedded fees for investment funds such as a fund's management expense ratio (**MER**) and trading expense ratio (**TER**). Currently, there is no requirement to provide ongoing reporting of such costs after the initial sale in a form that is specific to an individual investor's holdings. The amendments impact the account reporting requirements for registered dealers and advisers and would place obligations on registered investment fund managers to provide dealers and advisers with specific information to allow them to include the new TCR data in account statements.

The changes to NI 31-103 would require account statements to include information on embedded fees as a **percentage** (i.e. the newly coined fund expense ratio) for each fund held on the monthly and quarterly account statements. In addition, information would be required to be included on the annual report on charges and other compensation for the account as a whole which shows the aggregate **dollar** amount of fund expenses for all investment funds held during the year and the aggregate **dollar** amount of any direct investment fund charges (e.g. redemption fees or short-term trading fees) held in the account during the year. Fund expenses are to be calculated with reference to the *fund expense ratio*, which is the sum of the MER and the TER.

The disclosure would apply in respect of **all** investment funds, including scholarship plans, foreign funds and prospectus exempt funds. Existing exemptions for statements and reports for non-individual permitted clients would continue to apply. Investment fund managers must provide information to dealers and advisers on the daily cost per unit/share of the relevant class or series of an investment fund calculated in dollars, determined using the specified formula. The calculation requires the applicable fund expense ratio to be divided by 365, and then multiplied by the NAV of a share/unit of the applicable class or series for the day. With respect to the source of the required data, investment fund managers would be allowed to rely on publicly available information in fund facts, ETF facts documents, prospectuses, or management reports of fund performance, **unless** the information is outdated, or the manager reasonably believes that it would cause the information reported in the account statement or report to be misleading. If advisers or dealers do not believe the information received from the investment fund manager is reliable, there would be an obligation for them to make reasonable efforts to obtain the information by other means. If that is not possible, the registered firm must exclude the information from the calculation of the amount of fund expenses or of the direct investment fund charges reported to clients, or in the case of a fund expense ratio, not report the ratio and disclose the exclusions in the affected report.

The consultation also includes a sample prototype statement and report for both the securities and the insurance sectors, as well as an annex explaining the differences between products, distribution channels and regulation between segregated funds and investment funds. It is proposed that final amendments would come into effect in September 2024, meaning the new first quarterly account statements would be required for the period ending December 2024, and the new annual reports for the period ending December 2025.

We suspect market participants will have many questions and comments with respect to the new proposal, including with respect to the obligation to source the required data by other means, as

the proposed changes to 31-103CP suggest this may include relying on information reported by a reliable third-party service provider. We would be happy to answer any questions you have on these proposals or assist with comments, which are due by July 27.

2. Kicking Off a New Regime - Application for Recognition of New Self-Regulatory Organization

The Canadian Securities Administrators (**CSA**) has taken one step closer to realizing on its recommendations to consolidate the two existing self-regulatory organizations (**SROs**), IIROC and the MFDA, into a single SRO (**New SRO**) in CSA Staff Notice and Request for Comment 25-304 Application for Recognition of New Self-Regulatory Organization. The New SRO would be amalgamated under the *Canada Not-for-profit Corporations Act*. Current members of the MFDA and IIROC will be members of the New SRO.

The CSA has an ambitious agenda to work towards establishing the New SRO by December 31, 2022. The Chair of the Board of the New SRO, along with industry and independent board members, was also announced along with the publication of the CSA Staff Notice. The CEO of the New SRO remains to be announced.

The New SRO would have an expansive mandate to act in the public interest, including protecting investors from unfair, improper or fraudulent practices by its members and fostering public confidence in the capital markets. Other aspects of its mandate will include facilitating investor education, administering a fair, consistent and proportionate continuing education program, and recognizing and incorporating regional considerations and interests from across Canada.

Initially, the New SRO will have two classes of members, the first being Dealer Members, who are comprised of investment dealers and/or mutual fund dealers. The second class would be Marketplace Members, comprised of recognized exchanges, quotation and trade reporting systems and others that facilitate trading of securities or derivatives in Canada in the enumerated circumstances.

The application for recognition of the New SRO includes a draft by-law, draft interim rules, draft terms of reference for the New SRO Investor Advisory Panel, and new requirements for Québec. The application also includes a draft recognition order and draft Memorandum of Understanding among regulators regarding oversight of the New SRO.

The application and draft approval order sets out the proposed governance structure for the New SRO, including a requirement for the board and committees to be composed of a majority of independent directors and independent chairs, with the governance committee composed of all independent directors. It is proposed the initial board will consist of 15 members, six of which will represent the members and 8 of which will be independent, plus the President and the CEO of the New SRO. The New SRO will also have policies and procedures to manage actual, potential or perceived conflicts of interest of its directors, officers, employees and members of its disciplinary panels.

The current IIROC District Councils will be replaced by Regional Councils, which will have an advisory role to staff of the New SRO on regional regulatory policy matters. It is proposed that there be a National Council and seven Regional Councils, comprised of Dealer Members from each region (as defined). The National Council would be comprised of the Chairs and Vice-Chairs of the Regional Councils to act as a forum for cooperation among the councils and make

recommendations to the CEO and Chair of the New SRO. A new Appointments Committee will have responsibility for appointing members of the District Hearing Committees.

In addition, the new SRO will have new formal investor engagement mechanisms, including an Investor Advisory Panel and investor office. The investor office will support rule development and provide investor education and outreach, while the Investor Advisory Panel will provide independent research or input on regulatory and public interest matters. The Investor Advisory Panel will provide input to the New SRO with respect to its annual priorities, strategic plans, policies, and other regulatory initiatives, and may also raise current and emerging policy issues that it identifies. Members of the panel will be selected by a public application process administered by staff of the New SRO and will consist of 5-11 members. The Chair of the panel must meet with the New SRO board at least once a year and will publish a public report annually to be posted on the New SRO's website.

The New SRO continues its planning to develop an appropriate fee model post amalgamation. On an interim basis, the existing fee structures and models of IIROC and the MFDA will initially be maintained by the New SRO, as will the existing criteria for access to membership and the provision of regulation services.

With respect to rules, the New SRO will initially adopt interim rules which incorporate the regulatory requirements in the rules of IIROC and the MFDA, which include:

- Investment Dealer and Partially Consolidated Rules;
- Mutual Fund Dealer Rules;
- Mutual Fund Dealer Form 1; and
- Universal Market Integrity Rules.

The Interim Rules include proposals to **(i)** amend the current IIROC proficiency requirements to allow dual registered firms to employ mutual fund only licensed persons without having to upgrade their proficiencies to those required of a securities licensed person, and **(ii)** permit introducing/carrying broker arrangements between mutual fund dealers and investment dealers.

The SRO will work toward harmonizing CE programs, but for now the existing CE requirements will continue to apply. Mutual fund dealers will continue to be exempt from the CE requirements of the New SRO for their activities in Québec. Furthermore, the power to make decisions relating to the supervision of the New SRO's activities in Québec will be exercised mainly by persons residing in Québec, and complaints will be referred to staff of the New SRO in Montreal or to the Autorité des marchés financiers or the Chambre de la sécurité financière. Members of the hearing panels of the New SRO in respect of Québec residents will themselves be Québec residents. While firms registered as mutual fund dealers in Québec will join the New SRO, there will be a transition period for their activities in Québec and their fees will be prorated to the services offered to them by the New SRO.

Comments on the materials are due shortly, by June 27.

3. Investor Protection Funds in the Limelight - Application for Approval of the New Investor Protection Fund

In mid-May, the Canadian Securities Administrators (**CSA**) released CSA Staff Notice 25-305 *Application for Approval of the New Investor Protection Fund.* The release of the application is the

next step following the recommendations in CSA Position Paper 25-404 to amalgamate the two existing contingency funds, The Canadian Investor Protection Fund and the MFDA Investor Protection Corporation into a single compensation fund (**New IPF**) for customers of investment dealers and mutual fund dealers who are members of the new self-regulatory organization (**SRO**). The New IPF will be amalgamated under the *Canada Not-for-profit Corporations Act* and will be independent from the new SRO. The New IPF's objective will be to either return assets to customers upon an insolvency of an SRO member, or if the assets are not available, provide compensation for their value as at the date of the insolvency.

The New IPF is also to be established by December 31, 2022. The Chair of the Board of the New IPF, along with industry and independent board members, was announced along with the publication of the CSA Staff Notice. The CEO of the New IPF remains to be announced.

The application for approval of the New IPF includes a draft by-law, coverage policy, claims procedures and draft appeal committee guidelines, as well as a draft approval order and draft Memorandum of Understanding among the CSA members regarding oversight of the New IPF. Members of the New IPF would be the persons who compose the board from time to time, and membership is consistent with the current structure of each existing compensation fund.

The application and draft approval order sets out the proposed governance structure for the New IPF, including the composition of the board, proposed to be a mix of Industry Directors, Public Directors (as such terms are defined) and the CEO. It is proposed that the number of Public Directors must exceed the number of Industry Directors by at least one. Various committees of the board are also proposed, each of which must be constituted by a majority of Public Directors, including the chair. With respect to conflicts, the New IPF's mandate indicates it must identify and avoid "real, potential or perceived conflicts of interest between its own interests, or the interests of its directors, officers, or employees and the New IPF Mandate".

The funding and investment of the assets in the New IPF is also addressed. The New IPF will be required to publish its methodologies of establishing assessments for contributions from each category of SRO members. It will also conduct a risk analysis associated with each category in order to determine whether a single assessment methodology is appropriate. Until the review is completed, it is contemplated that the funds available to satisfy potential claims for coverage by investment dealers (or dually registered investment fund dealers and mutual fund dealers) and mutual fund dealers will **remain separate** and be subject to separate assessments. There will be a moratorium on changes to the current assessment methodologies that would result in a material increase to the assessments levied on each category. The money in each fund must be invested in accordance with the relevant policies applicable to that fund and require safety of principal and a reasonable income while assuring sufficient liquidity for potential claims.

The draft coverage policy describes eligible customers, the losses and property covered, limits on coverage and how claims can be made.

Similar to the proposal for the new SRO, a separate regime is contemplated for mutual fund dealers in the province of Québec given their existing regulatory framework and the fact that such dealers are not currently registered with the MFDA. It is proposed that the New IPF will **not** provide coverage for mutual fund dealer customer accounts in Québec and SRO members will not be subject to assessments to contribute to the mutual fund dealer fund of the New IPF in respect of those accounts, but instead will continue to contribute to the existing Québec financial services

compensation fund. The Autorité des marchés financiers (**AMF**) has published for comments its proposed transition plan for mutual fund dealers, described in more detail below.

Comments on the application and related documents are due by June 27.

In Brief

Amendments Relating to the Transition for Québec Mutual Fund Dealers to the New SRO – The Plot Thickens

The Autorité des marchés financiers (**AMF**) has proposed a Regulation to amend Regulation 31-103 respecting *Registration Requirements, Exemptions and Ongoing Registrant Obligations* to set out transitional provisions to ensure that mutual fund dealers registered in Québec become members of the new self-regulatory organization (**New SRO**) resulting from the consolidation of IIROC and the MFDA.

All mutual fund dealers in Québec will be required to become members of the New SRO. Québec mutual fund dealers will be transitioned to the New SRO in two phases (a transition phase and permanent phase), on a number of terms and conditions. Effective January 1, 2023, mutual fund dealers in Québec will become members of the New SRO. However, they will not be subject to the rules of the New SRO, except for its operating rules. Instead, dealers will continue to be subject to the regulatory framework currently applicable in Québec. However, dealers would be able to participate in the New SRO's committees and in its consultations.

The permanent phase will begin on the later of: **(i)** the implementation date of the New SRO's harmonized rule book, **(ii)** the date that is one year after AMF approval of the New SRO's harmonized rule book or on any other date determined by the AMF, on a consultative basis. As of that date, mutual fund dealers would be subject to the same oversight as in the other Canadian jurisdictions, while taking into account features specific to the framework applicable to the mutual fund sector in Québec. The transition period is expected to be at least one year following the adoption of the New SRO's harmonized rule book. Comments on the proposed amendments are being accepted until June 27.

CSA Staff Notice 25-503 – 2021 CSA Annual Activities Report on the Oversight of Self-Regulatory Organizations and Investor Protection Funds – The Show Must Go On

Despite the impending consolidation of IIROC and the MFDA discussed earlier in this bulletin, staff of the Canadian Securities Administrators (**CSA**) are required to assess both self-regulatory organizations (**SROs**) and their respective investor protection funds (**IPFs**) for their compliance with securities legislation requirements. The latest report, released on April 28, covered the period from January 1 - December 31, 2021. Staff were generally of the view that the CSA continues to fulfill its oversight obligations, and the report sets out key highlights of some of these activities, including:

- Work related to the consolidation of the two SROs and two IPFs, including nine specific workstreams to manage the integration project and hiring Deloitte as an integration manager;
- Continuing to deal with issues arising from the COVID-19 pandemic;
- A project to streamline and modernize various orders and memoranda of understanding relating to CSA oversight;

- A project to identify and implement improvements to the CSA methodology for coordinated oversight, including updates to the CSA risk assessment framework; and
- Conducting a risk-based desk review of IIROC, targeting specific processes within IIROC's equity market surveillance and debt market surveillance functions.

The Staff Notice reports that during regular meetings held with IIROC, key subjects were discussed including IIROC's COVID-19 response, order-execution only service levels (particularly client complaints with respect to delays and service disruptions), crypto assets, and the client focused reforms (**CFR**s). Of interest, it is stated that the CSA, IIROC and the MFDA intend to publish findings from their coordinated review of the CFR conflicts of interest rules and provide implementation guidance to the industry on these enhanced requirements.

With respect to the MFDA, topics such as the COVID-19 response (focusing on the MFDA's process in granting exemptive relief), the CFRs and the MFDA's targeted review on performance data reporting to clients by members was discussed.

Going forward, CSA Staff intend to publish an activities report on the new SRO and new IPF on an annual basis.

Encouraging Dialogue - FSRA's New Whistle-Blower Program: Enhanced Protection in the Non-Securities Financial Services and Pensions Sectors

Recent amendments to the *Financial Services Regulatory Authority of Ontario Act, 2016* (**FSRA Act**), effective April 29, 2022, marks the Financial Services Regulatory Authority of Ontario's (**FSRA**) ongoing efforts to help identify misconduct in the non-securities financial services and pensions sectors. The amendments usher in a new Whistle-Blower Program designed to offer enhanced protection to a whistle-blower's identity from disclosure, reprisal and liability in civil proceedings, where the person or entity discloses alleged or intended contraventions of certain Acts corresponding to "regulated sectors" under FSRA's purview. Specifically, the following Acts are now covered:

- the *Credit Unions and Caisses Populaires Act, 2020*;
- the *Financial Professionals Title Protection Act, 2019*;
- the *Insurance Act*;
- the *Loan and Trust Corporations Act*;
- the *Mortgage Brokerages, Lenders and Administrators Act, 2006*;
- the *Pension Benefits Act*; and
- the *Pooled Registered Pension Plans Act, 2015.*

To encourage persons or entities to come forward with timely insider information of suspected contraventions, FSRA is required to keep confidential not only the identity of the whistle-blower but also any information or record that may reasonably be expected to reveal their identity.

It is important to note that the Whistle-Blower Program does not only protect employees, but rather any "person or entity" who comes forward in good faith, so long as the associated requirements as set out in the FSRA Act are met. To help ensure anonymity, submissions to FSRA may be made through a whistle-blower's lawyer.

Important Reminders

Modernizing Registration Information Requirements, Clarifying Outside Activity Reporting and Updating Filing Deadlines

A friendly reminder that amendments to legislation clarifying the "Outside Activity" (**OA**) reporting framework and modernizing registration information requirements will be coming into force on June 6, 2022. These amendments are meant to establish a more efficient registration and oversight process for registrants by simplifying and streamlining certain regulatory requirements. However, in the short-term, firms will need to take certain actions, including updating their policies and procedures in-line with the new requirements. Additionally, most registered and permitted individuals' existing reporting forms will require updates to be filed by the earlier of **(a)** the date the individual is next required to notify the regulator of a change to their registration and **(b)** June 6, 2023.

The Ontario Securities Commission (**OSC**) recently published an implementation guide to help firms prepare for these changes. The guide touches on: **(i)** the new framework for reporting activities carried on by individuals outside of their sponsoring firm, **(ii)** the restrictions on the client base of individuals whose reportable activities are positions of influence over certain clients, **(iii)** the new requirement to report the business titles and professional designations used by an individual at their sponsoring firm and at each reportable outside activity, **(iv)** other NRD update obligations, and **(v)** the new rule to reduce multiple filings of the same information by affiliated registered firms.

AUM Law would be pleased to assist firms to update their policies and procedures in line with the new requirements, as well as assist their individuals to make required updates to their registration forms.

Update Your SEDAR Profile – It's Crunch Time

As the Canadian Securities Administrators (**CSA**) continue to work toward SEDAR+ as its new filing portal - now scheduled to be implemented in February 2023 - companies and fund groups with an existing SEDAR profile are asked to ensure that all profile information is up to date in order to ensure a smooth transition. Ideally this would be done by the CSA's deadline of June 30, 2022. Additional information about SEDAR+, including key project dates and process changes, can be found here. BLG's senior law clerks expect to be part of the SEDAR+ Pilot Program, so we should have a front seat on how SEDAR+ will improve our world.

FAQ Corner

CFR FAQ - The Sequel

Since the enhancements introduced as part of the Client Focused Reforms (**CFR**) came into force in 2021, the Canadian Securities Administrators (**CSA**) has been providing the industry with additional guidance by publishing an FAQ with a few updated responses to questions posed by the industry. The latest was released on April 29, 2022, and it provides some clarity to previous responses. The responses below relate to the regulators' expectations regarding business titles and a few EMD-specific scenarios.

Question: I was appointed as an officer with my firm before CFR came into effect, can I still use my title?

Answer: The answer to this question depends on whether you are responsible for specific duties and functions within the firm that warrants a corporate level title, such as "Director" or "Vice-President". If the title does not match your specific function within your firm or your level of responsibility, then use of the corporate title is prohibited. The CSA is concerned about public misunderstanding, when the public deals with someone that has a title that doesn't reflect a registrant's true role. The CSA have stated in previous communications that the use of titles that do not accurately portray the level of responsibility and the authority a registrant has within their firm could be confusing to the public (i.e., can this person bind the firm legally, or is the person part of the "mind and management" that makes decisions on behalf of the firm?). The CSA has made it clear that it does not matter if the client is sophisticated enough to qualify as a "permitted client" and that the use of a corporate level title that is not consistent with the registrant's true role is prohibited.

The CSA will pay rapt attention to the titles and designations used by all registrants during their next wave of compliance reviews. To reinforce the importance the CSA has placed on the use of titles and designations, they have also published amendments to NI 33-109, that come into effect June 6, 2022, mandating that all business titles and professional designations used by registrants must be reported via the NRD.

Question: We have a referral arrangement in place with some clients, and they pay fees based on those arrangements. We disclose this to all our clients on our website, isn't that enough?

No, the CSA expects full transparency. The CSA strongly believes that clients, especially those of a similar size, asset holdings and sophistication, receiving similar products and services should all be charged the same for the products and services provided. If there are referral arrangements or other considerations in place with some clients that reduce the fees those clients pay, then clients that do not benefit from such an arrangement must be made aware of this so that they can make an informed decision about the fees they pay versus the products and services provided to them. Full transparency allows for informed decisions; if the client is not happy, and the situation cannot be resolved in the client's best interest, then the client can go elsewhere. A firm cannot claim that they have met the standard of care principle by simply disclosing that referral arrangements exist on their website. The CSA expects firms to be able to demonstrate that in carrying out their obligations they are treating all clients in similar circumstances fairly. This should be part of an on-going process whereby clients are duly informed of differing fees and charges in effect. The CSA will be specifically focused on differing fees charged for similar products and services rendered, and firms should be prepared to defend the difference during the next compliance review.

Question: My firm is an EMD, why do I have any suitability obligations when my firm's interaction with these clients is limited?

No matter the relationship with a non-permitted client, whether it be transactional or an ongoing relationship, at the time that a service is provided (i.e., product or advice) the suitability requirement applies. The CSA believes that suitability cannot be waived simply because the nature of the relationship is brief, i.e., until the transaction closes, or the ink is dry.

Even prior to the April 2022 FAQ release, CSA regulators have always maintained that for transactional relationships, firms should always understand the requirements for each client prior to a trade being executed or a recommendation given. The EMD must know that client and must still gather the required information needed to make an informed suitability assessment of the client's requirements prior to conducting and concluding the client's business.

Once the transaction is over, the requirement to keep KYC information current on an annual basis would not apply, unless there is another service provided for that client within that period. Similarly, when it comes to changes to the nature of a product which is the subject of the sale, if product information changes prior or during a transaction, the EMD would be required to report this to the client. However, if the client is strictly a "one time client", and there is a significant change to the product after the transaction concludes then the EMD would not be obligated to report to the "one-time client" regarding any changes to the product. It is very important to maintain evidence of the client relationship to support the nature of the relationship with the client.

BLG's Resource Corner

Our colleagues at BLG have written the following articles we thought might interest our readers:

- Ontario Court Grants Anton Piller Order in Cryptocurrency Heist
- Immediate and Permanent Changes to Canada's Anti-Money Laundering Laws
- Mind Your Spreadsheets: Tips to Improve Your Data Governance Before an Incident
- Bill 96: New French Language Obligations Affecting Workplaces, Business, Contracts and More
- 2022 Privacy Risk Management – Top Tips for Organizations

For more information, please visit the BLG website.