AUM LAW

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Asteroid Edition

Many of us know that asteroids are small, rocky objects that orbit the sun. But did you know that June 30 is celebrated globally as International Asteroid Day? It commemorates the Tunguska event in 1908 in Siberia, where a meteor air burst destroyed a large tract of forest. International Asteroid Day was first celebrated in 2014 and was proclaimed as a global day of observation by the United Nations in 2016. The day is, in part, intended to be educational and raise awareness about the potential threat from the impact of asteroids, as well as their place in our solar system.

While you keep one eye on the sky, you can keep one eye on the rest of this bulletin where we discuss the impact of regulatory consultations and amendments.

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1. FSRA Consults Further on the UDAP Rule and Impactful Fee Choices

The Financial Services Regulatory Authority of Ontario (**FSRA**) released for consultation a second set of amendments relating to Rule 2020 – 002 *Unfair or Deceptive Acts or Practices Rule* (**UDAP Rule**). The proposed amendments to the UDAP Rule relate to deferred sales charges (**DSC**s) in individual variable insurance contracts entered into prior to June 1, 2023. The proposals will allow insurers to simplify the information they provide customers if they provide a new sales charge option that is better than a DSC (as described in the proposed amendments to the UDAP Rule).

These special rules apply if the owner and insurer had previously agreed to make future payments to the contract on a DSC basis (e.g. under a pre-authorized payment agreement). The written disclosure that the insurer will have to provide will depend on whether they offer a new default sales charge option that is "unequivocally better" than a DSC. A sales charge will be unequivocally better for an owner if:

- The % amount of any initial sales charge is no greater than for the DSC;
- The management expense ratio is no greater than for the DSC;

- No other fee or charge associated with the sales charge option is less favorable to the owner than under the DSC option; and
- The sales charge option applied does not involve any new conflict between the interests of the owner and the interests of the insurer or an agent to the detriment of the owner.

Importantly, it is explicitly stated that an advisor chargeback option does not qualify as unequivocally better than a DSC. An advisor chargeback option is any option under an IVIC where an insurer pays compensation to an agent when an owner invests money in a segregated fund in an IVIC, and an agent that receives this compensation may need to repay all or part of it to an insurer, if the owner withdraws money from a segregated fund or changes the sales charge option. An advisor chargeback is also defined to include a charge that a reasonable insurer would consider to be an advisor chargeback sales charge option.

If the new default is better for the owner, disclosure can be sent before or promptly after first applying the new sales charge option to a deposit under the contract, describing the new charge, how it works, if other sales charge options are available and how to get more information about those charges. If the new sales charge default option is **not** unequivocally better than a DSC, then the insurer must provide additional disclosure prior to applying the new sales charge, designed to help the owner choose a suitable option. It must include a list of available sales charge options, how they work, and information about the fees. The insurer must obtain the owner's consent before applying the charge or wait a reasonable time after providing notice without any reply.

The amendments are intended to, in part, reduce the cost of insurer compliance for insurers that do not need to provide owners with the more costly detailed disclosure, and reduce the time owners need to spend reviewing documents about other charges if the new charge is an unequivocally better option.

Comments on the consultation are due by June 30, 2023.

2. Federal Review of AML Regime with Global Implications

The Department of Finance Canada released a sweeping consultation paper with respect to Canada's anti-money laundering and anti-terrorist financing regime (**AML/ATF** regime), including potential changes to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (**PCMLTFA**) and the *Criminal Code*. The review of the PCMLTFA is required every five years under the Act, which provides the government with an opportunity to keep the AML/ATF regime current in response to market developments. The Parliamentary Committee involved in the review will release a report that will help determine future policy measures. The consultation paper seeks input to support the development of these policy measures.

Both domestic and international reports have indicated there are challenges in the ability of Canada's AML/ATF regime to use financial intelligence, ensure transparency of legal persons, successfully investigate and prosecute money laundering and remove the proceeds of crime from criminals. The consultation paper covers a lot of ground, including the history of the AML/ATF regime, international regimes, national security considerations, and potential enforcement mechanisms including possible criminal law reforms and the creation of a new Canada Financial Crimes Agency (**CFCA**) to become the lead enforcement agency against financial crimes. The summary below focuses on possible measures to improve operational effectiveness of the AML/ATF regime, and the potential impact on securities registrants.

The consultation paper contemplates enhancing information sharing to facilitate the detection and disruption of money laundering and terrorist financing activities, including a framework for private sector organizations to share information among themselves. The Department of Finance indicated its interest in reviewing the ability of the Financial Reports and Analysis Centre of Canada (**FINTRAC**) to request additional information from reporting entities when needed to analyze suspected money laundering or terrorist financing.

Another potential consideration is the viability of creating and maintaining a federal database of politically exposed persons (**PEP**s) and heads of international organizations (**HIO**s) and their family members/close associates.

With respect to sharing information with other regulators, the consultation asks whether the government should amend the PCMLTFA to allow FINTRAC access to findings from other regulators and share FINTRAC compliance information with other regulators to help inform compliance assessments of those subject to the Act. The scope of the PCMLTFA itself is also under consideration. For example, the paper queries whether the Act should be expanded to cover new sectors, including luxury goods, title and mortgage insurers, and crypto and digital assets technology.

Currently, reporting entities are required to document a review of their AML/ATF compliance program to test its effectiveness every two years. AUM Law performs many such reviews for registrant clients. The consultation paper considers the ability for FINTRAC to direct a compliance review in addition to the two-year effectiveness review, in circumstances of urgent or significant non-compliance matters. It is currently contemplated that reporting entities could be required to share the results of the review, and any remedial measures identified, with FINTRAC.

The framework's review is also meant to ensure that FINTRAC can effectively supervise people and entities subject to the Act. One proposal would involve requiring all regulated persons and entities subject to the PCMLTFA, such as registered dealers and advisers, to register with FINTRAC and provide relevant information about their businesses. Currently, this is only a requirement for money service businesses which have to provide information about their business, ownership and senior management to FINTRAC. The purpose of any such requirement would be to support sharing updates on new guidance and better risk-based compliance processes.

With respect to existing obligations, reporting entities must appoint an AML/AMF compliance officer, and the government is considering amendments to the PCMLTFA to specify the knowledge and competencies required of a qualified compliance officer. The government may also in future provide further details as to when a "business relationship" is considered to have ended, which may help relieve some of the obligations on reporting entities for ongoing monitoring of a business relationship that no longer exists. Open ended questions are also asked with respect to whether there are other opportunities to streamline AML/ATF requirements to reduce the regulatory burden on reporting entities, while balancing the risk-based approach to these obligations and Canada's international commitments.

Submissions on the consultation close on August 1, 2023. If you are interested in commenting on any aspect of the consultation and would like assistance, please don't hesitate to reach out to your usual AUM professional.

3. CIRO's Annual Priorities Released: Star Map Set for the New Regulator

Effective January 1, 2023, the New Self-Regulatory Organization of Canada (**New SRO**) – the amalgamated self-regulatory body formed from the Mutual Fund Dealers Association of Canada (**MFDA**) and the Investment Industry Regulatory Organization of Canada (**IIROC**) – launched operations. Along with rebranding and renaming the organization to the Canadian Investment Regulatory Organization (**CIRO**) on June 1, 2023, CIRO has published its annual priorities for its fiscal year 2024 (April 2023 to March 2024), building off the work of the previous priorities of the two legacy self-regulatory organizations.

For fiscal year 2024, CIRO will have the following eight priorities:

- Determine mission, vision, values, and brand for CIRO and develop a three-year strategic plan.
- Promote the investor perspective through the Office of the Investor and Investor Advisory Panel.
- Create a harmonized regulatory approach.
- Articulate the plan for an integrated fee model.
- Maintain an engaged, empowered, and unified staff.
- Continue to deliver on the regulatory mandate and support investors through industry and regulatory transformation.
- Strengthen stakeholder relationships.
- Demonstrate progress on the integration of corporate systems and processes.

Highlights of the priorities include, as part of supporting the Office of the Investor and the Investor Advisory Panel (**IAP**) - whose mandate is to support investors in various ways, including through education, outreach and in the complaints process - launching a specific site which will be used to provide relevant information to the mandate of the Office of the Investor and IAP, including research and educational materials. With respect to CIRO's ongoing harmonization and integration efforts of the two legacy organizations, CIRO aims to create an integrated compliance department, aligning investment dealer and mutual fund dealer compliance processes where appropriate. Along with harmonizing continuing education requirements, CIRO also aims to publish Phase 1 of the consolidated investment dealer and mutual fund dealer rules, for public comment. Of interest to many of our readers, CIRO also intends to publish its proposed approach regarding directed commissions and personal incorporations, which are expected to be made available to an expanded group of registered individuals. Other initiatives include the finalization and implementation of amendments to modernize dealer member rule requirements for derivatives, which will be harmonized with proposed National Instrument 93-102 *Derivatives: Business Conduct*.

A full list of the annual priorities can be accessed on CIRO's webpage. If you have any questions regarding CIRO's annual priorities or how they may impact you, please contact us.

In Brief

CSA Launches TCR Implementation Committee

On June 13, the Canadian Securities Administrators (**CSA**) and the Canadian Council of Insurance Regulators (**CCIR**), with the participation of the Canadian Investment Regulatory Organization

(**CIRO**), discussed the formation of an implementation committee for the new total cost reporting rules. As mentioned in our April bulletin here, the first new annual reports to clients will have to be delivered for the calendar year ending December 31, 2026.

The new committee is intended to support the industry by providing guidance and answering questions with respect to the implementation of the new rules, which are intended to enhance the current disclosure of the total embedded costs of owning investment funds and segregated funds. The committee is also intended to provide regulators with updates as to the industry's progress toward implementation of the new requirements. It was noted in the CSA's press release discussing the formation of the committee that industry stakeholders will have a forum to submit questions directly, and also through industry associations.

CSA Defers Launch of SEDAR+

On June 1, the Canadian Securities Administrators (**CSA**) issued an update announcing that the much anticipated launch of SEDAR+ was being postponed, with a revised launch date of July 25, 2023, and a contingency date of September 12, 2023. To ensure that organizations have sufficient time to prepare, the CSA has indicated that they will confirm a go-live date shortly.

While the launch of SEDAR+ has been delayed, the CSA opted to keep the pre-launch onboarding window closed. As such, filers who have already completed their onboarding remain well prepared for the launch, while those who did not make the pre-launch onboarding deadline will need to register for SEDAR+ after the platform is up and running. The flat-fee model originally announced in March was not included in the postponement and thus came into effect on June 9, applying to all SEDAR and National Registration Database (**NRD**) filings moving forward.

CSA's Review of Chargebacks Soon to Take Off

The use of chargebacks in the mutual fund industry is the latest practice to draw the focus of Canadian regulators who have been set on addressing conflict of interest concerns in the Canadian investment industry. On June 1, the Canadian Securities Administrators (**CSA**) announced that, in conjunction with the Canadian Investment Regulatory Organization (**CIRO**), it would be undertaking a review of the use of chargebacks in the mutual fund industry.

Chargebacks are a form of compensation structure whereby a dealing representative is paid upfront commissions and/or fees when their client purchases securities. If the client decides to redeem their securities before a fixed schedule expires, the dealing representative is required to pay back all or part of the upfront commission/fee they received. Similar to a deferred sale charge (**DSC**) structure which was banned in the securities space as of June 1, 2022 (and in the segregated fund space as of June 1, 2023), the chargeback model is predicated on clients maintaining their holdings for a set period of time. The potential conflict embedded in the structure is that dealing representatives may be incentivized to keep their clients in their holdings until the chargeback period has expired. This arguably interferes with a dealer's obligations to recommend and evaluate investment recommendations influenced only by the best interests of the client.

The CSA's scrutiny of the use of chargebacks follows a lengthy public consultation conducted by the Canadian Council of Insurance Regulators (**CCIR**) and the Canadian Insurance Services Regulatory Organizations (**CISRO**) which concluded earlier this year that there is a risk of customer harm with the chargeback model in the segregated fund space. Both the CCIR and CISRO indicated they intended to share their findings with the CSA and would monitor the work

the CSA undertakes to address similar compensation models on the mutual fund sale side. For now, the CCIR and CISRO have opted to develop guidance and controls with respect to compensation practices, deciding not to ban chargebacks outright.

The CSA has indicated that the results of the review of chargebacks will guide any possible changes to the mutual fund sales practice rules going forward.

Taking Action to Extend Moratorium on Institutional Trade Match Reporting

As we first described in our April 2020 bulletin, securities commissions across the country granted exemptions to certain requirements in National Instrument 24-101 *Institutional Trade Matching and Settlement* (**NI 24-101**) to provide for a three-year moratorium on the trade match exception reporting requirement (Exception Reporting Requirement). Prior to the moratorium, registered dealers and advisers were required to file a Form 24-101F1 if less than 90% of trades executed by or for the firm in the preceding quarter matched within the time required in NI 24-101. The Canadian Securities Administrators (**CSA**) have also since published for comment proposed amendments to NI 24-101 intended to shorten the standard settlement cycle for institutional equity and long-term debt market trades from T+2 to T+1, as well as permanently repeal the Exception Reporting Requirement. These amendments are expected to come into force in May 2024 to coincide with Canada's move to a T+1 settlement cycle.

On June 15, the CSA published a further temporary exemption on the applicability of the Exception Reporting Requirement through local blanket orders that are substantively harmonized across Canada. These exemptions will cease to be effective on the earlier of the effective date of the amendments to NI 24-101 and the date that is 18 months after the date of the blanket orders, unless further extended.

If you have any questions about the impact of this extension on the moratorium, please contact your usual lawyer at AUM Law.

BLG's Resource Corner

Our colleagues at BLG have provided the following insights we thought might interest our readers:

- What does the 'S' stand for?: Understanding the social pillar of ESG
- Exemptions facilitate transition to SEDAR+
- Environmental, Social and Governance (ESG) Trends: Why it's important and what you need to know

For more information, please visit the BLG website.

Practical Advice • Efficient Service • Fixed-Fee Plans

AUM Law focuses on serving the investment management sector with legal and consultancy services related to regulatory compliance. AUM Law provides its registrant clients with annual fixed-fee regulatory compliance support plans and related offerings. It provides registrants with an efficient, innovative approach to help manage their legal and regulatory compliance obligations.

BLG + AUM Law

AUM Law has been part of BLG since May 2021 and is integrating with BLG's suite of alternative legal services known as BLG Beyond.

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.