AUM LAW

July 2023 | Bulletin

Anti-Boredom Edition

While it is hard to believe we have already reached mid-summer, it is almost harder to believe that July has been designated as Anti-Boredom Month! Thirty-one days designed in part to break out of our routines, and embark on a month of creative, exciting endeavours and new experiences. And what is more creative, exciting and new than a monthly bulletin dedicated to summarizing updates and changes in the regulatory compliance world? We can't think of anything else either.

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1. A Visit from Old Friends – OSC Releases Annual Summary Report for Dealers, Advisers and Investment Fund Managers

On July 27, 2023, the Ontario Securities Commission (**OSC**) released its annual report outlining the work staff conducted in 2022/23 (to date). The report has four parts, outlining the OSC's **(i)** education and outreach to registrants; **(ii)** regulatory oversight activities and guidance; **(iii)** views on the impact of upcoming initiatives; and **(iv)** registrant conduct activities.

For the 2023-2024 review period, the key focus of the Canadian Securities Administrators (**CSA**) and Canadian Investment Regulatory Organization (**CIRO**), will be:

- know-your-client (**KYC**), know-your-product and suitability determination reviews to assess the effectiveness of the implementation of the client focused reforms (**CFRs**);

- compliance reviews of high-risk firms, following the analysis of the data collected in response to the 2022 Risk Assessment Questionnaire (**RAQ**); and
- compliance reviews of crypto asset trading platforms.

This article highlights only a few sections of the comprehensive report. For a fulsome read of all 63 pages, click here (we promise you won't be bored).

New Team in the Compliance and Registrant Regulation Branch – a new team has been created to oversee specialized dealers and restricted dealers, separate and apart from dealers such as EMDs, mutual fund dealers and investment dealers.

The not so Typical Inclusions in the Report, New Desk Reviews – The OSC has launched a few new desk reviews to help staff get a better understanding of some new trends in the industry. The questions posed to the affected issuers and restricted dealers noted below were designed to gather more information about their activities and to help gauge their impact on the industry and the public.

Desk Review of Mortgage Investment Entities (MIEs) – These entities are typically mortgage pools or corporations holding mortgage investments that are sold on a private placement basis. The report states that the OSC wanted to gather more information about these relatively new real estate securities offerings. Staff wishes to gauge how these firms are dealing with recent trends such as rising interest rates and the potential for mortgage defaults that may result from rising rates. The information gathered from the responses from MIE issuers and their loan portfolio performance data will help the OSC determine the type of additional guidance that needs to be given to these industry participants. These desk reviews will be ongoing, and the findings will be posted once the reviews have been completed.

Desk Review of Crypto Asset Trading Platforms (CTPs) – In February 2023, the OSC began desk review of restricted dealer CTPs for which the OSC was the principal regulator. CTPs have been around for a while, and as part of the "*Registration as the First Compliance Review"* process the OSC focused on key practices, controls around custody arrangements, corporate governance structures, insurance bonding policies, and management of conflicts of interest.

A few of the common issues identified involved inappropriate third-party custodians used to hold clients' crypto assets. Several CTPs failed to perform reconciliations on a regular basis of the crypto assets held in custody for clients to the clients' crypto asset liabilities. There was a noted lack of effective system of controls and supervision to address custodial risks and safeguard clients' crypto assets. The OSC also reminded the CTPs subject to the review to implement adequate business continuity plans (**BCPs**).

The Typical Inclusions in the Report – Key issues uncovered during the review period are covered in the regulatory oversight activities and guidance section of the report. The suggested best practices are an attempt to help industry get in line with CSA expectations.

Results of the Conflicts of Interest Sweeps – As previously reported in AUM articles, the CSA and CIRO conducted sweeps focused on the implementation of the CFR conflicts of interest requirements. The results will be published later in the year and we will report on them with our analysis once released.

Observed Trends for Smaller Firms – Firms with a small number of compliance staff had deficiencies with inadequate compliance systems, as well as not meeting their client reporting obligations.

Trading and Advising Prior to Obtaining Registration – The OSC has also noted a trend in applicants who prior to obtaining registration, are engaging in dealing, advising and/or IFM activities. The OSC reminds individuals and firms interested in becoming registered that their past activities will be reviewed as part of the determination of "fitness for registration". It is also noted that fines might be imposed if previously due filings (such as reports of exempt trade) were missed, and that the registration process would be expected to take longer in these circumstances.

Certain Online Adviser Activities – Certain types of online advisory activity is considered to be a material conflict, where the OSC has observed that some online advisers are aligning their services with a third-party's (i.e. referral party's) interests rather than with the interests of its clients. Firms that engage in providing online advice are expected to:

- develop policies and procedures for identifying, addressing and disclosing material conflicts of interest that arise at both firm and individual registrant levels;
- develop a process for suitability determinations that ensure that investment actions proposed or taken for clients are suitable for those clients and put the clients' interests first; and
- implement a process and controls to monitor and supervise business arrangements, including referral arrangements.

Other Topics of Interest

IFM Related Activities - Attention was given to remind the industry that if a firm engages in activities that directs or manages the business, operations or affairs of an investment fund, that firm will be required to register as an c (**IFM**) – "*Staff is of the view that a firm that is not registered as an IFM but attempts to direct the business, operations or affairs of an investment fund by either taking on the responsibilities of an IFM, or by entering into agreements that impose restrictions on the registered IFM from exercising its powers, is not in compliance with the Act.*"

Other topics covered by the report included marketing partnerships with third parties, registered firms operating start-up funding portals, surrender applications by entities that have failed to cease registerable activity, and recordkeeping obligations of registered firms based outside Canada.

Finally, the report reminds registrants that the next RAQ will be released in 2024, and that registrants should start to prepare for the total cost reporting requirements without delay.

2. Learning Something New – CIRO's Proposed New Proficiency Model

The Canadian Investment Regulatory Organization (**CIRO**) has released a consultation paper that should be reviewed by every dealer member of the self-regulatory organization. CIRO's proposed new proficiency model represents a significant change from current requirements and moves away from requiring exams tied to courses toward an assessment model with specific mandatory continuing education and training elements. The model is currently only focused on individuals at investment dealers.

The proposed new model would not include any mandatory courses but would require all prospective approved persons to write a general industry exam based on competencies common across all CIRO registration categories. Once the general exam is completed, an individual registrant would require sponsorship from a dealer prior to being permitted to write the additional exams, which will be specific for each approved person category (based on the proposed competency profiles which we have written about most recently here). It is proposed that there will be nine approved person exams available, details of which are found in the consultation paper. After approval for registration is granted, individuals would be required to take a mandatory professional conduct training course within 30 days of approval. In general, CIRO intends to take a larger role in program and exam design than in the past.

It is also proposed that on an annual basis, individuals would be required to engage in 1-3 hours of CE training on key regulatory topics set out by CIRO, as part of the current mandated applicable CE requirements.

Of interest to industry will also be the proposed new baseline education requirements for registered representatives to include a (as yet undefined) relevant diploma, degree, or two years of relevant experience in the financial industry. The consultation paper also notes that CIRO is of the view that each Executive at the dealer, including the UDP, should have the same experience requirements applicable to Supervisors in addition to the existing general experience requirements set out in the rules.

Among other next steps, CIRO plans to publish amendments to its proficiency rules by the fall of 2024.

Please look out for a future bulletin from AUM and our friends at BLG LLP with additional information and analysis. In the meanwhile, if you have any questions or wish to comment on the proposal, please reach out to us in advance of the comment deadline of September 20, 2023.

3. A Trip Around Alberta - ASC Releases 2023 Annual Report

On June 21, 2023, the Alberta Securities Commission (**ASC**) released its 2023 Annual Report, detailing its achievements in the final year of its F2021-2023 three-year strategic plan. The ASC highlighted its active participation in the crypto regulation space, its co-lead in two CSA projects: client related ESG disclosure rules and enhanced diversity disclosure, its engagement with indigenous students, its continuing work to establish a framework that provides the Ombudsman for Banking Services and Investments (**OBSI**) with the authority to make binding awards, and its co-led project on the offering memorandum prospectus exemption.

The discussion of these activities were reviewed in the context of the ASC's three pillars of strategy, being:

- **Pillar 1:** Intelligent regulation aimed at fostering a thriving capital market;
- **Pillar 2:** Protect investors and market integrity through effective compliance oversight; and
- **Pillar 3:** Foster a culture of engagement.

Under the first pillar, the ASC noted its involvement in ESG consultations, and also noted that it had launched the first ASC Capital Markets Awards for Indigenous students in 2023 and that it continues to work with the CSA's Taskforce on Indigenous Peoples in the Capital Markets to develop a consistent approach to engagement with Indigenous communities in its regulatory and

investor education work. The first pillar also captures the ASC's work and oversight of crypto asset trading platforms operating in Canada. The amendments to the self-certified investor prospectus exemption (available only in Alberta and Saskatchewan) was also mentioned, which allows self-certified investors to invest along with accredited investors, and which now allows special purpose vehicles to be formed by both accredited and self-certified investors.

The second pillar included activities such as the ASC's participation in the CSA's client focused reforms sweep, and the publication of the ASC's Investment Caution List to help educate investors in making an informed decision before making an investment.

With respect to the third pillar, the ASC listed several channels where staff had engaged with market participants throughout the year, highlighting that in addition to industry events, the ASC published the Alberta Capital Market Report, the Corporate Finance Disclosure Report, and the Energy Matters Report.

The remainder of the report details highlights from ASC's financial statements, and for more information you can find the ASC Annual Report here.

4. Never a Dull Moment – CSA Provides Temporary Relief from Filing Reports of Exempt Distribution and Offering Memorandum through SEDAR+ for Certain Foreign Issuers

The Canadian Securities Administrators (**CSA**) announced on July 20 with effect from July 21, 2023, that they were issuing substantively harmonized exemptions from the requirement to file certain private placement forms [Form 45-106F1 *Report of Exempt Distribution*] through SEDAR+, provided that various conditions are met. The relief was granted through a co-ordinated Blanket Order 13-933 *Temporary exemption from the requirement to transmit a report of exempt distribution through SEDAR+ in connection with distributions of eligible foreign securities to permitted clients* (the **Blanket Orders**). The purpose of the exemption is to allow the CSA additional time to consider possible enhancements to the functionality of SEDAR+. In certain jurisdictions, the Blanket Orders expires after a specified period (e.g. 18 months in Ontario).

Pursuant to National Instrument 13-103 *System for Electronic Data Analysis and Retrieval+ (**SEDAR+**)* that came into force on June 9, reports of exempt distribution must be filed through SEDAR+. The Blanket Orders provide a temporary exemption from this requirement, but only for a distribution of an **eligible foreign security** to a **permitted client**, where the form of report is alternatively filed in the manner set out in Appendix A to the Blanket Order, on the Form set out in Appendix B to the Blanket Order.

An "eligible foreign security" is defined for these purposes as a security offered primarily in a foreign jurisdiction as part of a distribution of securities in either of the following circumstances:

A. The security is issued by an issuer:

- **(i)** That is incorporated, formed or created under the laws of a foreign jurisdiction,
- **(ii)** That is not a reporting issuer in a jurisdiction of Canada,
- **(iii)** That has its head office outside of Canada, and
- **(iv)** That has a majority of the executive officers and a majority of the directors ordinarily resident outside of Canada; or

B. The security is issued or guaranteed by the government of a foreign jurisdiction.

A "permitted client" has the same meaning as in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

If the distribution occurs in a jurisdiction that requires a copy of the offering memorandum be delivered to the regulator, the Blanket Order also provides an exemption from filing through SEDAR+ provided it is also transmitted in the manner set out in Appendix A to the Blanket Order.

Appendix A includes information that varies by jurisdiction, such as the email address to which the form of report or offering memorandum should be sent, as well as the specific from of spreadsheet or PDF document acceptable by each regulator.

The form set out in Appendix B is slightly different from the report of exempt distribution form that is otherwise required to be filed through SEDAR+, because it includes items that would have been otherwise captured in a SEDAR+ profile filing.

In terms of confidentiality, reports of exempt distribution filed under the Blanket Orders will be publicly available only on request made to CSA members (as compared to reports of exempt distribution filed through SEDAR+ which will be publicly available through the SEDAR+ search function). The Schedule 1's to the reports, and offering memoranda (other than those used in reliance on section 2.9 of NI 45-106), whether filed through SEDAR+ or under the Blanket Orders are private.

In Brief

Manitoba Joins the Crowd – Consultation Paper issued on Title Protection Framework

The Manitoba government has joined Québec, Ontario, Saskatchewan and New Brunswick in considering or implementing legislation respecting the use of the titles "financial planner" and "financial advisor". Title protection legislation in the province would prohibit the use of those titles unless the individuals using them are qualified to do so.

The Consultation Paper notes in its introduction that currently, people can hold themselves out to the public in the province as "financial advisors" or "financial planners" without holding any qualifications. Manitoba Finance is seeking views on the advisability of title protection legislation and poses a number of specific questions about the elements and structure of any such regulatory regime. The Consultation Paper reviews the current status of the title protection rules in the jurisdictions noted above, and thus many of the specific questions posed relate to the differences in the rules and asks for comments as to which elements Manitoba should adopt, including with respect to enforcement powers, how broad the regime should be in terms of titles in addition to the two mentioned above, and the importance of a single, central, public database listing all individuals entitled to use these titles.

The consultation is open for comment until September 30, 2023. Firms that would be subject to the legislation may wish to comment on certain aspects of the proposal relating to harmonization, particularly firms that operate across jurisdictions.

New Potential – CSA Amends Rules to Provide for Commodity Benchmarks

As we first mentioned approximately two years ago, a number of the securities regulatory authorities, including the Ontario Securities Commission, proposed changes to Multilateral Instrument 25-102 *Designated Benchmarks and Benchmark Administrators*, and its Companion Policy, to provide for a regime for commodity benchmarks and their administrators. The proposed amendments arose in part due to the allegations of manipulation of the London inter-bank offered rate back in 2012, which led to a loss of market confidence in the credibility of financial benchmarks in general. On June 29, the regulators announced that amendments to the Instrument are being adopted effective as of September 27, providing for the designation and regulation of commodity benchmarks and their administrators and stated that the amendments will codify international best practices. While the amendments are for the most part unchanged from the original proposals, there is now new guidance in the Companion Policy regarding the scope of the definition of a commodity benchmark to clarify the regulators views on certain intangible commodities, such as carbon credits and emissions allowances.

There remains no current intention to designate any commodity benchmarks or administrators under the Instrument, but it is noted that the regulators may designate administrators and their associated commodity benchmarks in future on public interest grounds, including where a commodity benchmark is sufficiently important to the commodity markets in Canada, or there are activities that otherwise raise concerns aligning with regulatory risks that have previously been identified within these markets.

CIRO Republishes Proposals for Derivatives Rule Modernization, Stage 1 – Time to Declutter

On July 13, the Canadian Investment Regulatory Organization (**CIRO**) released for the third time proposed amendments to modernize and simplify its derivatives related requirements. One of CIRO's predecessor organizations, IIROC, initially published proposed amendments back in November, 2019. The purpose of the amendments is to ensure, to the extent appropriate, that there is consistent regulatory treatment between securities-related and derivatives-related activities. This particular consultation suggests some changes to the previous proposals in order to incorporate them into the most recent version of the Investment Dealer and Partially Consolidated Rules which came into effect in January, but also to address suggestions from the CSA and commenters, including to ensure consistency with the anticipated final version of CSA National Instrument 93-101 *Derivatives: Business Conduct*.

The proposed changes to the definition of "derivative" is meant to alleviate confusion and ensure CIRO can make a determination that a contract or instrument is not a derivative when the classification of a product is questioned. In addition, changes are proposed to the definition of a non-individual "hedger" to cover partial hedging of risks, and additional guidance has been added to assist investment dealer members in their assessment of whether a client qualifies as such. Of interest, CIRO is also now proposing to extend the product due diligence and KYP requirements to derivatives related activities, which it believes are needed to ensure consistent regulatory treatment. Comments on the consultation are due by August 14.

Important Reminders

Everything Old is New Again - Interim Financial Statements

For collective investment vehicles with December 31 year ends, upcoming interim financial statement deadlines should be on your radar. In particular, issuers that rely on the offering memorandum (**OM**) prospectus exemption in Ontario are subject to new requirements regarding interim financial reports this year.

You may recall reading about the new requirements for issuers relying on the OM prospectus exemption in National Instrument 45-106 *Prospectus Exemptions* that took effect on March 8, 2023 (the **Amendments**). There is a new requirement for an issuer to amend its OM to include interim financials for the most recently completed six-month period where a distribution is ongoing if more than 60 days have elapsed since the end of the second interim period. For issuers with a December 31st year end, this means addressing this requirement by August 29th. Amending an OM to include the semi-annual financials may necessitate updates to other disclosure in the OM to ensure that it continues to meet the OM form requirements as of the date of the amended OM. An exemption from having to update the interim financial statements is available if the issuer appends an additional certificate to the OM certifying that:

- the OM does not include a misrepresentation when read as of the date of the additional certificate;
- there has been no material change in relation to the issuer that is not disclosed in the OM; and
- the OM, when read as of the date of the additional certificate, provides a reasonable purchaser with sufficient information to make an informed investment decision.

In either case, the updated OM must be filed with the Ontario Securities Commission and any other applicable regulators within 10 days of a distribution under the updated OM. The new OM requirements do not yet apply to issuers with OMs dated prior to March 8, 2023 that qualify for the transition provisions contained in the Amendments. The Amendments also include an exemption for issuers with OMs that include an interim financial report for the issuer's most recently completed third interim period.

In addition, all investment funds that are reporting issuers, and investment funds that are not reporting issuers that qualify as mutual funds under securities legislation (other than those organized under the laws of certain provinces) with December 31st year ends that are subject to the financial statement delivery and filing requirements under National Instrument 81-106 *Investment Fund Continuous Disclosure* must prepare, file and deliver interim financial statements for the semi-annual period ending June 30th by August 29th (subject to applicable exemptions and any standing or annual instructions received from unitholders). The statements must be prepared in accordance with NI 81-106. One potential filing exemption exists for issuers who have filed a letter with the relevant securities commission (a **Section 2.11 Notice**) and indicated that they are relying on the exemption in the financial statements, but those issuers must still prepare the statements by the deadline and deliver them to investors who have not otherwise properly opted out of receipt. To the extent issuers have obtained financial statement delivery opt-outs from investors pursuant to annual or standing instructions, there is a requirement to send an annual reminder to such investors with the prescribed information.

If you have any questions about your interim financial reporting requirements, please contact us.

BLG's Resource Corner

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

- ISSB publishes global sustainability and climate change standards – Here's what you need to know
- Environmental, Social and Governance (ESG) Trends: Why it's important and what you need to know
- Cybersecurity guidance for small organizations
- Understanding the Canadian Investment Regulatory Organization (CIRO): A quick primer
- CIRO Rule Consolidation Project: The journey begins

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.