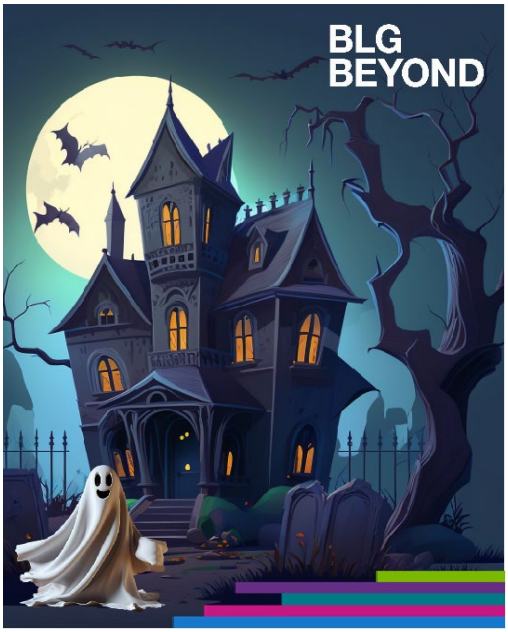
October 2023 | Bulletin

Ghoulishly Good Governance Edition



We all find different things to be scary – but at the end of October, it is difficult to find anyone who is truly not afraid of…. a haunted house. It is thought that haunted houses may have originated in 19th century England, where the public first started to attend a series of gruesome attractions. These "attractions" included wax sculptures by Marie Tussaud of famous (decapitated) French figures. Soon, themed haunted houses during the Great Depression in the United States emerged. While these early haunts were mere decoration, today's attractions boast everything from ghostly apparitions to optical illusions, to jump scares. Boo!

Whether you are visiting an amusement park filled with ghouls, the Mackenzie House in Toronto (said to be haunted by William Lyon Mackenzie himself) or sitting alone in advance of your regulatory audit, let us shine a flashlight to get you through the darkest of nights.

In this bulletin:

1. Multilateral Instrument 93-101 Derivatives: Business Conduct – A Labyrinth of Compliance Obligations

The Canadian securities regulators adopted a business conduct rule for derivatives dealers and advisers which will become effective on September 28, 2024 (the **rule** or **MI 93-101**). British Columbia intends to adopt substantially similar rules and when they do so, the CSA will convert this business conduct rule (which is currently a multilateral instrument) into a national instrument. Implementing business conduct standards for OTC derivatives fills a regulatory gap and aligns the standards in Canada with international standards.

This article shines a spotlight on the impact of the new rule on advisers.

Core obligation

The rule establishes the fair dealing obligation which is a principles-based obligation and is intended to be similar to the duty to act fairly, honestly and in good faith applicable to registered firms and registered individuals under securities legislation (the registrant fair dealing obligation).

Does the rule apply to you if you are an adviser?

The rule applies to a person or company if they are in the business of trading in or advising on OTC derivatives regardless of whether they are registered or exempted from registration. However, the rule is drafted using the catch and release approach to policy design. In other words, even if you are "caught" based on the business trigger test and would otherwise have to comply with the rule, you may be exempt from some of the requirements of the rule. This approach permits the regulators to take a nuanced approach which includes allowing already-registered securities advisers to leverage their current compliance regimes under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) to meet the requirements of the rule. But it does make the rule a bit more complicated and difficult to understand.

To explain how catch and release works, let's look at how the rule applies to an adviser who is registered under securities or commodity futures legislation in Canada.

If you are a derivatives adviser based on the business trigger described above, you are caught by the rule. However, if you already comply with substantially similar provisions of securities legislation (in this example NI 31-103) or commodity futures legislation, you are exempt from the following business conduct requirements in MI 93-101:

- Handling complaints
- Tied-selling
- Dealing with or advising derivatives parties (in other words, KYC collection supporting suitability, suitability determination requirements and referrals)
- Derivatives party accounts (in other words, RDI, account statements, notice to clients by non-resident registrants and handling client accounts)

- Compliance and recordkeeping (in other words, general requirements for records, accessibility and retention of records).

However, you are still required to comply with the sections in MI 93-101 on fair dealing, conflicts of interest, know your derivatives party and policies and procedures.

A helpful chart that clearly sets out which sections of MI 93-101 you do not need to comply with is included as Appendix B to the Companion Policy.

Does the rule apply to you if you are a foreign adviser or sub-adviser?

There is an exemption for advisers from jurisdictions that have comparable requirements (see Appendix D). The list is dynamic, has been expanded to include Norway and Iceland and may be further expanded as staff consider the regulatory regimes in other jurisdictions. The initial and annual filings and other requirements of this exemption are similar to the international adviser exemption in NI 31-103.

When you are advising a client, can the client waive some investor protections?

For a firm that is not already registered as a securities adviser or adviser under commodity futures legislation, MI 93-101 takes a two-tiered approach to investor protection. Certain core obligations apply in all cases when you are advising a client, regardless of their level of sophistication or financial resources. Certain additional obligations apply if you are advising a client that is not an eligible derivatives party (that is, a "non-eligible derivatives party"). However, the additional obligations may be waived if you are advising a client who is an eligible derivatives party that is an individual or a specified commercial hedger.

The term "eligible derivatives party" (**EDP**) refers to those clients that do not need the full set of protections afforded to "retail" customers or investors, either because they are considered sophisticated, can afford professional advice or can protect themselves contractually.

When do you need to repaper client contracts and relationship documentation so that you can rely on the EDP waivers?

If you have received any of the following representations from your client before the rule takes effect in your jurisdiction, such as:

- permitted client,
- non-individual accredited investor (in Ontario),
- accredited counterparty (in Québec),
- a qualified party (in several jurisdictions),
- an eligible contract participant (in the United States),
- a financial counterparty (in the European Union and the United Kingdom) or a non-financial counterparty above certain clearing thresholds (in the European Union and the United Kingdom, which is generally referred to by the acronym NFC+),

you can treat obtaining that representation as having obtained the required EDP representation for purposes of the transition period. The transition period begins on September 28, 2024, and ends 5 years later.

What is the impact on your compliance program?

As you develop your compliance priorities for the coming year, remember to update your internal compliance programs and documentation before September 28, 2024 and establish a plan to ensure the appropriate representations have been updated before the end of the transition period. AUM Law would be happy to assist.

2. The Witching Hour – AML/ATF Obligations for Mortgage Lenders are Here

As noted in our June, 2023 bulletin article, the Department of Finance Canada is considering sweeping amendments to Canada's anti-money laundering and anti-terrorist financing regime (**AML/ATF** regime) primarily contained in the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (**PCMLTFA**) and the *Criminal Code*. Even prior to the latest consultation, there have long been signals that mortgage lending entities would become subject to the regime.

Changes have now been introduced to bring entities involved in mortgage lending into the AML/ATF regime by considering them "reporting entities". Once in force entities involved in the mortgage lending process will need to meet AML/ATF obligations. These entities include brokers involved in mortgage origination, lenders who underwrite loans or supply funds, and administrators who service loans.

In response to comments on prior consultations, additional clarity was provided to the definition of mortgage lending entities so that only mortgage lending activities for **business purposes** are covered by the regulations. The definitions in the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* will be amended to include the following definitions:

> "mortgage administrator" means a person or entity, other than a financial entity, that is engaged in the business of servicing mortgage agreements on real property or hypothec agreements on immovables on behalf of a lender;
>
> "mortgage broker" means a person or entity that is authorized under provincial legislation to act as an intermediary between a lender and a borrower with respect to loans secured by mortgages on real property or hypothecs on immovables; and
>
> "mortgage lender" means a person or entity, other than a financial entity, that is engaged in the business of providing loans secured by mortgages on real property or hypothecs on immovables.

The new AML/ATF obligations include:

- A requirement to development a compliance program;
- Customer due diligence measures such as identify verification and beneficial ownership identification;
- Record keeping;

- Transaction reporting, including suspicious transaction and terrorist property reports; and
- Following ministerial directives when funds are moved from or to certain countries.

Penalties for violations (in the form of administrative monetary penalties) will range up to $1000 for minor violations, up to $100,000 for a serious violation and up to $500,000 for a very serious violation (up to $100,000 if an individual).

The Financial Transactions and Reports Analysis Centre of Canada (**FINTRAC**) has also released guidance to assist those in the mortgage lending business to comply with their obligations.

As an example, the guidance expands on what elements are expected to be included in a compliance regime:

- The appointment of a compliance officer;
- Written policies and procedures;
- A risk assessment to document the risk of a money laundering or terrorist activity financing offence;
- A written, ongoing training program for employees;
- Documentation for ongoing compliance training program; and
- Documentation of a plan to review the compliance program to test its effectiveness at least every two year (the two-year AML effectiveness review).

The record-keeping obligations as outlined in the guidance are quite extensive, and would include:

- Large cash and virtual currency transaction records;
- Receipt of funds records;
- Mortgage loan records, including information on the financial capacity of the client, the terms of the loan, the nature of the client's principal business/occupation, and the name/address of their business;
- Beneficial ownership records;
- Politically exposed persons records;
- Client ID;
- Records relating to business relationships; and
- Third party determination records.

Records must be kept for at least five years. FINTRAC is authorized to conduct compliance examinations (i.e. audits) to assess if a reporting entity is meeting its requirements under the law.

Currently, reporting entities such as investment dealers and advisers are also required, among other things, 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 and is well positioned to do so in future for mortgage lenders. We can also assist with the creation of the necessary policies and procedures and with reporting requirements.

These and other amendments to the regulations under the PCMLTFA itself will come into force 12 months after final publication, being October 11, 2024. Please contact us for any assistance.

3. Reporting on Diversity – A Spellbinding Challenge

On October 5, 2023, the Canadian Securities Administrators (**CSA**) released CSA Multilateral Staff Notice 58-316 (the **Notice**) – their ninth notice summarizing the responses provided by issuers obligated to disclose information relating to women on boards and in executive positions.

The notice was a summary of a review of the corporate governance disclosures of 602 non-venture issuers with fiscal year-ends between December 31, 2022, and March 31, 2023. As of May 2023, there were approximately 1,776 issuers listed on the Toronto Stock Exchange, such that the review is a snapshot of only 33.89% of the industry.

National Instrument 58-101 *Disclosure of Corporate Governance Practices* (**NI 58-101**) requires certain issuers to provide specific information regarding women on boards and in executive officer positions. The required corporate governance disclosures focus on five topics that are meant to provide investors and other stakeholders information on the firm's efforts relating to improving representation, being written policies, consideration of the representation of women, director term limits / board renewal, targets, and numbers and percentages that women represent at the issuer.

The main objective of mandating these disclosure requirements is to increase transparency for investors.

Of note, there has been a steady increase in the number of women on the boards of the issuers captured by the disclosure requirements and women in senior management positions. A few highlights in the Notice are that 89% of the issuers have at least one woman on their board, an increase from last year, and 36% of the issuers have at least three women on their board, an increase of six per cent from last year.

A point emphasized in the Notice is that firms have consciously set representation targets to achieve a truly diverse board and in their senior management make-up. The number of executive positions held by women has also increased, albeit slowly. Only 5% of the issuers had a woman in the chief executive officer role. At least 71% of issuers had at least one woman in an executive position. The issuers that adopted targets for representation really saw an uptick, from 7% in Year 1 (of collecting and reporting on this data) to 43% in Year 9. The maturity of the issuer also seemed to have a direct correlation to the effort to diversify the make-up of the board and executive levels of the firm.

Another item of note is the industries that seem to be leading the way in the number of women on boards and in executive positions. When it comes to board representation, the manufacturing, retail and utilities industries are leading the way over the last nine years at 98%, 96% and 95% respectively, with mining and biotechnology lagging slightly. When it comes to the percentage of issuers with women in executive positions, the retail and real estate industries lead the pack with 90% and 87% respectively, with technology and mining being the laggers at 69% and 50% respectively.

Note that larger Canadian banks are not represented in the Notice, and notably were early adopters of diversity initiatives.

In Brief

Break out the Halloween Brooms: Regulators Begin Focused Compliance Sweeps

It appears that the long promised regulatory KYC, KYP and suitability audits have begun. Regulators have started reaching out to conduct focused compliance reviews to ensure compliance with the Client Focused Reform requirements that were enacted in 2021.

Considering how much work our readers have put into updating their systems to meet the Client Focused Reform requirements, this is a bit of a bad news/good news situation.

The bad news is that audits… are audits (we think they rank just behind drilling for cavities after Halloween as a favorite activity). The good news is that the information collected from these promised audits will result in targeted regulatory guidance. We believe that this guidance will give industry more certainly around the application of the Client Focused Reforms.

As some of our clients start the audit process, we have noted the following interesting items from the initial document request list:

- Requests for detailed records of training on each of **i)** Know-Your-Client; **ii)** Trusted Contact Persons; **iii)** Know-Your-Product; **iv)** suitability; and **v)** older and vulnerable clients;
- A list of each and every client directed trade from your trade blotter; and
- The registrant's standard template to determine suitability at the time an investment action is taken.

The above is in addition to a number of other requests that include policies and procedures, due diligence records and account opening documentation. If you have any questions about the Client Focused Reforms or the audit process, please feel free to contact your usual lawyer at AUM Law.

Haunted Housekeeping: AMF Approves Delegation of Powers to CIRO

The Autorité des marchés financiers (**AMF**) and the government of Quebéc announced the approval of delegation of powers to the Canadian Investment Regulatory Organization (**CIRO**). As described in our May 2022 bulletin, it had already been contemplated that all mutual fund dealers in Québec would become members of CIRO. They would be transitioned to CIRO in two phases where membership was effective as of January 1, 2023, but not subject to CIRO rules except for its operating rules until a later date. This delegation of powers is one of the first steps in the permanent transition, which will result in CIRO as the organization to register dealing representatives of mutual fund dealers in the province and administer compliance examinations. The timing of the implementation of this delegation of powers has yet to be announced but will include a transition period to allow mutual fund dealers registered in Québec to make changes to their systems for their integration into CIRO's platform.

Safely Navigating Financial Complaints – Single External Complaints Body Named

After many consultations and years of discussion, it was announced by the Deputy Prime Minister and Minister of Finance on October 17 that the Ombudsman for Banking Services and Investments (**OBSI**) would be the single external complaints body for banking effective November 1, 2024. The designation in part is based on the recommendation of the Financial Consumer Agency of Canada (**FCAC**) which was made based on a review of application material for external complaints bodies wishing to serve as Canada's single banking complaints body.

Since 2009, Canada has had two approved external complaints bodies (OBSI and ADR Chambers Banking Ombuds Office) to address banking complaints, and banks were allowed to choose between those two. Consumers can have a complaint reviewed by an external complaints body if the complaint has not been resolved through a bank's internal process or if at least 56 days have passed since the bank received the complaint. Prior reports from the FCAC had shown that banking consumers were subject to delays when escalating complaints, and that the multiple complaints bodies model resulted in complexities and was inconsistent with international standards.

There will be a transition period of twelve months, during which time the two existing external complaints bodies will still handle complaints, supervised by the FCAC.

It should be noted that this development is separate and apart from the potential development of a proposal for public comment by the Canadian Securities Administrators to provide OBSI with binding authority. All registered advisers and dealers (except in Québec) are already required to use OBSI as a dispute resolution service.

Lurking Below the Surface – OSC Proposes Permanent Exemption from the Underwriting Conflicts Disclosure Requirements

Earlier this month on October 5th, the Ontario Securities Commission (**OSC**) released Rule 33-509 *Exemption from Underwriting Conflicts Disclosure Requirements*. Provided the rule is approved by the Minister of Finance, it will provide an exemption from the requirement to include specific underwriting conflicts disclosure in an offering document when foreign securities are distributed on a private placement basis to investors in Ontario. The rule would replace a blanket order that currently is in place.

National Instrument 33-105 *Underwriting Conflicts* (**NI 33-105**) requires that disclosure be provided of certain conflicts of interest where there is a direct or indirect relationship between the issuer or selling securityholder and the underwriter that might result in a perception that they are not independent in connection with the distribution. An exemption from the underwriting conflicts disclosure requirements would be available if:

- The distribution is made under an exemption from the prospectus requirement;
- The distribution is of a security that is an "eligible foreign security" as defined in NI 33-105; and

- Each purchaser in Ontario is a "permitted client" as defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

In NI 33-105, an eligible foreign security means 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.

The proposed rule is expected to be in force by February 17, 2024.

Update on Continuous Disclosure Amendments for Non-Investment Fund Issuers – Compliance Spells and Potions

The Canadian Securities Administrators (**CSA**) have indicated they are not immediately moving forward with proposed amendments to modernize the continuous disclosure requirements for non-investment fund reporting issuers. These proposed amendments, published for comment in May 2021, would streamline the disclosure requirements for the management's discussion and analysis (**MD&A**) and the annual information form (**AIF**). They would also combine financial statements, MD&A, and the AIF into one document. The CSA intends to continue to work on this proposal alongside their proposals for a model for electronic access to information. The CSA anticipates publishing a revised access model for continuous disclosure in future.

Important Reminders

Frighteningly Close to Deadline to File Capital Markets Participation Fee Calculation Forms

As per our reminder last month, if you are a firm registered in Ontario under the *Securities Act* or the *Commodity Futures Act*, or relying on international exemptions from the registration requirements, be sure to file your 2023 fee forms and pay the applicable capital markets participation fees on time. The deadline to file the applicable fee form has been moved up to **November 1, 2023**, with payment due no later than January 2, 2024. Ontario Securities Commission (**OSC**) staff have also recommended, if a firm is considering surrendering its registration or notifying the OSC it is no longer relying on a registration exemption, to do so no later than December 8, 2023.

News

Movin' and Shakin' We've Moved!

AUM Law is pleased to announce that we have moved to the BLG Offices at Bay Adelaide Centre, East Tower, 22 Adelaide St. West, Suite 3400 as of Friday October 27. Please update your contacts accordingly. If you have any questions regarding the move, please contact our communications team here.

2023 Canadian Hedge Fund Awards

We would like to congratulate the following AUM Law clients for their outstanding investment performance, which was recognized at the 16th Annual Canadian Hedge Fund Awards:

- **AIP Asset Management Inc.** (AIP Convertible Private Debt Fund LP)
- **Ewing Morris & Co.** (Broadview Dark Horse LP)
- **GFI Investment Counsel Ltd.** (GFI Good Opportunities Fund)
- **Picton Mahoney Asset Management** (Picton Mahoney Special Situations Fund, Picton Mahoney Market Neutral Equity Fund, and Picton Mahoney Arbitrage Plus Fund)
- **Quintessence Wealth** (Quintessence Wealth Enhanced Private Debt/Equity Fund)
- **RP Investment Advisors LP** (RP Select Opportunities Fund)

Also, congratulations to Alternative IQ and Julie Makepeace for again hosting an evening that celebrates success, hard work and collegiality in the hedge fund industry!

Watching Out for Goblins and Invitations

Along with our colleagues at BLG, we will be hosting a fall in-person seminar and reception at BLG's offices, on **November 23.** The seminar will have a broad range of topics and speakers (including from AUM Law). Please watch for your invitation and contact us here if you don't receive it.

BLG Resource Corner

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

- ETFs in the spotlight: The CSA review exchange-traded funds
- What does a managed service look like in the legal world?
- Gender diversity in the Canadian boardroom: Where are the women leaders?
- Crypto asset trading platforms – Terms and conditions for trading VRCAs (stablecoins)

For more information, please visit the BLG website.

Practical advice. Efficient service. Fixed-Fee plans. Singular focus.

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.