

November 2023 | Bulletin

The Telly Edition

November is filled with chilly days and national days of observance. Here at AUM Law, when “chilling out,” we like to learn about the more obscure days of celebration, such as World Television Day (still a thing!) which occurs every November 21st. Originally established in 1996 by the United Nations General Assembly to recognize the impact of television on the world, its founding also commemorated the first World Television Forum. Throughout the years, various events and discussions have taken place to highlight the impact of television on our lives and shared experiences around the globe. The day also acknowledges the contributions of those in the industry who work to provide accurate and engaging content. Speaking of accurate and engaging content, we hope you enjoy the following regulatory updates during the next commercial break.



In this bulletin:

1. Rate your Priorities - OSC Releases Draft Statement of Priorities
2. The Digital Transformation: OSC Report on Artificial Intelligence in Capital Markets
3. Reporting Transparency on Air: Report on OBSI Oversight
4. From Script to Screen: CIRO Releases First Phase of Rule Consolidation Project
5. Stay Tuned: FSRA Seeks Consultation on Proposed Statement of Priorities for FY 2024-2025

In Brief: Behind the Scenes: Shorter Consultation Periods Proposed ▪ Compliance Unplugged: OSC Proposes Amendments to Fee Rules for Non-Compliant Firms and Restricted Dealers ▪ CSA and CIRO Responses on Short Selling Consultation – Reality TV Check

Important Reminders: Must See TV: Annual Filing Exempt Trade Reports Deadline Quickly Approaching

News: AUM Law Spoke at the PMAC AML and ATF Training Session ▪ Proud Repeat Sponsor of the PMAC National Conference ▪ 2023 CCLS Education Sub-Committee Event ▪ Canada’s Annual AIMA’s Regulatory Forum

BLG Resource Corner

1. Rate your Priorities - OSC Releases Draft Statement of Priorities

The Ontario Securities Commission (**OSC**) has released its annual draft [Statement of Priorities for 2024-2025 \(SoP\)](#). There are no less than 16 key priorities set out in the SoP. The priorities we think may be of most relevance to our readers are described below.

- **Assess implementation of Client Focused Reforms and consider impact of limited product shelves.** The draft SoP mentions that OSC staff is concerned about the impact proprietary product shelves could have on clients, including potentially higher fees and inferior performance, if other products are not easily available to investors. The Canadian Investment Regulatory Organization (**CIRO**) and the Canadian Securities Administrators (**CSA**) intend to consider this further. The current sweeps with respect to the Client Focused Reforms (**CFRs**) will continue, and regulators plan to consider the need for additional measures to ensure the CFRs are attaining desired outcomes.
- **Advance Cooperation with Indigenous Peoples and Work to Understand and Integrate their Perspectives and Interests.** As part of this priority and as part of its larger inclusion and diversity strategy, the OSC intends to develop an action plan for truth and reconciliation, and integrate its learnings to engage with Indigenous Peoples more meaningfully.
- **Conduct Initiatives for Retail Investors Through Specific Education, Policy, Research and Behavioural Science Activities.** The draft SoP discusses the increasing complexity of Ontario's capital markets, including new products continually being introduced. The importance of ensuring that appropriate investor protections are in place, and that investors have the information needed to make informed financial decisions and have confidence in the capital markets is emphasized. The OSC intends to expand its application of behavioural science to policy making and operations, in part to improve investor outcomes. Through the Investor Office Research and Behavioural Insights Team (**IORBIT**), the OSC will continue applying behavioural science to policy and operational activities. A number of initiatives support this priority, including programs to enhance investor education and timely publication of investor research.
- **Strengthen the Dispute Resolution Framework of the Ombudsman for Banking Services and Investments and Modernize OSC's Disgorgement Framework.** The OSC (as part of the CSA) will release a proposal for comment that contemplates providing an independent dispute resolution service with binding compensation decision authority. The SoP also noted that earlier this month, the Ontario government introduced legislation to provide a streamlined statutory process for the distribution of money received by the OSC under disgorgement orders to eligible investors who have suffered direct financial losses in prescribed circumstances.
- **Further Initiatives that Promote Capital Formation and Foster Competition.** Actions in the next fiscal year include reviewing the current temporary blanket order (Ontario Instrument 45-507 *Self-Certified Investor Prospectus Exemption*) that allows purchasers in Ontario who do not otherwise qualify as accredited investors to purchase exempt market securities provided they otherwise demonstrate financial knowledge, investment knowledge or relevant industry-specific experience. In addition, and of particular interest to exempt market dealers, it is noted that the OSC will consider taking steps to allow EMDs to participate as a selling group member in a prospectus offering and sponsor reverse takeover

transactions, subject to “reasonable conditions.” The SoP also referenced consideration of the registration regime and issues in connection with introducers and finders.

Comments on the draft SoP will be accepted until December 18, 2023, and the final version of the SoP will form part of the OSC’s business plan for the fiscal years 2025-2027.

2. The Digital Transformation: OSC Report on Artificial Intelligence in Capital Markets

This month, the Ontario Securities Commission (**OSC**) in collaboration with Ernst & Young LLP published its first report (the **Report**) on the adoption and use of artificial intelligence (**AI**) in Ontario’s capital markets. The Report canvasses the ways AI is currently being utilized to support capital market processes including asset allocation, price and liquidity forecasting, hedging, trade order execution and surveillance, high-frequency trading, futures market analysis, and sales and marketing.

The Report notes that the current AI landscape in Ontario is already strong and internationally competitive, citing Vector Institute Reports which noted significant spending on AI research and development in Ontario as well as over \$2.8 billion in venture capital investment in Ontario’s AI ecosystem from 2021-2022. The influx of spending on AI related applications, the uptick in new AI companies founded in Ontario and the corresponding increase in AI-related jobs all suggest that supporting the responsible development of AI systems can be a significant contributor to economic growth in Ontario.

Through interviews conducted with Ontario capital market participants, the Report identified three overarching purposes for which market participants are adopting AI systems – efficiency improvements, revenue generation, and risk mitigation. The Report found AI could contribute to improvements in efficiencies for firms through things like improved pre- and post-trade processes automation, execution quality improvement through better liquidity forecasting, and improved customer services through the use of customer support chatbots which can interface with customers and help address common questions.

With respect to revenue generation, the Report found that firms were leveraging AI’s ability to draw insights from previously untapped datasets, to provide deeper insights into client relationships and clients themselves, and for the development of sales strategies and bespoke marketing materials. The Report also found AI was being effectively used as a risk management tool for things like AML, trade surveillance, hedging, and onboarding processes.

The Report also comes with a word of caution noting the various challenges and risks associated with the burgeoning adoption of AI applications. “Explainability,” for example, has proven to be one of the main hindrances to the broader adoption of AI models in capital markets. Given the complex workings of AI models and significant difficulties explaining how certain computational systems function, AI models may not garner the trust of parties who are uncomfortable relying on a system that cannot be cohesively explained.

There are also significant data-related concerns including difficulties for organizations in terms of data aggregation, quality, and consistency. The reliability of AI models is predicated on the quality and reliability of the data being synthesized, all of which occurs under a complex data protection and privacy framework

which requires specific consent for the use of customer data. The Report also identified various risks unique to AI models which require specific governance measures beyond those traditionally employed by firms. The Report suggests that an AI-specific governance framework can be an important tool to ensure that the culture of accountability and compliance extends to the responsible use of AI. This can help address a situation where an advisor is too reliant on AI tools and is unable to recognize if flawed data is providing poor or biased recommendations that are not in a client's best interest.

The Report characterizes the adoption of AI in Ontario's capital markets as being at an intermediate stage with varying levels of adoption, integration, and maturity across different functions. As capital market participants continue to embrace AI innovations, the Report reminds market participants that enthusiasm should be tempered with a sensible implementation approach which prioritizes the protection of investors and the integrity of Ontario's capital markets.

3. Reporting Transparency on Air: Report on OBSI Oversight

On October 12, 2023, the Canadian Securities Administrators (**CSA**) and the Canadian Investment Regulatory Organization (**CIRO**) published Staff Notice 31-364 (the **Notice**) containing their Annual Report (**Report**) of the Joint Regulators Committee (**JRC**) which oversees the Ombudsman for Banking Services and Investments (**OBSI**).

Part of the JRC's mandate is to facilitate information sharing and to monitor dispute resolution processes to promote investor confidence in the dispute resolution service and investor protection. The Notice highlights the CSA's continued efforts to strengthen OBSI into an independent dispute resolution service that closely aligns with OBSI's international ombuds service counterparts, including efforts to create a binding authority framework for OBSI that is fair, efficient, and accessible.

The annual meeting of the JRC with the OBSI Board was held on September 28, 2022. In addition to discussing operations and governance issues, the effectiveness of OBSI's processes was a focus of the discussion, as well as OBSI's planned public consultations for 2023, and the CSA's work to strengthen OBSI's powers to secure redress for investors.

OBSI provides the JRC with quarterly reports of any investment related complaints, compensation refusals and the number of low settlements which fell below OBSI's recommendations. OBSI tracks all related compensation data as a risk-based indication of potential problems with participating firms. The data reflects whether a firm's complaint handling practices are being carried out in good faith or raise questions about whether a firm is participating in OBSI's services consistently with the applicable standard of care. In 2022, there were no compensation refusals.

Systemic issues: OBSI tracks significant issues as those that impact multiple clients or issues with significant regulatory implications. In 2022, there was one systemic issue reported to the JRC involving an order execution-only (**OEO**) dealer. The dealer in question received two complaints regarding a systems glitch that impacted the ability of two Canadian investors to purchase US derivatives. The dealer rectified the problem quickly, and it was determined only two complainants were impacted.

The Report referenced a previously reported systemic issue involving a portfolio manager who was the subject of multiple complaints. It has been alleged that the portfolio manager was misrepresenting the risk of a fund and disregarding documented investor risk tolerance levels. The matter was referred to the relevant CSA jurisdiction and conditions have been applied to the registration of the portfolio manager with the review ongoing.

Emerging and ongoing complaint trends: The JRC has worked with OBSI to continuously identify and monitor emerging and ongoing trends related to complaints received. OBSI provides aggregated complaints data on products, issues, and outcomes for trend analysis.

Despite regulatory issued warnings and alerts to the public, supplemented with fraud reduction steps taken by firms, instances of fraud continue to be high. The year 2022 saw a rise in complaints about restricted dealers and crypto assets, 85% of which related to clients being coerced or tricked into granting a third-party access to their account and crypto assets, which were transferred to the third-party's wallet.

In the fourth quarter of 2022, OBSI informed the JRC of an increase in complaints relating to issues of suitability of mutual funds. OBSI determined that the increase in complaints had to do with the current interest rate environment that had adversely impacted fixed income mutual funds. OBSI will continue to monitor this trend and report to the JRC, as necessary.

Consultation regarding the IIROC Arbitration Program: The JRC provided the working group and IIROC with feedback, noting the complexity of the overall complaint handling landscape, the potential for investor confusion and how potential overlap between claims that can be pursued through either OBSI or IIROC Arbitration could impact consumer decision making. IIROC published the working group's recommendations for public comment in December 2022, and the JRC continues to receive updates. OBSI discussed its concerns with the JRC, including that application of the Arbitration Program to lower value, unrepresented complainants would increase the complexity of the dispute resolution system and potentially increase investor confusion. On publishing the recommendations, IIROC encouraged commenters to address the Arbitration Program's coexistence with OBSI within the current dispute resolution framework and indicated that consideration is being given to making the Arbitration Program available only for claims that fall outside of OBSI's compensation limit, given the Arbitration Program is designed to be an alternative to litigation with a focus on complex and large claims.

Federal developments relating to external complaint handling in banking: On June 30, 2022, the federal government introduced a new financial consumer protection framework into the Bank Act with a goal to strengthen complaint-handling procedures for banking consumers, making the process effective and timely. Banks are now required to deal with consumer complaints in 56 days, which has resulted in record high overall banking and investment case volumes for OBSI. The impact of these federal developments and the response to various other initiatives will be closely monitored.

4. From Script to Screen: CIRO Releases First Phase of Rule Consolidation Project

The objective of [Phase 1 of the Canadian Investment Regulatory Organization's \(CIRO's\) Rule Consolidation Project](#) is to establish a framework for the development of consolidated rules that will apply to all CIRO Dealer Members, to be known as the CIRO Dealer and Consolidated (DC) Rules. The DC Rules structure involves the adoption of rule interpretation provisions, definitions of common application throughout the rules, rule exemption provisions, and general standards of conduct applicable to all activities of dealers and their employees, as well as Approved Persons.

CIRO noted that there were material differences in the interpretation, application, definitions, exemptions, and general standard provisions of the IDPC Rules and MFD Rules that will require further consideration. As a result, CIRO has proposed the use of interim definitions, where applicable, which retain the status quo. These definitions will likely require revision once a decision is made on the material differences in other phases of the project.

A few things to note: proposed DC Rule 1100 will include provisions to adopt existing IDPC Rule general rule application provisions relating to the use of electronic signatures.

In addition, a difference was identified between the existing IDPC and MFD Rule interpretation and application provisions regarding delegation of tasks and activities. As part of the Phase 1 Proposed DC Rules, CIRO is proposing to adopt the existing IDPC Rule relating to delegation, but has not yet made a final decision whether the final general rule requirement should permit or prohibit the use of delegation, subject to specific prohibited exceptions itemized elsewhere throughout the rules.

In the case of discretionary accounts (advisory accounts for which a client who is frequently or temporarily unavailable has given to their advisor temporary discretionary authority), CIRO has proposed the elimination of the offering of the discretionary account arrangement within a future phase of the Rule Consolidation Project but intends to continue in the interim to limit the dealer types that can offer this account type to investment dealers. CIRO is also proposing to adopt within DC Rule 1300 provisions that incorporate the previous ability within the former MFDA General By-law to grant exemptive relief to a group of regulated persons rather than on a case-by-case basis. CIRO is also proposing to adopt within DC Rule 1400 existing language such that general standards of conduct will be applicable to all Dealer Members, including Mutual Fund Dealer Members.

The consultation seeks general comments and asks specific questions relating to items such as the proposed drafting approach for permitted delegation, the need for temporary discretionary accounts and whether Mutual Fund Dealers should be permitted in future to offer managed accounts and order execution only accounts. The comment period for the consultation ends on December 19, 2023.

5. Stay Tuned: FSRA Seeks Consultation on Proposed Statement of Priorities for FY 2024-2025

On October 10, 2023, the Financial Services Regulatory Authority of Ontario (**FSRA**) launched a public consultation on its [proposed 2024-2025 Statement of Priorities \(SoP\)](#) and budget. The objective of the consultation is to obtain feedback from stakeholders, including consumers, credit union members, pension plan beneficiaries, investors and others and is a part of FSRA's ongoing commitment to transparency and accountability.

FSRA has noted that the proposed SoP was shaped by certain environmental factors facing Ontarians today, including various economic, technological, and other emerging issues. Such issues include inflationary pressures, the impact of increased interest rates, the use of automation and artificial intelligence and its associated risks for consumers, environmental, social and governance investing by regulated entities, the need for regulated entities to better serve vulnerable persons, and the increase in alternative and private lending, including private mortgage transactions.

FSRA lists among its proposed priorities for fiscal year 2024-2025:

- Advancing the consumer interest across various sectors regulated by FSRA;
- Enabling innovation;
- Modernizing systems and processes;
- Protecting consumers who invest in segregated fund contracts;
- Promoting strong conduct culture in mortgage brokering;
- Enhancing professional competence of licensed individuals in mortgage brokering; and
- Ensuring the effectiveness of the title protection framework for financial planners/financial advisors.

Highlights of the proposed priorities for mortgage brokers and administrators include enhancing protection of vulnerable consumers. FSRA also intends to develop rules and guidance to support the effectiveness of principal brokers (the chief compliance officer of the mortgage brokerage), commence supervision of mortgage brokers and administrators against regulatory expectations outlined in the mortgage suitability guidance and mortgage administrator financial filing guidance, and implement a risk-based conduct intervention approach to address deficient firms. FSRA will publish its final guidance on how it evaluates the suitability of a mortgage broker to hold a license and how brokers should conduct suitability assessments, and will implement an enhanced competency and continuing education framework for brokers and agents. The later is seen as critical to mitigate the risks associated with an environment of increased interest rates and inflation leading to consumers increasingly using private lenders for mortgages.

In Brief

Behind the Scenes: Shorter Consultation Periods Proposed

The Ministry of Finance in Ontario (**Ministry**) released [a consultation](#) last month that would impact the time the public is afforded to comment on proposed rules released by either the Ontario Securities Commission (**OSC**) or the Financial Services Regulatory Authority of Ontario (**FSRA**). These regulators must currently provide for a minimum 90-day comment period, but the Ministry has proposed this be shortened to 60 days for “simple, straightforward” rules. The OSC and FSRA would still be able to have a longer consultation period for more complex rules. Comments will be accepted on the proposed legislative amendments until December 4.

Compliance Unplugged: OSC Proposes Amendments to Fee Rules for Non-Compliant Firms and Restricted Dealers

The Ontario Securities Commission (**OSC**) has [proposed amendments to OSC Rule 13-502 Fees and OSC Rule 13-503 \(Commodity Futures Act\) Fees](#) in order to charge new fees for (i) restricted dealers and (ii) firms that are permitted to carry on business under terms and conditions imposed by the OSC.

Restricted dealers would be subject to the following new fees:

- \$24,500 at the time of OSC registration as an additional fee; and
- An additional exemptive relief application fee of \$24,500 for restricted dealers operating as a marketplace.

These new fees are intended to address the costs the regulator faces when onboarding restricted dealers as compared to most other existing market participants.

The definition of “registered firm” is also proposed to be expanded to include individuals or companies **required** to be registered as dealers, advisers or investment fund managers under Ontario securities law (or dealers or advisers under the *Commodity Futures Act*), thus requiring non-compliant firms to pay the same participation fees as a registered firm. Comments on the proposal are due by February 7, 2024. The amendments are proposed to become effective as of July 2, 2024.

CSA and CIRO Responses on Short Selling Consultation – Reality TV Check

The Canadian Investment Regulatory Organization (**CIRO**) and the Canadian Securities Administrators (**CSA**) recently released Staff Notice 23-332 *Summary of Comments and Responses to CSA/IIROC Staff Notice 23-329 Short Selling in Canada* (the **Staff Notice**).

The Staff Notice describes the comments received in connection with the consultation, and concluded that there was no consensus amongst the commentators on the regime for short selling, with some people arguing for major changes, others for only minor amendments while one commentator suggested short selling should be banned altogether. No changes to regulatory provisions are currently being proposed, however the regulators noted they would continue to review whether any changes are required.

Proposals from CIRO can be expected in early 2024 with respect to its current requirement to have a reasonable expectation to settle a short sale on the settlement date. CIRO and the CSA also intend to study potential mandatory close-out or buy-in requirements. As referenced in the Staff Notice, a “buy-in” is started by a buyer who has not received the securities purchased on the date for settlement where they purchase securities in the market to cover the delivery failure, and the seller who failed to deliver is responsible for any increase in price between the failed trade and the buy-in trade. A “close-out” occurs when a dealer fails to deliver securities sold on the date for settlement and must close out the failed position by borrowing securities or purchasing them in the open market. The regulators indicated more than once that the upcoming transition to a T+1 settlement date would need to be considered prior to or at the same time as any changes to the short selling rules.

Important Reminders

Must See TV: Annual Filing Exempt Trade Reports Deadline Quickly Approaching

It is never too early to think about filing exempt trade reports for investment fund issuers that file on an annual basis. Investment funds that have relied on specified prospectus exemptions under National Instrument 45-106 *Prospectus Exemptions*, being the accredited investor exemption, the minimum investment of \$150,000 (for non-individual purchasers) and the exemption for additional investment in investment funds, must file by no later than **January 30, 2024**. As in past years, the process of completing the forms and calculating the fees can be quite time consuming and should be started well in advance of the deadlines. This is particularly true in 2024 as many filers may not have a completed SEDAR+ profile which must be created and verified in order to complete the filings, and the profile also takes a significant amount of time to set up. We would be pleased to help you with this process – please [contact us](#) as soon as possible if you anticipate requiring assistance.

News

AUM Law Spoke at the PMAC AML and ATF Training Session

Don't change that dial; on November 29 AUM Law's [Chris Tooley](#) participated as a speaker for the third year in a row at the Anti-Money Laundering and Anti-Terrorist Financing Training Session hosted by PMAC. Chris covered core concepts around money laundering and terrorist financing, client identification, what information you must collect from clients, record keeping, and suspicious transactions.

Proud Repeat Sponsor of the PMAC National Conference

We are proud to have sponsored the Portfolio Management Association of Canada (**PMAC**) Annual Conference, alongside [Borden Ladner Gervais \(BLG\)](#) on November 14 at the Fairmont Royal York in Toronto.

2023 CCLS Education Sub-Committee Event

AUM is equally happy to have sponsored the Conduct, Compliance and Legal Section (**CCLS**) Education Sub-committee of the Canadian Investment Regulatory Organization (**CIRO**) event, alongside [Borden Ladner Gervais \(BLG\)](#) on November 30.

Canada's Annual AIMA's Regulatory Forum

AUM Law's founder [Kevin Cohen](#) had the pleasure of moderating the annual AIMA Canada Regulatory Forum, which discusses a number of current topics impacting compliance, registration and investment funds, as well as questions for the regulators on November 30.

BLG Resource Corner

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

- [Understanding the Canadian Investment Regulatory Organization \(CIRO\): A quick primer](#)
- [OSC issues new summary report with guidance for investment fund and structured product issuers](#)
- [Understanding what the derivatives business conduct rule means for your business](#)
- [Navigating the currents of ESG expectations: Survey Report on ESG perceptions and practices of Canadian Fund Managers](#)

For more information, please visit the BLG [website](#).

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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.

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