January 2024 | Bulletin

Polar Vortex Edition

As we navigate the start of another year, and the landscape that is securities regulatory compliance, one can see parallels between the complexities of our industry and the dynamic forces impacting our planet. What are we talking about? The effects of the polar vortex, of course, which impacted much of the country earlier this month. First discussed in the 1940s, the polar vortex is a swirling mass of frigid air and low pressure that surrounds both Earth's poles. It is highly influenced by the jet streams, those pesky high altitude air currents that blow from west to east. While we can't stop or predict the polar vortex, we can help you navigate any impending dynamic regulatory storm by providing you with timely information on new and proposed amendments that impact your business.

In this bulletin:

1. Polar Precision: CIRO's Proposals on Directed Commissions

Introduction

On January 25, 2024 the Canadian Investment Regulatory Organization (**CIRO**) published its long-awaited Position Paper on the matter of the payment of commissions to a private corporation. Historically, mutual fund dealers have been permitted to pay commissions earned from registrable activity by Approved Persons who are in a principal/agent dealer relationship to a private unregistered corporation (except in Alberta and Québec). However, investment dealers could only pay commissions directly to their Approved Persons.

CIRO aims to eliminate this anomaly. They have proposed three different policy options for consideration and stakeholder comment.

The three options put forward are:

1. the **Incorporated Approved Person** approach;
2. the **Registered Corporation** approach; or
3. the **Enhanced Directed Commission** approach on an interim basis, while pursuing the permanent adoption of either approaches above.

If implemented, each of the three policy approaches would allow for both mutual fund dealer and investment dealer Approved Persons to have their commissions paid to a corporation. CIRO staff favour the policy option that would result in a new category of "Incorporated Approved Person" (the **IAP Approach**).

Taxation Considerations

CIRO specifically acknowledges that the taxation of compensation is a major motive underlying this policy initiative. The Position Paper explicitly states that compliance with tax laws is a not a matter considered by CIRO and that it only focuses on CIRO requirements and securities laws. CIRO's position is that compliance with tax laws is the responsibility of Approved Persons and Dealer Members.

Discussion of the Three Approaches

1. The IAP Approach

Under the IAP Approach, a personal corporation would be approved by CIRO to engage in non-registrable activities on behalf of the sponsoring dealer. The IAP would be a new non-individual Approved Person category. CIRO would have the same jurisdiction over the IAP as it currently has over individuals in all other Approved Person categories. The permissible activities under the IAP Approach would initially be limited to non-registerable activities, but if securities legislation changes are implemented in one or more jurisdictions in Canada to enable an IAP to engage in registerable activities, the full potential of this approach would be realized.

In the Position Paper, CIRO proposes numerous approval requirements for an IAP. The requirements include a written agreement between the sponsoring dealer, the IAP and the Approved Persons acting on their behalf. CIRO's intention is to oversee IAP ownership, activities, and records. In addition, the IAP must be incorporated as a professional corporation in jurisdictions where that is possible under corporate law. Dealers will be required to supervise an IAP and will remain liable to clients and third parties for the acts and omissions of the IAP.

CIRO's preliminary view is that the IAP Approach is the preferred approach because it:

a. provides Approved Persons with the ability to engage in non-registerable activities through a corporation, through modification of CIRO rules alone;

b. enhances investor protection as it provides CIRO with clear jurisdiction over the corporation that receives commissions, and provides Approved Persons with the future possibility of performing registerable activities through the corporation, should securities legislation in each Canadian jurisdiction evolve to allow for it; and
c. imposes less incremental burden on individual Approved Persons, Dealer Members, CIRO and CSA registration staff than would be introduced under the Registered Corporation approach (described below).

2. The Registered Corporation (RC) Approach

The RC Approach is similar to the existing mechanism in some provinces where a corporation is licensed to engage in the sale of life insurance products and may receive related sales commissions, including commissions received from the sale of segregated funds.

The permissible activities under an RC arrangement would include both non-registerable and registerable activities.

The CIRO approval requirements for an RC would be like those for an IAP. As with an IAP Approach, dealers would be required to supervise an RC and remain liable to clients and third parties for the acts and omissions of the RC.

However, a major disadvantage with the RC Approach is that it cannot be implemented through changes to CIRO Rules. Implementation across Canada would require changes in provincial and territorial securities laws.

3. The Enhanced Directed Commission (EDC) Approach

The EDC Approach is the least complex option of the three options. In essence, it would involve making available (with “enhancements”) the current directed commissions arrangement enjoyed by CIRO mutual fund dealer Approved Persons to all CIRO investment dealer Approved Persons.

The proposed enhancements would include ownership limitations, limitations on activities and more stringent dealer oversight.

CIRO’s major concern with the EDC Approach is that the private corporation receiving directed commissions would not be approved by and thus not directly under the jurisdiction of CIRO. CIRO views the EDC Approach as acceptable as an “interim” measure, with the end goal being the implementation of either the IAP or RC Approach.

Transition

Regardless of the policy option that is adopted, CIRO recommends a two-year transition period to allow mutual fund dealers and their Approved Persons to comply with any new requirements.

Specific Questions for Response

CIRO has requested that stakeholders respond to specific questions, including identifying which rulemaking option is preferable (and why). Other questions include whether there are other requirements not discussed in the Position Paper that should be included in any rule amendments, or if there are other matters not discussed that CIRO should consider when assessing which policy option to pursue.

Conclusion and Call to Action

All stakeholders should review the Position Paper and make their views and preferences known to CIRO. Comments should be in writing and delivered by **March 25, 2024**. Look out for additional commentary and analysis from our colleagues at BLG.

2. FSRA's Proposed Approach for Vulnerable Consumers to Weather Financial Storms

On January 8, 2024, the Financial Services Regulatory Authority of Ontario (**FSRA**) launched a public consultation (the **Consultation**) on a multi-year approach (the **Proposed Approach**) designed to create more positive outcomes and enhanced protections for vulnerable consumers and to obtain input on the operable definition of a vulnerable consumer.

The central aim of the Proposed Approach is to close the gap between the experiences of vulnerable consumers and non-vulnerable consumers who obtain services from those in FSRA-regulated sectors. FSRA notes that the Proposed Approach will be outcome-focused, and as such will be underpinned by an ongoing commitment to measuring vulnerable consumer experiences over years and will be informed by the work of other regulators across jurisdictions.

To achieve this central aim, FSRA has set out two primary goals.

Goal 1 *- Promote inclusive and fair treatment of vulnerable consumers and prevent targeted financial mistreatment.*

Proposed actions to meet this goal include:

- Speaking with other regulated entities to address the Proposed Approach and the needs of vulnerable consumers;
- Conducting quantitative and qualitative research on vulnerable consumers to measure outcomes;
- Strengthening FSRA's supervision work by applying research findings on vulnerable consumers;
- Utilizing research findings to inform regulatory policy decision-making;
- Creating data analysis mechanisms to measure vulnerability across FSRA sectors; and
- Improving complaint analysis to better identify risks of consumer harm for vulnerable groups.

Goal 2 *- Improve consumer education, engagement, and awareness building efforts.*

Proposed actions to meet this goal include:

- Community outreach and engagement with vulnerable and public interest communities;
- Global engagement to build knowledge on fair treatment and protection of vulnerable consumers;
- Publishing and promoting research findings on vulnerable consumers to raise awareness;
- Partnering with other regulators to exchange information;
- Administering focused campaigns to educate vulnerable consumers of their rights/protections; and
- Improving communication and disclosure practices across sectors.

FSRA is also seeking comments on the proposed definition of a vulnerable consumer, recognizing that the effectiveness of the Proposed Approach will require a shared understanding of the issue amongst FSRA regulated entities and stakeholders, and that defining the issue is critical to better ensure accurate scope and positive outcomes. The proposed definition is open-ended and principle-based rather than strictly defined and is to be informed by a list of non-exhaustive list of factors and personal circumstances.

The proposed FSRA definition is as follows:

> *A vulnerable consumer is someone who is at higher risk of experiencing financial mistreatment, hardship, or harm, due to various factors and personal circumstances.*

The list of non-exhaustive factors and personal circumstances that may result in vulnerability include age, poor health condition (mental and physical), being a recent immigrant/facing a language barrier, being a member of an equity deserving group or being a person subject to a natural disaster or other major environmental events. FSRA notes that vulnerability can be short-term or the result of external factors, such as economic volatility.

To guide stakeholder feedback on the Consultation, FSRA has provided a list of questions which can be found on FSRA's webpage for the Consultation.

Stakeholders should note that comments are due on **March 8, 2024**.

3. Skating on Thin Ice: FCSC Proposes New Rules Relating to Title Protection

Following a similar process as in Ontario and Saskatchewan (which you can read about here), earlier this month the New Brunswick Financial and Consumer Services Commission (**Commission**) proposed two rules under the *Financial Advisors and Financial Planners Title Protection Act* (**Act**). Rule TPA-001 General (**General Rule**) sets out the criteria for credentialing bodies and the credentials to be approved, and Rule TPA-002 Fees (**Fee Rule**) sets out the fees to be paid to the Commission under the framework.

Like the frameworks existing in other provinces which we've also written about in prior bulletins, the General Rule outlines the conditions for an applicant to receive approval as a credentialing body and the approval of a credential for the title of Financial Advisor or Financial Planner. Among other things, the applicant must demonstrate an effective governance structure and administrative policies and procedures that serve the public interest, a code of ethics and professional standards for its officers, directors and employees that serves the public interest and the necessary expertise and resources to effectively oversee the conduct of individuals holding approved credentials (in both English and French). Approval may be granted if the application shows that a regulatory authority elsewhere in Canada has already approved the applicant as a credentialing body based on substantially similar criteria.

Credentialing bodies must also be able to respond to complaints related to individuals holding credentials, adjudicate them and enforce discipline in a transparent and impartial manner.

With respect to credentials themselves, they must be based on a program that ensures a credential holder will deal with their clients competently, professionally, fairly, honestly and in good faith. Material conflicts of interest must be addressed in the best interests of clients, and credential holders must put their clients' interests first when making a suitability determination. Credentials will not be permitted to be issued to an individual unless the person has passed an exam that tests all the educational requirements set out in the rule. The individual is required to comply with a code of ethics and professional standards and is subject to continuing education (**CE**) requirements applicable to a financial advisor or financial planner, as applicable.

The Fee Rule would require an application fee of $10,000 for approval as a credentialing body, and a 50% discount will be available if the applicant is already approved by a regulatory authority in Canada as a credentialing body based on substantially similar criteria. Similarly, the fee for approval of a credential is $5,000, which is halved for credentials already approved by another regulatory authority in Canada.

It is also proposed that there would be an annual fee for the credentialing body based on the total number of individuals using a protected title, which range from $30-$50 per title holder, depending on the number of holders. Of note, the credentialing body can apply for a reduction in the annual fee under certain conditions, including if the applicant is already regulated pursuant to financial and consumer services legislation or is approved as a credentialing body by a regulatory authority.

Comments are being accepted on the consultation until **April 10, 2024**.

4. Cold Weather, Warm Access – CSA Finalizes Access Model for Non-Investment Fund Prospectuses

On January 11, 2024, the CSA published final rules to permit issuers (other than investment fund issuers, i.e. corporate finance issuers) to adopt an access equals delivery model for most prospectuses. The model does not apply to prospectuses for rights, medium-term notes and other continuous distributions under a shelf prospectus or to the continuous disclosure regime.

What does this mean for corporate finance issuers?

Generally, issuers will be able to satisfy the prospectus delivery requirement by:

- Publicly filing the document on SEDAR+; and
- Issuing and filing a news release announcing that the document is publicly available on SEDAR+ and that a paper or electronic copy can be obtained upon request.

Usually, the press release must be filed when the final prospectus is filed. However, for shelf and post-receipt pricing (PREP) prospectuses, the press release may be filed earlier and state that the prospectus will be available on SEDAR+ within two business days.

What does it mean for purchasers?

Purchasers will be able to:

- Access a prospectus electronically through SEDAR+; or
- Obtain an electronic or paper copy without charge from the issuer by providing an address.

It should be noted that there is no time limit within which an issuer or dealer must send a copy of a preliminary prospectus requested by a prospective purchaser.

The rights of withdrawal, revocation or cancellation of an agreement to purchase securities remain available.

When does this change take place?

These rules are effective April 16, 2024, provided that the necessary approvals are obtained.

Does this simplify the rules?

Not really. The access model described above is not mandatory. Rather, it is an alternate procedure. Each corporate finance issuer must choose whether to follow the current paper delivery rules or the access equals delivery rules.

What is the impact of the change?

According to the CSA, implementing these changes will "modernize the way prospectuses are made accessible to investors and reduce costs associated with the printing and mailing of prospectuses, which are currently borne by issuers. It offers benefits for both issuers and investors by providing a more cost-efficient, timely and environmentally friendly manner of communicating information to investors than paper delivery." We agree. But what about other rules that still require paper delivery?

What about the continuous disclosure regime and other types of documents?

According to the draft OSC Statement of Priorities for Fiscal Year 2024-25, the CSA anticipates publishing for comment an access equals delivery model for continuous disclosure of corporate finance issuers before the end of March. Stay tuned! For additional information on the changes, please see the article in the BLG Resource Corner below.

5. Regulatory Resolutions – CIRO Continues Rule Consolidation Project in Phase 2

On January 11, 2024, the Canadian Investment Regulatory Organization (**CIRO**) published for comment Phase 2 of the Rule Consolidation Project (the **Project**). The aim of the Project is to consolidate the Investment Dealer and Partially Consolidated Rules (**IDPC Rules**) and Mutual Fund Dealer Rules (**MFD Rules**) into a single set of rules, known as the CIRO Dealer and Consolidated Rules (**DC Rules**). The objective of Phase 2 is to identify and adopt rules that currently apply to investment dealers and mutual fund dealers that are unique to each dealer type, which can be adopted in the DC Rules without a material impact on stakeholders, including investors and the public.

The focus of the proposals is the harmonization of rules related to margin, debt markets and Inter-Dealer Bond Brokers (**IDBBs**), as well as trading. More details on the specific proposed changes are set out below.

Margin Requirements

CIRO proposes to largely adopt in the DC Rules the margin requirements currently in the 5000 Series of the IDPC Rules, with minor modifications and clarifications. CIRO will also adopt MFD Rule 3.2.1 that prohibits mutual fund dealers from allowing clients to purchase securities on margin, however, mutual fund dealers will be permitted to advance funds to clients in connection with redemption proceeds under defined conditions.

While we agree the changes appear to be minor and non-material, we urge dealers to review the modifications in detail to ensure there are no significant operational issues.

Debt Markets and IDBBs

CIRO proposes to adopt the current Series 7000 IDPC Rules in the DC Rules with modifications to clarify the application of the rules to mutual fund dealers.

The provisions of current IDPC Rule 7100 will apply to mutual fund dealers who deal in the debt securities market. The intent is to prevent regulatory arbitrage between dealer types. Mutual fund dealers who deal specifically in debt securities will be impacted and will have to develop policies and procedures concerning trading and settlement practices to comply with the proposed rule.

The provisions for current IDPC Rule 7200 regarding debt securities transaction reporting will be adopted in the DC Rules and will continue to apply **only** to investment dealers. Likewise, the provisions of current IDPC Rule 7300 regarding the requirements for IDBBs used by investment dealers will continue to apply **only** to investment dealers.

Again, we urge dealers to review these proposed minor modifications in detail to ensure there are no significant operational issues presented.

Trading

CIRO proposes to adopt in the DC Rules the trading related provisions in Series 3000 IDPC Rules regarding best execution (**BE**), client identifiers (**CI**) and client priority (**CP**).

To minimize opportunities for regulatory arbitrage, CIRO proposes to extend these requirements to mutual fund dealers dealing in Exchange Traded Funds (**ETFs**).

The impact on mutual fund dealers dealing in ETFs would be new requirements to:

- establish, maintain and apply policies and procedure to address BE for client ETF transactions;
- comply with CI requirements for ETF transactions; and
- ensure CP of client ETF orders or transactions over all other orders.

Mutual fund dealers who deal in ETFs will need to seriously consider the impact of these proposals from a compliance and operational point of view.

Rules Pending Implementation

CIRO also includes in Phase 2 certain "business as usual" amendments, specifically:

- amendments to facilitate T+1 settlement;
- inclusion of proposed amendments to introduce margin requirements for structured products; and
- inclusion of the proposed amendments regarding derivatives, and in particular revised BE requirements for over-the-counter derivative transactions.

Comments Requested on Specific Questions

In addition to general consultation, CIRO has asked for specific input on:

- the impact of the proposed BE, CI and CP obligations on mutual fund dealers dealing in ETFs;
- the impact of the proposed debt market trading and settlement practice obligations on mutual fund dealer debt market activity; and
- whether transaction reporting should be extended to mutual fund dealer debt market transactions.

Conclusion

Stakeholders should review the proposals in detail and consider providing comments to CIRO. Since most of the Phase 2 proposed DC Rules are taken directly from the current IDPC Rules, the impact on investment dealers will be largely neutral, but investment dealer legal and compliance teams should carefully review the details of the proposals to fully assess the impact. There will be an impact on mutual fund dealers who deal in ETFs or the debt market. Impacted mutual fund dealers should review the compliance and operational implications of the proposals and consider providing comments. Comments are due by **March 11, 2024**. If you have any questions, please feel free to contact us.

In Brief

Chill Credentials: CIRO Approved as a Credentialing Body

The Canadian Investment Regulatory Organization (**CIRO**) was recently approved by the Financial Services Regulatory Authority of Ontario (**FSRA**) as a credentialing body for purposes of the *Financial Professionals Title Protection Act, 2019*. The designation means that individuals approved by CIRO as a: **(i)** registered representative; **(ii)** mutual fund dealing representative; **(iii)** portfolio manager; or **(iv)** associate portfolio manager may use the title of “Financial Advisor”. CIRO, FSRA and the Ontario Securities Commission had been working to ensure that CIRO’s designation as a credentialing body would not have the consequence of regulatory duplication.

As set out in a prior AUM Law bulletin, FSRA is continuing to review the title protection framework, including proficiency standards for the Financial Advisor and Financial Planner titles, and still intends to release a registry of credentialed Financial Planners and Financial Advisors in Ontario.

Snowballing Toward Retirement Survey Results

On January 10, 2024, the Ontario Securities Commission, in partnership with Ipsos, released the results of a survey of Canadians 50 years and older that identified and addresses the needs of older investors. The survey detailed eight key findings from the survey, which divided the respondents into two groups, referred to as retirees and pre-retirees. Amongst other interesting findings, the survey suggested that:

- over one-third of the surveyed group did not own any investments;
- pre-retirees overall had a lower total value of investments and were less likely to have a financial plan for retirement than those already retired;
- 60% of retirees and 43% of pre-retirees had not appointed a power of attorney for property; and
- **71% of retirees and 83% of pre-retirees had not appointed a trusted contact person.**

While retirees appeared more likely to engage financial advisors or portfolio managers than pre-retirees, a high percentage of both groups had not appointed a trusted contact person. The most common reasons provided were that they had not been asked to appoint one, or that they did not know they could do so. More alarmingly, the survey found that familiarity with the term “trusted contact person” was low within both groups and few were able to correctly identify the purpose of this role. Retirees were more likely to believe that a trusted contact person was a substitute decision maker, while pre-retirees were more likely not to know. Although the survey did not make any suggestions for the industry at large, these findings greatly highlight the need for additional investor education on this topic.

Cold Cash, Hot Topic: CIRO Seeks Comments on Two Short Selling Proposals

Earlier this month, the Canadian Investment Regulatory Organization (**CIRO**) released proposed amendments to the Universal Market Integrity Rules relating to the reasonable expectation to settle a short sale (**Proposed Amendments**). UMIR 3.3 would require a seller to have a reasonable expectation to settle any resulting trade on the settlement date before entering an order for a short sale on a marketplace. In addition, the amendments would add supervisory and gatekeeper requirements relating to UMIR 3.3.

It is noted in the Proposed Amendments that CIRO and the Canadian Securities Administrators are continuing to review short sale regulations, including potentially mandatory close-out requirements. It is specifically noted that the fact a trade ultimately settles does not support a claim that a reasonable expectation to settle existed before the time of order entry. Factors impacting the ability to show a reasonable expectation would include a client history of prior failed trades, or if a particular security has been deemed "hard to borrow". Participants that engage in short selling (as principal or agent) will need policies and procedures to ensure that they comply with the Proposed Amendments. CIRO has proposed an implementation period of at least 90 days after approval and indicated that the effective date would not be prior to the date the implementation of T+1 is completed.

In addition, CIRO requests comment on its Proposed Guidance on UMIR Requirements Related to Short Selling and Failed Trades (**Proposed Guidance**). The Proposed Guidance is intended to clarify the short selling framework and help participants and access persons comply with the short selling requirements. While most of the Proposed Guidance address current requirements, one section specifically relates to the proposed additional requirement to have a reasonable expectation to settle a short sale, as discussed above.

The Proposed Guidance discusses expected documentation to establish that participants and access persons have complied with the obligation to establish a reasonable expectation to settle. It also further discusses factors that affect the ability to demonstrate a reasonable expectation to settle, including the presence of prior failed trades in a clients' history. The Proposed Guidance also includes information on the appropriate use of easy-to-borrow lists of securities (for example, using lists provided by dealers with whom there is a formal relationship regarding clearing or settlement). It is also noted that the reasonable expectation to settle applies to self-directed orders, and thus Participants that trade inter-listed securities may wish to consider technological solutions already in use for rules in other jurisdictions.

Comments are due by **April 12, 2024**.

BLG Resource Corner

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

- New trust reporting rules are now in effect
- Canada's Anti-Spam Legislation – 2023 Year in Review
- Is the printed prospectus dead? CSA to implement access model for non-investment fund prospectuses

- Criminal interest rate: Canada sets high stakes for high rates

For more information, please visit the BLG website.

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