BLG BEYOND AUM LAW Bulletin

August 2024 | Bulletin

Music Festival Edition

As August ends, you have hopefully had an opportunity for some down-time, and perhaps even a chance to enjoy one of Canada's very popular music festivals. One of the first music festivals in Canada may have taken place in Quebec City in June 1834, as "A Grand Performance of Sacred Music" with over 60 instrumentalists and 100 singers. Today, from the pulsating beats of Toronto's Veld Music Festival to the stomping Boots and Hearts Music Festival in Oro-Medonte, to the charm of Edmonton's Folk Music Festival, there's an event for everyone. Of course, staying attuned to the latest regulatory updates described below will help your firm hit all the right notes in the months to follow.

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BLG Resource Corner

1. Sound Justice: OSC Proposal on Disgorgement Orders

The Ontario Securities Commission (**OSC**) has published a notice and request for comment on several proposed rules that will establish a process to distribute money received by the OSC under disgorgement orders to harmed investors, primarily in Proposed OSC Rule 11-502 *Distribution of Amounts Paid to the OSC under Disgorgement Orders* and its related companion policy. Similar rules are proposed under the *Commodity Futures Act* (Ontario) (collectively, the **Proposed Rules**). Currently, there are no specified procedures for distributing those funds back to investors. The British Columbia Securities Commission and Autorité des marchés financiers both already have statutory frameworks.

On November 2, 2023, the government introduced Bill 146, *Building a Stronger Ontario Together Act (Budget Measures), 2023* that included legislative amendments to the *Securities Act* (Ontario), the *Commodity Futures Act* (Ontario), and the *Securities Commission Act, 2021*. The amendments, once in force, will establish a new statutory framework governing the distribution of money received by the OSC under disgorgement orders to investors who incurred direct financial losses due to the contravention of Ontario securities law or Ontario commodity futures law giving rise to the disgorgement order.

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While disgorgement orders are not intended to 'compensate' investors, the Proposed Rules suggest that, in certain circumstances, amounts received under these orders can be distributed to investors who incurred direct financial losses because of the conduct giving rise to the order.

The framework under the Proposed Rules include:

- the circumstances in which money received by the OSC under disgorgement orders is required to be distributed;
- the eligibility requirements for investors seeking a payment from the disgorged amounts received by the OSC;
- a process for distributing disgorged amounts to harmed investors in cases where a court-appointed administrator is not used; and
- the use of other monetary sanctions and settlement payments received by the OSC to pay certain administrative costs in relation to the distribution of disgorged amounts.

An "eligible applicant" for funds will be a person or company that **(i)** incurred direct financial losses as a result of a contravention that gave rise to a disgorgement order, and **(ii)** did not directly or indirectly engage in the contravention that gave rise to the disgorgement order.

It is currently proposed that the OSC will make disgorged funds available for distribution **unless** the disgorgement order related to a contravention of the "insider trading and tipping" provisions (because it is difficult to establish that this conduct has caused direct financial harm to investors or quantify losses) or the amount received is too small to justify the costs of distributing it (anticipated to be less than $50).

Funds will be made available through a notice and claims process conducted by either a court-appointed administrator or directly by the OSC, with the former being used in most cases. It is anticipated that a claims-based process will be needed to identify harmed investors and verify their financial losses. Investors are not precluded from seeking to recover from other sources such as a civil claim, but applicants under the proposed framework must disclose any such payments to prevent double recovery.

Amounts collected are anticipated to be held for three years or until sufficient amounts are collected to warrant making a distribution. In determining the amount to be paid to an eligible applicant, the OSC must consider the amount of money received under the disgorgement order, the direct financial loss suffered by the applicant, the direct financial losses suffered by all eligible applicants, and any other information considered appropriate in the circumstances.

The OSC will be obligated to publish information with respect to the money received, and if distribution is required, a notice of the claims process. A report will also be published on each completed distribution within a prescribed time frame. The OSC intends to create 'plain language' resources to help investors understand the new statutory distribution framework and the payment application process.

The consultation notes that the OSC will also continue to use other existing tools to return money to harmed investors, including in appropriate circumstances no contest settlements and receiverships.

Comments on the proposal are due by **October 9, 2024.**

2. An Orchestrated Collection of Information - 2024 CSA Investor Index

In late June, the Canadian Securities Administrators (**CSA**) published the 2024 CSA Investor Index (**Index**). This is the sixth iteration of the Index, with the previous version published a little while ago in 2020. The long-running survey is designed to track certain key measurements in the investment industry, including investor knowledge, confidence, risk orientation, behaviours, use of information and investor fraud.

The following are some of the key findings published in the Index:

1. **More Canadians are using social media for investment information, especially younger Canadians:** Compared to 2020, there has been an 18-point increase (to 53%) in the number of investors who use social media for investment information, with YouTube being the most frequently chosen application by respondents. The use of social media for investment information is more prevalent in younger cohorts, with 82% of 18–24-year-old investors using it as a source for information. There has also been an increase in encountering investment opportunities through social media, up to 46% from the 2020 Index (representing a 17-point increase).

2. **Older investors are more likely to say that the last time they looked for investing information, they only went to their advisor or bank:** 26% of investors solely relied on their bank or advisor for investing information, while 30% used an online source. Based on age, 9% of 18-24-year-old investors solely looked to their bank or advisor for investing information, while 43% of those who were 65+ did so.

3. **Fewer investors reported having a financial advisor in 2024, especially younger investors and those with smaller portfolios:** Only 61% of investors reported they worked with a financial advisor, representing a decrease from the 69-71% as reported by respondents from 2012 to 2020. The largest drop was for investors under 45 with portfolios less than $100,000. There was no drop for investors with portfolios over $100,000.

4. **About half of investors say they have at least some DIY (Do-It-Yourself) investments, more commonly men and younger investors:** 45% of investors reported having a DIY account, with 30% opening that account within the last two years. Investors over 55 are less likely to have DIY investments (under 35% do), as are women compared to men (36% compared to 52%, respectively).

5. **After several years of decline, 2024 saw an increase in reported fraud attempts:** Between 2006 to 2017 there was a steady decline in reporting of possible fraudulent investments, however since 2020, there has been a 5-point increase. The largest increases were seen among individuals with no savings (27%) and non-investors (34%). Interestingly, rates of investment fraud victimization continue to fall for older Canadians (over 55), while rising for all other (younger) age groups. However, the overall rate remains stable. Email remains the most common medium for fraud, and there has been an increase in fraud on social media since 2020.

6. **Investors are less familiar with the umbrella CSA than provincial regulators, while both have positive, but softly held, reputations:** 24% of respondents reported that they were very or somewhat familiar with the CSA, compared to 32% for provincial regulators. 47% hold a favorable view of the CSA and 54% for provincial regulators. Very few respondents reported a negative impression for either, with most stating a neutral impression or stating they do not know.

For more detailed information, the Index can be found on the CSA's website here.

3. Next in the Festival Line Up: Understanding New Complaint Handling Regulations in Québec

In Québec, the Regulation respecting complaint processing and dispute resolution in the financial sector (the **Regulation**) comes into effect on **July 1, 2025**. This regulation follows the consultation that the Autorité des marchés financiers (**AMF**) conducted in November 2021, which was discussed in a past bulletin here. The Regulation aims to strengthen consumer confidence and trust in the financial services sector in Québec and mandates standardized procedures for financial institutions, financial intermediaries (such as advisers and dealers), and credit assessment agents.

The meaning of a complaint is quite broad, and with respect to advisers and dealers, is defined as follows:

> "any reproach or dissatisfaction in respect of a service or product offered by a financial institution or a financial intermediary where the reproach or dissatisfaction is communicated by a person who is a member of the clientele of the financial institution or financial intermediary and a final response is expected".

The Regulation requires applicable entities to adopt clear, consistent practices for managing complaints, including timely responses thorough documentation and clear communication. A few key highlights of the new Regulation include:

- Requirements for the complaint processing and dispute resolution policy to set out the measures taken to ensure that the policy is applied across the firm, including appointing a person to the role of complaints officer.
- Among other specifics, the policy must set out the measures taken to develop a comprehensive view of the complaints received to identify the causes common to, and address the issues raised by, the complaints.
- Requirements for entities to draft disclosure documents using clear, readable, specific and non-misleading language regarding complaint processing and dispute resolution.
- Entities must take the necessary actions to understand what is being communicated to them and, in doing so, when necessary, help the complainants file their complaints. They must also ensure that staff use clear and plain language in any interactions with complainants.
- Entities must be diligent in how they handle complaints. They must send an acknowledgment, properly document the complaint, enter the complaint into a register and keep it updated, and provide the

complainant with a final response no later than 60 days after receiving the initial complaint (or 90 days in exceptional circumstances or circumstances beyond their control).

- Entities must provide a reasonable amount of time for complainants to respond to any offer made to resolve a complaint, which should allow time for a complainant to seek advice to make an informed decision.
- Complaints that could be resolved within 20 days to the complainant's satisfaction can be subject to an expedited handling procedure where an entity may provide a final response verbally or in writing and, if applicable, a settlement offer.

This new Regulation is designed to unify complaint handling practices, enhance transparency, and bolster consumer confidence in Québec's financial sector. However, the Regulation is not being harmonized with the complaints handling requirements imposed on firms with non-institutional clients by the CSA through the OBSI. We strongly encourage entities that are subject to the AMF's supervision to revisit their complaint handling policies before the new Regulation comes into effect. If you are contemplating updating your compliance manual this fall to be ready for 2025, it might be an opportune time to incorporate the AMF's new requirements. For more information or assistance with updating your policies, please contact our team.

In Brief

Dancing to FINTRAC's Beat: Expectations for Client Monitoring

Reporting entities such as advisers and dealers are required by FINTRAC to monitor clients with whom they have a business relationship on an ongoing basis. One reason ongoing monitoring is required relates to the obligation to report suspicious transactions to FINTRAC. The frequency of monitoring depends in part on the risk level that has been assigned to clients as part of a reporting entity's risk assessment. Reporting entities must keep records of both the measures taken and the information obtained from the ongoing monitoring of clients.

The requirement for ongoing monitoring only ends when the **business relationship** with a client ends, and thus the meaning of a "business relationship" is quite important for these obligations and can be nuanced. As an example, unless an exemption is available, a reporting entity that is an adviser or dealer generally enters into a business relationship with a client when an account is opened, or if a client otherwise engages in a financial transaction with the adviser or dealer twice within a five-year period where there is a requirement to verify client identity.

If a business relationship exists because of an account opening transaction, that relationship does not end until **five years after** the day on which a client closes their last account with the reporting entity. Otherwise, the business relationship ends after at least **five years** has passed since the day of the last transaction requiring the adviser or dealer to verify its client's identity.

As a result, we are aware that FINTRAC has been reminding reporting entities that ongoing monitoring requirements do continue to apply for five years after the account is closed (or if there is no account, from the last transaction requiring identity verification). During this period, the requirements to file suspicious

transaction reports with FINTRAC also continue. One implication is that if a **former** client engages in suspicious activity, that activity could be reportable as a suspicious transaction for five years after the client's account is closed. These obligations and timeframes should be on registrants' radar screens and reflected in AML training and policies and procedures. Please contact us if you have any questions.

Don't Get Lost in the Crowd – FINTRAC Rules for the Mortgage Industry

A friendly reminder to all mortgage administrators, mortgage brokers and mortgage lenders of the upcoming requirement to comply with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the **Act**) as of **October 11, 2024**. The requirements include the implementation of an AML/terrorist financing compliance program, reporting of certain transactions such as suspicious transaction reports, sanctions evasion reports and terrorist property reports, specified record-keeping, KYC obligations, and following all ministerial directives related to AML and terrorist financing.

A compliance program is expected to include written policies and procedures as well as the appointment of a compliance officer, a risk assessment to document the risk of money laundering or terrorist financing activities, a written, ongoing training program for employees and documentation of a plan to review the compliance program to test its effectiveness at least every two years (the two-year AML effectiveness review).

Examples of records that must be kept (with the specified information) include:

- receipt of funds records when amounts are received in connection with a mortgage on a real property;
- mortgage loan records which include information on the financial capacity of the client and the terms of the loan;
- information records every time a mortgage loan is serviced, arranged, or provided; and
- copies of official corporate records of clients and third-party determination records.

The required records must be kept for at least 5 years.

We expect that, over time, FINTRAC will conduct compliance examinations with respect to whether firms are meeting the requirements under the Act. Additionally, FINTRAC can levy substantial administrative penalties for non-compliance.

If you require any assistance with setting up your compliance program or employee training or have any other questions about your obligations under the Act, please contact your usual lawyer at AUM Law.

Important Reminders

Maintain Your Perfect Pitch Under New Derivatives Business Conduct Rule

The new Multilateral Instrument 93-101 *Derivatives: Business Conduct* (**MI 93-101**) and its related companion policy come into force shortly on **September 28, 2024**. MI 93-101 will have a direct impact on

firms that advise or deal in over-the-counter derivatives (**OTC derivatives**), as described in our prior article**.** Subject to ministerial approval in British Columbia, MI 93-101 will become a national instrument.

In our prior article, we addressed questions such as:

- Does the rule apply to you if you are a registered securities adviser or dealer?
- Does the rule apply to you if you are a foreign adviser or sub-adviser?
- When you are advising a client, can the client waive some investor protections?
- When do you need to repaper client contracts and relationship documentation so that you can rely on the Eligible Derivatives Party waivers?
- What is the impact on your compliance program?

Of note, MI 93-101 **also** impacts firms with funds or managed accounts that utilize the services of an international adviser or sub-adviser that provide advice on OTC derivatives.

Foreign advisers that currently rely on the international adviser or international sub-adviser exemption in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) will be required to comply with the new, corresponding registration exemptions under MI 93-101 to advise on OTC derivatives. Such advisers will, among other things, need to review their policies and procedures to ensure compliance. Foreign advisers (not sub-advisers) will also be required to **file a new form,** Form 93-101F1 *Submission to Jurisdiction and Appointment of Agent for Service of Process* with its principal regulator before the effective date of the rule to rely on the exemption under section 46 of MI 93-101. The same form must be filed by a foreign derivatives dealer to rely on the exemption in section 39 of MI 93-101.

If your firm relies on the services of a foreign derivatives dealer or foreign derivatives adviser, you should confirm that they have filed the necessary forms and otherwise complied with any applicable obligations under MI 93-101 by the deadline.

For additional information on the obligations for all derivatives firms that advise in or trade OTC derivatives and exemptions from certain obligations, please see this article published last year by our colleagues at BLG LLP. Some additional exemptions have since been made available in Coordinated Blanket Order 93-930, described here.

Keeping Capital Markets Participation Fee Filings Attacca

This year, the annual filings for Form 13-502F4 *Capital Markets Participation Fee Calculation* are due by **November 1, 2024**. The form must be completed by firms registered under either or both the *Securities Act* (Ontario) and the *Commodity Futures Act* (Ontario), as well as by unregistered capital markets participants. Your firm may also receive a direct reminder from the Ontario Securities Commission (**OSC**) shortly.

As you are aware, there have been changes to the rules related to the calculation and payment of capital markets participation fees, as well as the accelerated filing deadline for the related fee forms. Information in

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the forms must be based on the latest audited financial statements of your firm, available at the time of filing. A specified individual must certify the form to attest to its completeness and accuracy. Registrants with bank account information already recorded on the NRD will have their capital market participation fees automatically withdrawn by the OSC from the firm's bank account. Additional information with respect to common errors in the calculation can be found in OSC Staff Notice 33-756 *Registration, Inspections and Examinations Division Summary Report for Dealers, Advisers and Investment Fund Managers*.

Form 13-502F4s can be filed using the following portal link.

If you would like our assistance with the fee calculations or the filing, please contact us as soon as possible. Filings are permitted beginning **August 31, 2024**, and we would encourage firms to begin the filing process well in advance of the deadline.

BLG Resource Corner

Our colleagues at BLG have provided a variety of insights we thought might interest our readers:

- Public consultation: Proposed new measures for the banking sector and consumer protection
- Discharged bankrupts may be exempt from administrative penalties: Poonian v. British Columbia (Securities Commission)
- Québec Law 25 still has more to say: Answers to your questions on the new data portability right
- Harmonized sanction guidelines and more: CIRO releases 2023-2024 enforcement report

For more information, please visit the BLG website.

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