BLG BEYOND™ AUM® LAW Bulletin

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The Apple Orchard Edition

As the air takes on a decidedly chillier quality, apple orchards in Canada are reaching their peak season. Canada produces an impressive **1 billion** pounds of apples each year, with Ontario providing about 40% of this total. Some orchards throughout Canada date as far back as the 1600s. Popular apple varieties grown here at home include McIntosh, which was developed in Ontario in the 19th century, Gala, Red Delicious and Honeycrisp. It's time to get outdoors for a "pick-your-own-apple adventure", and to reflect on the harvest of regulatory changes impacting registrants. Read some slices below from CIRO's latest reports, the CSA's proposals for investment fund continuous disclosure, and more.

In this bulletin:

1. Getting to the Root of Continuous Disclosure for Investment Funds: Proposed Modernization

The Canadian Securities Administrators (**CSA**) recently released proposals to modernize the continuous disclosure regime for investment funds, which is intended to improve the quality of disclosure provided to investors as well as reduce unnecessary regulatory burden of certain requirements. The proposals impact all the key rules governing investment funds, including National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (**NI 81-101**), National Instrument 81-102 *Investment Funds* (**NI 81-102**), National Instrument 81-106 *Investment Fund Continuous Disclosure* (**NI 81-106**) and National Instrument 81-107 *Independent Review Committee for Investment Funds* (**NI 81-107**) (collectively, the **Proposed Amendments**). The British Columbia Securities Commission has not published the proposals at this time given the upcoming provincial election but is anticipated to do so shortly thereafter.

The Proposed Amendments would replace the annual and interim Management Report of Fund Performance (**MRFP**) with a new annual and interim fund report (a **Fund Report**). As a separate workstream, the CSA is proposing to provide an exemption from certain conflict of interest reporting

requirements if similar, new requirements are satisfied. As a third workstream, the Proposed Amendments would eliminate certain class/series level disclosure from investment fund financial statements.

The new Fund Report form is intended to be an improved update document for investors that is also easier for reporting issuer investment funds to put together. The CSA worked together with a behaviour insights consulting firm (Behavioural Insights (Canada) Ltd.) to suggest the appropriate form of the report. The consultant's background work has been published to the CSA website for those seeking further information on its research and process.

According to the notice accompanying the Proposed Amendments, the Fund Report has been improved as follows:

- Streamlined required disclosure to help investors focus on the most pertinent information;
- Thematically chunked information to avoid investors having to review different sections of the document;
- More bullets and less use of narrative;
- Call-out boxes for definitions and key concepts for ease of understanding;
- Opportunities to summarize the information in certain sections of the form; and
- Directions for investors to find more information in different documents.

A sample form is included in the Proposed Amendments, where the use of information boxes and call-out boxes is readily apparent.

Certain information is proposed to be deleted from the form, including several metrics in the "Ratios and Supplemental Data" table and provision of five years of cost information (only one year will be required). Other deletions include some of the information in the "Management Fee" section, and the requirement to provide performance information in respect of each series/class of a fund; instead, only the series or class with the **highest** management fee will be provided (as well as the performance of any other series/class for which performance will vary based on a characteristic besides fees).

It is intended that the section of the Fund Report describing the fund's investment objectives and strategies will require an overview of the manager's view of the success of the fund in achieving its investment objectives and using its investment strategies to achieve those objectives, and factors that are reasonably likely to materially impact the ability of the fund to do so. There are instructions provided for funds with environmental, social and governance (**ESG**) related aspects with respect to this section. For example, a fund will be expected to discuss how its use of proxy voting, shareholder engagement and issuer engagement, as applicable, as principal investment strategies satisfied the stated ESG-related aspects of the fund's investment objectives or the stated ESG-related criteria for the investment strategies. It will be interesting to review the comments on this section to determine the industry's comfort level with the proposed disclosure.

Several other changes have also been proposed. As an example, regulators have been closely following potential liquidity issues for certain types of investment funds. The Fund Report will have a new requirement

to include disclosure of the liquidity profile of the investment portfolio of the fund. The quarterly portfolio disclosure will also be moved to a new standalone form pursuant to amendments to NI 81-106.

The second workstream included in the Proposed Amendments involves removing the related party transaction disclosure that is currently required in the MRFP in favour of a new appendix report (prepared by the fund manager) to the annual report to securityholders that an Independent Review Committee must prepare under NI 81-107. The IRC report is already required to include disclosure of certain related party transactions, and the new appendix will standardize this disclosure and disclosure of other transactions currently subject to reporting in securities legislation. If the form is completed, managers will be exempt from the requirement found directly in the securities legislation of certain jurisdictions to separately file certain related party transaction reports (e.g. under section 117 of the *Securities Act* (Ontario)). The proposed exemption from the overlapping statutory reporting requirements is intended to clarify reporting obligations, standardize information requirements, and remove unnecessary duplication.

In the third workstream, it is proposed that certain class/series level of disclosure be removed from the Statement of Comprehensive Income, the Statement of Changes in Financial Position, and the notes to the financial statements, including disclosure in the notes identifying the differences between the classes/series of a fund.

Other minor amendments include utilizing the term Fund Expense Ratio (**FER**) in a fund's Fund Facts or ETF Facts as the sum of the fund's management expense ratio and trading expense ratio, as well as certain editorial revisions to the simplified prospectus form. The change regarding FER disclosure would align with what will be required in the annual report on charges and other compensation pursuant to the total cost reporting amendments.

The CSA intends to engage with its Investor Education Committee to consider how the CSA can obtain strong investor awareness and understanding of the new Fund Report. The CSA has asked twenty specific consultation questions in addition to seeking general feedback on the proposals, including with respect to the frequency of preparation of the Fund Reports, how many years of FER disclosure should be required, and the type of educational tools needed to support investor understanding of the Fund Report. They have also asked for data and information to help evaluate the effects of the Proposed Amendments. Comments are due by **January 17, 2025**. If you wish to comment on or discuss the Proposed Amendments, please contact a member of our team.

2. Nurturing Compliance: CSA Publishes FAQ on Derivatives Business Conduct Rule

On September 12, 2024, the Canadian Securities Administrators (**CSA**) published a list of answers to frequently asked questions (**FAQ**s) they have received about National Instrument 93-101 *Derivatives: Business Conduct* (**NI 93-101**), in force on September 28, 2024. The CSA notes that the purpose of the FAQ is to assist firms with implementation while also preserving flexibility, where possible, to help firms operationalize the requirements under NI 93-101 based on the particulars of their business framework.

As a brief reminder, NI 93-101 marks Canada's long-awaited introduction of a business conduct rule for the derivatives markets, the last of the G20 countries to do so. In substance, many of the rules that derivatives advisers and dealers will be subject to in NI 93-101 are similar to those that securities registrants are subject to under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. A derivatives firm under NI 93-101 refers to derivatives advisers and dealers, that is, persons or companies who engage in or hold themselves out as engaging in the business of advising others in respect of derivatives or trading in derivatives, respectively, and any other person or company required to be registered as a derivatives adviser or dealer under securities legislation. The NI 93-101 regime regulates the business conduct of derivatives advisers and dealers in the over-the-counter (**OTC**) derivatives market, that is, NI 93-101 applies only to certain derivatives products.

The FAQ covers various grounds, including answering general questions such as how a derivatives firm can determine the types of derivatives products subject to NI 93-101 (in Ontario, reference is made to OSC Rule 91-506 *Derivatives: Product Determination*). There is also information regarding how foreign derivatives dealers and advisers can submit Form 93-101F1 to perfect their reliance on certain exemptions from the provisions of NI 93-101; assistance with definitions and interpretations, including with respect to "eligible derivatives parties"; and additional guidance regarding the designation and responsibilities of a "senior derivatives manager", among others.

Interested readers are encouraged to review the full FAQ. It should be noted that the CSA has indicated that the FAQ may be updated from time to time. As such, derivatives firms should be on the look out for additional FAQ guidance in the future.

If you have any questions regarding the FAQ, NI 93-101 or the applicability of the instrument to your business, please contact us.

3. OSC Study on Ripening Changes of AI in Retail Investing

Earlier this month, the Ontario Securities Commission (**OSC**) released a report on research performed in conjunction with the Behavioral Insights Team (**BIT**) into the role that artificial intelligence (**AI**) plays in supporting retail investor decision making. The experiment and research performed is in line with the OSC's mandate to provide protection to investors from unfair, improper or fraudulent practices and to contribute to the stability of the financial system and the reduction of systemic risk.

The OSC collaborated with the BIT to provide a research-based overview of:

- The current use cases of AI within the context of retail investing; and
- The effects of AI systems on investor attitudes, behaviours, and decision-making.

To do this, the teams used two research streams:

- A literature review and environmental scan of investor-facing AI systems to identify the current use cases of AI that are retail investor-facing; and

- A behavioural science experiment to determine how the source of an investment suggestion (AI, human, or a combination) impacts the extent investors follow that suggestion.

Based on the literature review, the report identified three broad use cases of AI which are specific to retail investors, being decision support (where systems provide recommendations to investors), systems that automate portfolio management, and systems that facilitate scams and fraud.

The report highlighted some benefits associated with some of these use cases, including reduced cost of personalized advice, increased access to financial advice, and improved decision making in areas such as portfolio diversification and risk management.

The report also explored some risks that are associated with the adoption and use of AI systems by retail investors, including the biases and assumptions embedded in AI models, herding behaviour/convergence of investment strategies, and potential poor outputs due to poor data quality at the outset.

The second part of the experiment looked at hypothetical investment suggestions for three types of assets: equities, fixed income, and cash. The investment suggestions came from a human financial services provider, AI investment tool and a human financial services provider using an AI tool. The team found that people who received investment suggestions from a human using an AI tool followed that suggestion more closely that the other two sources. Although, this was a scenario using hypothetical money, the results may vary in a real-world setting. Readers of the report were strongly cautioned that the differences shown did not meet the testers' stringent statistical thresholds. It was noted that there is an ongoing need to better understand the provision of investment recommendations from AI systems:

> "In particular, there is a need to ensure that algorithms are based on high quality data, that factors contributing to bias are proactively addressed, and that these applications prioritize the best interests of investors rather than the firms who develop them."

If you have any questions on the report, or how your firm can start to formulate AI policies, please contact us.

In Brief

Fruitful Updates in CIRO's Annual Report

On September 19, 2024, the Canadian Investment Regulatory Organization (**CIRO**) released its Annual Report for 2023-2024 (the **Annual Report**), alongside the inaugural Investor Advisory Panel (IAP) Annual Report (the **IAP Report**). These reports provide a comprehensive update on the activities of CIRO over the last year.

The Annual Report includes enforcement, financial, and governance information that will be of interest to all CIRO stakeholders. The Annual Report opens with an indication that in fiscal year 2025, CIRO will focus on publishing Phase 4 of the Rule Consolidation Project, complete its consultation on the Integrated Fee Model

(for implementation in the 2026 fiscal year), and develop proposals to harmonize continuing education regimes, among other things.

In a discussion measuring its progress against its priorities, it is noted that CIRO will continue the project it has begun to develop rules to expand the group of Approved Persons that are permitted to conduct activities for Dealer Members through a corporation (i.e. directed commissions). Under "business as usual", CIRO intends to finish their sweep on CFR Phase 2, deal with public comments on its fully paid lending and financing arrangement rule amendments, develop surveillance tools to review over-the-counter trading activity of crypto assets, and implement the first phase of a Public Analytics Data Portal to provide access to aggregate trading information. CIRO will also issue a survey to members to elicit feedback on its regulatory effectiveness and efficiency.

The Annual Report also mentions CIRO's intention to propose changes to its Arbitration Program to make it available to clients of both investment dealers and mutual fund dealers along with enhancing accessibility, efficiency and transparency of the arbitration process. CIRO will also be proposing amendments to existing rules to accommodate the structure of exchange traded funds, recognizing the role of the Authorized Participants and the relationship between the primary and secondary markets.

The IAP Report discusses the activities of the IAP in its first year, including its participation in a variety of consultations such as CIRO's strategic initiatives, the future direction of CIRO's arbitration program, and CIRO's new proposed proficiency model.

Seeds of Change: CIRO Updates Rule Consolidation Progress

On September 12, 2024, CIRO released a Rule Consolidation Project Update, providing very useful information on the project status, comment period participation and decisions made to date by CIRO. Of note, rather than wait until the completion of the project, CIRO announced some decisions already made with respect to prior phases.

For example, CIRO has decided not to allow mutual fund dealers to offer managed accounts, but subject to the approval of the Canadian Securities Administrators, will allow mutual fund dealers to offer margin and use client free credit balances within their operations. Consolidation of rules regarding business conduct matters have been moved up to Phase 4 from Phase 5, to allow for earlier review by stakeholders.

The update also provided timelines for Phase 4 and Phase 5 of the project and noted that CIRO plans to complete all rule consultations and publish the complete rules again as a whole for comment in winter 2025-2026.

Important Reminders

Pruning the Process: Surrendering Registration

A firm may want to surrender its securities registration in one or more categories in Ontario for a variety of reasons, usually when it ceases or intends to cease conducting registerable activities. The surrender will not

be accepted until the registrant can demonstrate to the regulators that **(i)** all financial obligations of the person or company to clients have been discharged; **(ii)** all requirements for the surrender of registration have been or will be fulfilled in an appropriate manner; and **(iii)** the surrender of the registration is not prejudicial to the public interest.

To apply, registrant firms must complete and file an application letter in accordance with the template provided by the Ontario Securities Commission and filed through its online portal. The application must include specified information, including a description of:

- why the firm has ceased or plans to cease registerable activities;
- the business activities of the firm including non-registerable activities and its future planned activities;
- what has happened to the firm's clients;
- confirmation whether the firm holds or has ever held client assets; and
- if the firm runs a fund, whether the fund has been liquidated or had its assets transferred to another registrant.

Various documents must be included with the application, including an officer's/director's certificate, and audited financial statements (or unaudited interim financial information). Among other things, the certificate must confirm that there are no existing or potential claims or liabilities against the registrant by its clients, and no unresolved complaints against the firm by its clients. Also required is an auditor's comfort letter dated after registerable activities have ceased, or a specified procedures report showing evidence that all financial obligations to clients have been discharged.

Registrants are reminded that those wishing to surrender in advance of year end should submit the application no later than **December 6, 2024**, before the deadline for payment of capital markets participation fee is due on **December 31, 2024**.

BLG Resource Corner

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

- The OSC wants registered firms' "go bags" packed and ready: how firms can tailor their packing lists and how owners can protect their legacies
- CIRO investment dealer proficiency requirements: What's new and what's next
- Not "trusting" average Canadians: Exceptions added to new trust reporting rules
- Let's inspect the OSC's 2024 Registration, Inspections and Examinations Division Summary Report

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.