Back to School

Bulletin

August 28, 2015

We normally associate August with frenzied preparations for a new academic year. But some may also know that this month's namesake is Augustus, Rome's first emperor. This shrewd ruler combined lawmaking, institution-building and military might to lay the foundations of an empire that lasted for nearly 1,500 years. August was the month of his greatest victories.

Our mission this month is humbler: to inform you of current and upcoming developments that may affect your business. Please contact your usual lawyer at AUM Law if you would like to discuss any of these topics.

1. Are You Ready for CRM2?

The next phase of CRM2 is around the corner! We recommend that you speak with us to ensure that your compliance systems observe the new rules well in advance of the December 31, 2015 deadline. Your client statements relating to the period ending on December 31, 2015 must include the following new items of disclosure:

- securities subject to a deferred sales charge
- if applicable, the name of the securities' custodian and a description of the way they are held
- position cost information for each security and a total for all securities in the account, for which you must choose between providing either book cost or original cost information (if neither is available, you have certain options you can consider)
- the market value for securities held in the account – calculated as of the last net asset value for investment funds, and the last bid or ask price for publicly traded securities; in the case of private or illiquid securities, you can estimate the value or list their value as "not determinable"

Regarding the requirement that client statements disclose the securities covered by an investment protection fund, CSA Staff Notice Notice 31-341 states:

> The requirement to identify securities that may be covered under an investor protection fund in their additional statements does not have to be met (we plan to publish a proposal to amend this requirement at a later date). IIROC's existing investor protection fund disclosure requirements remain in effect. The MFDA has introduced equivalent requirements that will come into effect as of December 31, 2015.

2. Does Your Policies and Procedures Manual Need TLC?

Pursuant to section 11.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103), a registered firm is required to establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation, and to manage the risks associated with its business in accordance with prudent business practices. This means that registrants should review and update their policies and procedures regularly to ensure that their business practices continue to address their obligations with respect to evolving securities laws (and other applicable legislation).

There have been several changes in the legal landscape over the past year that require registrants to revisit their policies and procedures, make any necessary changes, and update their policies and procedures compliance manuals.

In addition to a general review, we suggest you target the following written policies and procedures to assess whether they require updating:

- **Cybersecurity**. The recent Ashley Madison hack certainly serves as a reminder of the importance of cybersecurity. As discussed in our June 2015 bulletin and as highlighted in the Ontario Securities Commission's (OSC) June 24, 2015 outreach seminar, this area of focus in compliance and risk management is gaining momentum in the financial industry, which is the number one target industry for cyber criminals. Registrants should review their cybersecurity policies and procedures in light of this heightened focus. Strong and tailored cybersecurity measures are an important element of your controls, operational reliability and protection of confidential information. Please contact a member of our Regulatory Compliance Group for information about our fixed-fee cybersecurity services module, aimed to help registrants meet their internal control obligations and stay ahead of cybersecurity risks.
- **NI 45-106 exemptions and new risk acknowledgement form**. Effective May 5, 2015, a number of important changes to National Instrument 45-106 *Prospectus Exemptions* were implemented to address investor protection concerns, facilitate capital raising and further harmonize existing exemptions. Issuers and registrants should ensure that all of their compliance and client disclosure documents are updated to reflect those changes (including offering memoranda, subscription agreements, investment management agreements, and policies and procedures compliance manuals). For more information, see our February 2015 and March 2015 bulletins, and our April 2015 video presentation, or call us.
- **Outside business activities (OBAs).** In January 2015, the OSC announced that registered firms with registered or permitted individuals may apply for late fee relief for changes to OBAs that were previously reported on item 10 of Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals*. In light of this focus on compliance with the OBA reporting requirement and the hefty late filing fees for non-compliance, registrants should review their policies and procedures compliance manuals with respect to OBAs to ensure they understand what is required to be filed, and the prescribed filing deadlines. For more information, see our January 2015 bulletin or call us.
- **Expense allocation.** Securities regulators in the United States and Canada have recently signalled (through staff guidance, and compliance and enforcement actions) that they are increasingly concerned about perceived issues with fund manager expense allocation practices. In light of these developments, fund managers should review their written expense allocation practices to ensure that they manage – and are seen to appropriately manage – the conflicts of interest that may arise with expense allocation practices. In addition, fund managers should ensure they are able to demonstrate that the allocation of expenses between the manager and the funds it manages, and across multiple funds, is consistent with the fund manager's written policies and procedures. See our November 2014 bulletin for more information.
- **Canada's Anti-Spam Legislation (CASL).** Effective July 2014, CASL applies to all electronic communications sent with a commercial purpose from Canada or accessed in Canada.

As a result, many everyday activities such as sending emails or electronic newsletters to clients are subject to the new legislation. To avoid hefty penalties, registrants will want to ensure that their policies and procedures have been updated to reflect this important change in business practices. See our August 2014 nutshell for more information.

- **Ombudsman for Banking Services and Investments (OBSI).** As of August 2014, all registered dealers and advisers outside of Québec are required to use OBSI as their independent dispute resolution services provider. Disputes that arise in Québec continue to be administered by the Autorité des marchés financiers (AMF). Registrants will want to ensure that their policies and procedures compliance manuals reflect their current dispute resolution regime. See our January 2014 bulletin and May 2014 nutshell for more details.
- **CRM2.** As discussed above, CRM2 is the Canadian Securities Administrators' (CSA) client relationship model project, developed to enhance the relationship disclosure obligations set out in NI 31-103 by imposing additional reporting requirements in four transitional periods between 2013 and 2016. December 31, 2015 marks the effective date of the next phase of CRM2 and the last phase comes into effect on July 15, 2016. See our January 2014 nutshell for more details.
- **Anti-money laundering and anti-terrorist legislation.** In February 2014, amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* (AML Regulations) came into force for registrants (as described in our January 2014 bulletin). Among other obligations, the amendments require registrants to collect certain information at the account opening stage. Registrants should ensure that their policies and procedures reflect those obligations. In addition, on July 4, 2015, long-awaited amendments to the AML Regulations were published for comment. Policies and procedures compliance manuals will likely require revisions when these amendments are expected to come into force. See our July 2015 bulletin for more information.
- **FATCA.** The Foreign Account Tax Compliance Act (FATCA) is a complex reporting and withholding regime enacted by the US government in March 2010. Investment fund managers, portfolio managers and exempt market dealers are subject to FATCA, and may have reporting requirements under the regime. Registrants will want to ensure that their written policies and procedures with respect to FATCA reflect their current business practices. See our April 2015, May 2014 and December 2014 bulletins for more details.
- **Privacy policies and procedures**. Registrants that handle personal information in the course of their commercial activities will want to undertake a review of their privacy policies and security safeguards in light of the new measures now in force under the *Digital Privacy Act* that introduce new provisions to the *Personal Information Protection and Electronic Documents* Act. See our June 2015 bulletin for more information.

Please contact a member of our Regulatory Compliance Group for assistance with updating your policies and procedures compliance manual to reflect your current business practices and the above legislative developments.

3. Scope of Future-Oriented Relief for Pooled Funds Investing in Related Pooled Funds

Exemptive relief may be required from the conflict of interest investment restrictions in securities legislation to permit a pooled fund to invest in a related pooled fund. For example, relief is generally required to place a trust on top of a related limited partnership.

Recently, OSC Staff have begun to limit the scope of the future-oriented relief they are willing to grant that would be applicable for any future fund-on-fund structures. The scope of the future-oriented relief that is requested in these applications has, historically, been broader than the specific fund-on-fund structure being contemplated in the application. In the July 2015 issue of *Investment Funds Practitioner* released by the OSC's Investment Funds and Structured Products Branch, Staff recognized that they have provided broad

future-oriented relief in the past, but that they are now generally limiting such relief to structures substantially similar in features and purpose to the actual "live" structure being contemplated in the application.

The terms and conditions that are set out in the decision document address the conflicts that are inherent in the specific fund-on-fund structure being contemplated, and may not necessarily address the conflicts that would be inherent in a different fund-on-fund structure (such as a future fund-on-fund structure that has not yet been planned and that may involve different entities or different jurisdictions of formation). As a result, if a future fund-on-fund structure deviates from the structure and representations provided in the initial exemptive relief application, Staff will likely refuse to provide such relief, and another application in the future will be required once the specific structure is determined.

To minimize delays in the receipt of a decision document for a current transaction, please speak with a member of our Investment Funds Group. We have recently worked on a number of these applications and are familiar with the scope of the permitted relief.

4. Prospectus Review Priorities

In the July 2015 issue of *Investment Funds Practitioner*, the OSC highlights three areas of disclosure that Staff are reviewing during their prospectus reviews, and discusses their expectations with respect to such disclosure:

- **Multiple Classes or Series Offered.** The disclosure of the different classes or series that are being offered should be sufficiently clear. Staff expect the disclosure to be in plain language and clear for each class or series so that the disclosure assists investors to distinguish the differences between the classes and series and better understand their purpose. The disclosure should include: the intended investor type for each class or series; the fee model with respect to each class or series, if applicable; and the dealer compensation for each class or series. Sufficient disclosure should also be provided regarding switches (automatic and default) between classes or series.
- **Fees and Expenses.** A summary of all applicable fees and expenses should be set out in plain language and clear so that all investors can understand the purpose of the fee and the services/activities that the fee covers. It appears from Staff's comments that Staff will review the disclosure of the fees and expenses to determine if there is any duplication of fees and expenses and, importantly, whether the overall costs of the fund are comparable to similar investment funds and not contrary to the public interest.
- **Investment Objectives and Strategies.** The investment objectives and strategies of a fund should provide investors with a clear and accurate picture of the fund and its investments in particular asset classes. The disclosure should allow investors to distinguish between multiples funds that are within the same prospectus or fund family, and understand the differences between funds with similar names and/or investment strategies. All material risks associated with the fund's investment objectives and strategies should also be identified.

The OSC's current prospectus review priorities are intended to (i) encourage more consistent disclosure by investment funds to enhance the comparability of the above three topics; (ii) promote disclosure of all relevant information to investors in a clear, understandable and accurate manner; and (ii) provide more focused comments to issuers that are of particular importance to investors to assist them in making more informed investment decisions. Issuers should expect Staff to challenge boiler plate disclosure during their prospectus reviews, and to request more detailed disclosure in line with the above expectations. If you are starting a fund or renewing a fund's prospectus, please speak with a member of our Investment Funds Group about disclosure matters.

5. Revocation of Derivatives Blanket Order in Québec

In its August 6, 2015 bulletin, the Autorité des marchés financiers (AMF) reminds all unregistered firms and individuals availing themselves of Blanket Order No. 2009-PDG-0007 (the Blanket Order) in Québec that

- the Blanket Order will be revoked as of September 5, 2015 (for the April 22, 2015 revocation order, see the AMF's bulletin dated April 30, 2015, Vol. 12, No. 17) and
- they will have to file – *no later than September 4, 2015* – a completed form 33-109 F6 *Firm Registration* with AMF to continue dealing in listed options and futures derivatives for which an exemption was available in the Blanket Order.

The AMF also points out to persons who are not participating dealer members of the Investment Industry Regulatory Organization of Canada (IIROC) that they will also have to concurrently file an application with IIROC, as it is a prerequisite for registration as a derivatives dealer with AMF. Applicants are expected to complete their registration within 6 months of filing.

All entities who are relying on the Blanket Order and intend to continue to deal in these listed options and futures in Québec should immediately consider applying for registration as derivatives dealers under the Québec Derivatives Act if they have not done so. Discretionary registration exemptions may also be granted by the AMF. The existing statutory exemptions for over-the-counter derivatives and standardized derivatives are not affected by this revocation.

6. CSA Propose Harmonized Reporting for the Exempt Market

The CSA have proposed amendments to National Instrument 45-106 *Prospectus Exemptions* (NI 45-106) that would create a new single harmonized report of exempt distribution (the Proposed Report) for issuers and dealers (filers) across Canada. The CSA indicate that the new amendments aim to reduce the compliance burden for filers by having a harmonized report of exempt distribution.

The Proposed Report streamlines the process for reporting exempt distributions, which will be a welcome change for issuers and underwriters. However, the information required under the Proposed Report may lead to a greater compliance burden and therefore may be less well received by some issuers and underwriters.

Currently, there is one form of report of exempt distribution for British Columbia (Form 45-106F6 *British Columbia Report of Exempt Distribution* (the Current BC Report)), and one form of report of exempt distribution for the rest of Canada (Form 45-106F1 *Report of Exempt Distribution* (collectively, the Current Reports)).

Last year, the CSA proposed for comment a new form of report of exempt distribution (the February 2014 Proposal) and certain jurisdictions (Ontario, Alberta, Saskatchewan and New Brunswick) separately proposed for comment two new forms of reports of exempt distribution (one for investment funds, and one for non-investment funds) (the March 2014 Proposals). The CSA indicate that the comments received on those proposals have informed this latest proposal. Notably, a number of the information requirements included in the March 2014 Proposals are *not* required in the Proposed Report, including:

- certain information that can be gathered through an issuer's continuous disclosure filings, SEDAR, or from a registered firm's profile on the National Registration Database; and
- age range of purchasers, name of the parent of the issuer, and business email addresses of the underwriter's CEO.

The quarterly filing requirement for investment funds in the March 2014 Proposals has (thankfully) been replaced with a new filing deadline of within 30 days after the calendar year end (i.e., by January 30) for certain investment funds.

The proposed amendments also contemplate carve-outs from certain information requirements for investment fund issuers, reporting issuers and foreign issuers (and their wholly owned subsidiaries) and issuers distributing eligible foreign securities only to permitted clients.

The Proposed Report would require issuers and underwriters to disclose some additional information, including the following:

Information Requested in Proposed Report	Non-Investment Fund Issuers	Investment Fund Issuers
Name, title and province, state or country of residence of directors, executive officers, control persons or promoters	• the identities of the directors, executive officers, control persons and promoters of certain non-reporting issuers, and the number of, and total price paid for, voting securities of those issuers beneficially owned or directly or indirectly controlled by those persons	• no similar requirement
Residential address of directors, executive officers, control persons and promoters	• the full residential addresses of each of the directors, executive officers, control persons and promoters of certain non-reporting issuers (in a separate schedule that will not be publicly available)	• no similar requirement
Primary industry/type	• the stage of development if the issuer is in the mining industry and type of business operations if the issuer is involved in certain investment activities (including mortgages, real estate, commercial or business debt, or consumer debt) • details of the primary business of the issuer using the North American Industry Classification System codes and three-letter code categories for information regarding the type of securities distributed	• the type of investment fund • the date of formation, financial year-end, jurisdictions where reporting and stock exchange listings
Net proceeds of investment fund	• no similar requirement	• the net proceeds (meaning the gross proceeds realized in the jurisdiction from the distribution(s) less the gross redemptions relating to such distribution(s)) per jurisdiction
Size of issuer	• a range of the approximate number of employees to serve as a proxy for the size of the issuer and (if the issuer does not have a SEDAR profile) the range of the size of the issuer's assets	• the range of the net asset value of the fund
Compensation information	• the identity of insiders, registrants or other individuals or entities being compensated and disclosure regarding those persons compensated, including whether that person is an employee of the issuer or connected to the issuer	
Offering materials	• a list of all offering materials that are required to be filed with or delivered in connection with the distribution under the securities legislation of Saskatchewan, Ontario, Québec, New Brunswick and Nova Scotia (e.g., an offering memorandum)	

The Proposed Report also provides detailed instructions for the filer when completing the report. For example, the Proposed Report provides that issuers and underwriters are required to collect information from a registered advisor, trust company or trust corporation purchasing securities on behalf of a fully managed account under subsections 2.3(2) and (4) [*Accredited Investor*] of NI 45-106 regarding each beneficial owner of the fully managed account (the address, telephone number, email address, number of securities purchased, total purchase price, whether the beneficial securityholder is an insider of the issuer or a registrant, etc.) and include this information in their report.

For more information on the proposed amendments, see the CSA Notice and Request for Comment – Proposed Amendments to NI 45-106 *Prospectus Exemptions* relating to Reports of Exempt Distribution.

The CSA are accepting comments on the proposed amendments until October 13, 2015. If you are interested in providing comments, or if you require more information about the Proposed Report, please contact a lawyer in our Regulatory Compliance Group.

7. FINTRAC Examinations: Forewarned is Forearmed

If you are a "reporting entity" for purposes of Canada's anti-money laundering legislation, you are subject to a compliance examination by FINTRAC officers. Reporting entities include securities dealers and portfolio managers. Also included are life insurance agents and brokers, and money service businesses.

The FINTRAC examination process typically begins with a telephone call to the chief compliance officer. A letter will follow, advising that the examination has commenced. The letter will generally advise that as the examination has begun, any reportable transaction that has occurred during the period under review and has not been reported is to be considered as not having been reported and could result in a deficiency. Likewise, any other "compliance program document", including policies and procedures "found to have been created or adjusted after the date of the letter may result in a deficiency and potential violation."

The message here is clear: a reporting entity cannot backfill inadequate policies and procedures, or complete an independent effectiveness review, or file reports that are past due, once the FINTRAC compliance examination begins. The time to complete those policies, procedures, risk assessments, independent review is *before* any examination begins.

8. Draft *Capital Markets Act* and Regulations

The jurisdictions participating in the Cooperative Capital Markets Regulatory System released for public comment a revised consultation draft of the uniform provincial/territorial *Capital Markets Act*, as well as a draft of the initial regulations. This is an important step in the transition to the Cooperative Capital Market Regulatory System. The materials are available at http://ccmr-ocrmc.ca. The comment period will run to December 23, 2015.

The proposed legislation and regulations have been based on existing requirements in the participating jurisdictions, which are intended to minimize disruption to market participants and facilitate the regulatory interface with non-participating jurisdictions. However, the proposed framework represents a significant advance towards harmonization by eliminating several of the carve-outs and local variations from the current patchwork of national and multilateral instruments, local rules, policies and forms. Harmonization towards a single set of consistent requirements across the participating jurisdictions would be a significant improvement for market participants.

The regulatory regimes for derivatives in the participating jurisdictions are not currently harmonized. The initial regulations provide for the adoption of the exchange contract model for exchange-traded derivatives and maintains the regulation of over-the-counter derivatives as securities for certain purposes as an interim step. However, the draft legislation contemplates the development of a new regulatory regime for both exchange-traded and over-the-counter derivatives, similar to the recent amendments to the *Securities Act*

(Ontario) and other jurisdictions. This structure will allow for the combination of the regulatory reform regarding derivatives currently being undertaken by members of the CSA.

Additional draft regulations regarding prospectus exemptions and fees will be published in the future to allow for additional work to resolve differences in the existing rules of the participating jurisdictions. We will continue to monitor developments related to the Cooperative Capital Markets Regulatory System and keep you updated. In the meantime, if you have questions, please contact a member of our Regulatory Compliance Group.

9. Global Intermediary Identification Numbers (FATCA)

Financial Institutions, as defined under the Foreign Account Tax Compliance Act (FATCA), and which generally include most investment fund managers, portfolio managers and exempt market dealers, were required to have applied for a Global Intermediary Identification Number (GIIN) before January 1, 2015.

If you have not already applied for a GIIN, or you are unclear about your FATCA obligations, a member of our Investment Funds Group would be pleased to answer your questions and assist you with coordinating your FATCA compliance strategy.

10. Legal Entity Identifiers (Derivatives)

Over-the-counter (OTC) derivatives trade reporting, pursuant to OSC Rule 91-507 *Trade Reporting and Derivatives Data Reporting*, commenced on October 31, 2014 for derivatives dealers and clearing agencies, and on June 30, 2015 for all other counterparties. To satisfy reporting requirements, a 20-character code called a legal entity identifier (LEI) is used to identify entities that enter into derivatives transactions. Every reporting and non-reporting counterparty to an OTC derivatives transaction must have an LEI to meet their obligations under the rule.

If you have not yet obtained an LEI or are unsure whether you require one, please contact a member of our Regulatory Compliance Group for assistance.

11. Ch-ch-ch-Changes…

Registered firms have ongoing obligations under securities legislation to inform the OSC of the following changes to a firm or a registered individual's information. Failure to notify the OSC within 10 calendar days of most of these changes can lead to a $100 late fee per day up to a maximum of $5,000 per year, going back two years ($10,000):

Changes to Firm	Changes to Registered and Permitted Individuals	Changes to Operations
• Operations (e.g., organizational structure, officers and directors) • Ownership or anticipated acquisition of securities of another entity • Insurance, auditors and constating documents (e.g., articles of amendment)	• Individual Forms 33-109F4 • Outside activities*	• Offering of new products/business lines

*As mentioned in 2. Updating Your Policies and Procedures Manual above, the OSC has been imposing late filing fees for failure to disclose all outside activities of individuals (i.e., directors, officers, trustees, shareholders and other roles). If you are unsure what is considered an outside activity, please contact us for further analysis and potential filing.

An ounce of prevention is worth a pound of cure. Contact a member of our Regulatory Compliance Group to ensure that you are compliant.

12. Osgoode Intensive Course in Securities Law and Practice

Last but not least, you may be interested to know that Erez Blumberger (our Chief Regulatory Counsel) and Kimberly Poster (our Chief Counsel, Investment Funds) will be presenting the "Registration and Investment Funds" section of Osgoode Professional Development's *Intensive Course in Canadian Securities Law and Practice*, designed to teach the fundamentals of Canadian securities law in four evenings. Their session, which will be held on October 21 at 6:00 pm, will cover the following topics:

- Requirement to register and exemptions
- Process for getting registered
- Ongoing requirements for registrants
- When do you need exempt market dealer registration
- What are investment funds
- Developments in investment fund regulation

The course is eligible for CPD hours. More information and registration are available via the Osgoode Professional Development website, by calling 416.597.9724 or 1.888.923.3394, or by emailing osgoodepd@osgoode.yorku.ca.