January 2016

Bulletin

Dear valued readers:

As part of new year's resolutions, the editors of the AUM Law bulletin have decided to move away from the irrelevant and tedious introductory language previously found in this space. No more silly puns, anecdotes or tortured attempts at humor. Moving forward, this bulletin will be devoted to the serious business of law.

In this bulletin

OM and Crowdfunding Exemptions ● Outsourced CCOs ● Referral Arrangements

1. Risk Classification for Use in Fund Facts

Last month, the Canadian Securities Administrators (CSA) republished proposals relating to the Fund Facts document mandated for public mutual funds. The CSA is continuing to propose a specific risk classification methodology for fund managers, which will determine the investment risk level of mutual funds (as well as ETFs in the proposed ETF Facts document). Currently, managers are permitted to use their own methodology to determine the risk classification for their funds, although in practice many managers utilize the classifications set out by the Investment Funds Institute of Canada (IFIC). The proposals would require that managers utilize standard deviation as the risk indicator, which is also currently used by IFIC. While the first set of proposals released two years ago would have changed the number of risk categories to six, the most recent proposals retain the current five category scale. The standard deviation ranges used to identify the risk category will be consistent with those used by IFIC. For those funds lacking the 10-year performance history, the manager can choose a reference index in accordance with the stated principles. New requirements have been added to deal with the calculation where the mutual fund has undergone a reorganization or transfer of assets, or where there has been a change of fundamental investment objectives. While the original proposals would have required a manager to reassess the risk level every month, in response to comments, the CSA has now proposed that the level only be determined each time a Fund Facts (or ETF Facts) document is filed, and at least annually. The CSA is accepting comments on the proposal until March 9, 2016.

For more information on this topic, please contact a member of our Investment Funds Group.

In Brief

The new **offering memorandum and crowdfunding exemptions** are now in full-effect – the OM exemption is now available across Canada. See our October and November bulletins for background information.

The Securities Exchange Commission recently published a risk alert warning of a growing trend of the **outsourcing of compliance activities by registrants to third parties**, problematic if the CCO merely "sets and forgets". There were, however, some instances when the third party, be it a consultant or law firm, effectively administered the registrant's compliance program. The common themes that made these relationships between registrants and third parties successful were found to be:

- Frequent and meaningful communication
- Outsourced CCOs that invested sufficient resources and time to registrants they serviced

2. Proposed Transition to Cooperative Capital Markets Regulatory System

The Capital Markets Regulatory Authority (CRMA) recently published a notice providing a summary of the proposed approach to transitioning market participants in each of the CMR jurisdictions (BC, NB, ON, PEI, SK and YT) to the Cooperative Capital Markets Regulatory System (CCMR). Their approach is intended to minimize the impact of transition on market participants and their businesses and in many cases, market participants would not have to take any action to continue their activities under the new regulatory system – existing regulatory arrangements will largely be carried over to the new regime. Some general principles of the approach to transition include:

- Decisions of a predecessor regulator would become decisions of the CMRA, and those decisions would have effect in all CMR jurisdictions (for example: registration decisions, prospectus receipts and exemptive relief decisions).
- Hearings, reviews and appeals in progress or requested prior to launch would continue to be heard by the panel or decision maker who was seized of the matter, or where no panel or decision maker is yet seized, would be heard by the CMRA or Tribunal, as appropriate.

The notice also includes a chart that sets out how the general principles would apply in various situations when the CCMR launches.

Market participants can expect further communications from regulatory staff in the CMR jurisdictions with more information on transition, including any local transition matters, and what steps, if any, would be required to be taken by the market participant.

Please contact us if you would like to discuss this update.

> Empowerment of the outsourced CCOs to independently obtain records

The U.S. experience in this area has been mixed. Will the Canadian regime ever permit outsourcing of a registrant's CCO function?

Referral arrangements are a common source of new business for registrants. They are also a common source of regulatory scrutiny. When was the last time you considered whether your arrangements comply with securities laws? We can work with you on a fixed-fee basis to review the written referral agreement (you have one, right?) and explain your regulatory obligations.

3. Notifying Regulators of Corporate Changes

In January 2015, regulators amended NI 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103), to change the language in Sections 11.9 and 11.10 (the sections associated with providing advance notice to a regulator regarding changes in ownership), to simplify and clarify these provisions.

Prior to the January 2015 amendments, if Individual A owned 100% of a registrant and then decided to interpose a holding company between the individual and the registrant, no advance notice was required, as Individual A still beneficially/indirectly owned 100% of the registrant and could rely on exemption language in these provisions.

The January 2015 amendments removed the exemption language. Accordingly, advance notice may now be required, even when beneficial/indirect ownership has not changed.

Implications. We often advise registrants that are transferring their ownership in a registrant to a holding company for tax planning purposes or other corporate reasons. As mentioned, prior to January 2015, the transfer was expressly exempt from the advance notice requirement in Sections 11.9 and 11.10. However, with the removal of the exemption language, things are somewhat murky since there is no clear policy rationale for the removal of the exemption language.

What should I do? Please contact a member of our Regulatory Compliance Group to discuss the particulars of your transfer, and for advice regarding next steps.

4. General Partners, Registrants and Ownership Chart Reporting

In light of increasing scrutiny by regulators over National Registration Database (NRD) filings and disclosure (and the potential for late fees!) we want to stress that when creating or updating a registrant's ownership chart, consider whether to include all Specified Affiliates and Specified Subsidiaries.

Specified Affiliates mean a person or company that is a parent of the firm, a specified subsidiary of the firm, or a specified subsidiary of the firm's parent.

Specified Subsidiaries mean a person or company of which another person or company has significant control.

These two definitions are important as they speak to entities that the registrant controls or that the registrant's parent controls. For example, if a registrant operates an investment fund structured as a limited partnership, often the registrant or the registrant's parent may control the general partner of that partnership. Accordingly, technically there may be a requirement to ensure that the general partner of the partnership is included on the registrant's ownership chart that is filed or updated on NRD.

We note that while the above may be technically required, it is generally not well understood nor standard industry practice to consider and disclose all entities that would be considered a Specified Affiliate or a Specified Subsidiary of the registrant.

Please contact a member of our Regulatory Compliance Group to learn more about your reporting obligations.

5. Investment Dealer Exemption Announced

Exciting news (kind of)! The securities regulatory authorities in British Columbia, Alberta, Saskatchewan, Manitoba and New Brunswick – not Ontario – recently announced that they are each adopting a prospectus exemption that allows issuers listed on a Canadian exchange to raise money by distributing securities to investors, provided they have obtained advice about the suitability of the investment from an investment dealer (i.e., not an exempt market dealer). This is a prospectus exemption only, i.e., there is no corresponding registration exemption. Accordingly, the traditional registration business trigger analysis will still apply when relying upon this new exemption. The stated purpose for this new exemption is to facilitate capital raising for listed issuers and foster participation of retail investors in private placements, while maintaining appropriate investor protection. Some of the key conditions are:

- The issuer must be a reporting issuer in at least one jurisdiction of Canada and have a class of equity securities listed on the Toronto Stock Exchange, the TSX Venture Exchange, the Canadian Securities Exchange or Aequitas Neo Exchange Inc.
- The issuer must have filed all timely and periodic disclosure documents as required under securities legislation.
- The offering can consist only of a listed security, a unit consisting of a listed security and a warrant to acquire another listed security, or another security convertible into a listed security at the security holder's sole discretion.
- The news release announcing the offering must disclose, in reasonable detail, the distribution, including use of proceeds, and any material fact not yet generally disclosed, and to include a statement that there is no material fact or material change about the issuer that has not been generally disclosed.
- The investor must obtain advice regarding the suitability of the investment from an investment dealer.

This exemption marks an interesting regulatory development. The idea of doing away with the disclosure found in a prospectus or offering memorandum is not new. This idea was bandied about 15 or 20 years ago as part of regulatory discussions for an "integrated disclosure system" – a concept that never took hold. And reliance on suitability advice has for years been part of the Alberta version of the OM exemption. This new exemption marries both concepts.

In practice, it will be interesting to see if investment dealers will have the economic and risk appetite to provide the suitability advice contemplated by this exemption. Who knows, if it works well, we may eventually see it come to Ontario, much like the recent arrival of the OM exemption.

See CSA Notice 45-318 for more information.

6. Are You Relying on Section 8.6?

Section 8.6 of NI 31-103 provides an exemption whereby registered advisers (or international advisers exempted under section 8.26) do not require a dealer registration for trades in securities of non-prospectus qualified investment funds.

The exemption is available provided that:

- the registered firm acts as the fund's portfolio manager and investment fund manager
- trades are made only to managed accounts of the firm's clients

This exemption recognizes that advisers often establish pooled funds to facilitate the efficient investment of their clients' money. However, one aspect of the exemption that receives less attention is that firms that rely on it must provide written notice to the regulator within 10 days of its first use.

While there are no late fees in Ontario with respect to the filing of this notice, there may be regulatory implications of non-compliance.

Please contact a member of our Regulatory Compliance Group if you wish to discuss further.

7. More Fun for Exempt Market Filings in Canada

There are changes coming soon to the way you will deliver your OM and file your F1 with the regulators.

The members of the CSA (excluding Ontario and British Columbia) recently adopted amendments to the rules concerning exempt market filings, which will result in three different filing platforms across Canada: the OSC's Electronic Filing Portal in Ontario, BCSC eServices in British Columbia and SEDAR in all other provinces and territories. The amendments come into force on May 24, 2016.

We will continue to keep you apprised of developments in the months to come.

Upcoming Events

Erez Blumberger will be chairing a panel at this year's National Society of Compliance Professional's (NSCP) *Canadian Conference – Stickhandling Compliance Challenges*. Erez will be speaking from his unique perspective as an ex-regulator – offering guidance on the implementation of new rules and tips for interacting with regulators – among other topics.

The conference will take place Monday, April 4 at St. Andrew's Club. NSCP is extending a $50 registration discount for friends of AUM Law (discount code FRIENDSTO). Visit the conference page for more details, or to register.

AUM Law News

We are pleased to announce the addition of Mona Kumar as Senior Legal Counsel to our Investment Funds Group.

Mona comes to AUM Law with a wealth of knowledge in the investment fund and asset management space.

Welcome, Mona!