The Best of 2016

The most exciting night of the year is once again upon us. As you read this Bulletin, last minute preparations are taking place and anticipation is high for this evening's Noche de Rábanos, or Night of the Radishes. This annual event, which dates back to 1897, takes place every December 23rd in Oaxaca Mexico, with artisans creating elaborate sculptures from oversized radishes grown exclusively for the event. But don't eat them! These carvings are part of a fierce sculpture competition, with the winner taking home a substantial cash prize and even more street cred.

We at AUM Law have judged the regulatory landscape of 2016, and though there will be no cash prize, we have rounded up the top Regulatory Highlights of the Year (in no particular order). As an added bonus, we have linked our previous and related Bulletin articles should you wish to catch up on your reading over a glass of eggnog (or while the in-laws visit).

Happy Holidays and all the best for 2017!

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Regulatory Highlights of 2016

1. The OSC Has Been A Busy Beaver

As noted in our August 2016 Bulletin, the OSC had a record year with respect to the number of new initiatives it released to registrants.

The OSC signaled its goals to us early with the release of its Draft Statement of Priorities in March, focusing on consultations on a best interest standard; consultations on reforms under National Instrument 31-103 to improve the client/advisor relationship; and its analyses of advisor compensation practices, amongst other things.

In June, the OSC proposed a new rule for out-of-province distributions and called for comments on same. Stay tuned.

In July, the Compliance and Registrant Regulation (CRR) Branch of the OSC released its Annual Report, outlining its own set of priorities and affirming that compliance reviews in the year ahead will focus on high risk firms, conflicts of interest relating to sales incentives and compensation practices, and compliance with new regulatory requirements (e.g., new prospectus exemptions).

The Report also outlines common areas of deficiency, regulatory action taken by the OSC in response to registrant misconduct, and re-affirms that regulatory requirements apply to all business models, including crowdfunding portals, online advisers and lending platforms. The CRR Report warrants a close reading as the OSC has strongly recommended that it be used by registrants as a self-assessment tool to strengthen and enhance their systems of compliance, internal controls and supervision.

Finally, in August the OSC published its 2016 Annual Report, in which it outlines its mandate, vision, and 2015-2016 goals, as well as the steps it is taking to achieve them. The Report highlights important initiatives including the OSC's mutual fund fee review, the introduction of derivatives rules and a review of the order protection rule framework.

We at AUM Law have had a busy year providing comments on proposed changes to NI 81-102, NI 31-103 and Proposed OSC Rule 72-503, amongst others. We hope the OSC takes a well-earned rest in 2017 and allows the rest of us to catch up!

2. What is FinTech Anyways? Robo-Advisors, Crowdfunding, LaunchPads and More…

The term FinTech, which references technological innovation in the financial services industry, was frequently used and occasionally abused in 2016. The Competition Bureau launched a market study in May to examine the competitive impact of FinTech on incumbent financial service providers, barriers to entry and potential regulatory reform. Results are expected in early 2017. The CRR Branch of the OSC also acknowledged the challenges evolving technologies pose to regulators in its above-noted Annual Summary Report.

Regulators are trying to keep pace with technology, however, as recently demonstrated by the OSC's recent approval of the launch of a platform in Ontario under its new LaunchPad initiative, a program that engages with FinTech companies to provide them with guidance and flexibility in navigating securities law requirements, accelerate time-to-market, and keep securities regulation in step with digital innovation. The OSC LaunchPad was unveiled on October 24, 2016.

As we have previously highlighted, given the continued regulatory focus and commentary on evolving technologies, firms looking to utilize evolving technologies such as crowdfunding or online platforms should be prepared to fulfill a number of requirements, including (in the case of online platforms) the submission of a business plan to the regulators.

AUM Law is uniquely qualified to provide guidance in the crowdfunding and online advisory and dealer space. Please contact a member of our Regulatory Compliance Group if you would like to discuss online platforms or crowdfunding in greater detail.

3. The Cyber

No discussion of technology is complete without a mention of cybersecurity. Though the Yahoo and Ashley Madison breaches received much attention in 2016, it is important to remember that the financial services industry continues to be among the top sectors targeted by cybercrime.

In May, the MFDA published Guidance on appropriate policies and controls for cybersecurity, emphasizing the importance of developing a cybersecurity framework to protect a firm's confidential information.

In September, the CSA published a Cybersecurity Notice for financial market participants and announced plans in November to host a roundtable discussion on cybersecurity issues. In the Cybersecurity Notice, the CSA emphasizes the importance of adhering to guidance issued by organizations such as IIROC and the MFDA and taking meaningful steps to protect against cyber threats.

Though this Cybersecurity Notice is not binding, it would be unwise to disregard the guidance it contains, especially given the significant liability and reputational damage that can result from having an inadequate

cyber risk management program. Further, as cybersecurity has been identified as a priority area for the CSA going forward, you can be sure that the sufficiency of market participants' cyber programs will be under increased scrutiny.

Please contact our Regulatory Compliance Group to discuss the issue of cyber security further.

4. Privacy

Privacy is another area that is firmly in the sights of regulators these days. In March, Innovation, Science and Economic Development Canada published a consultation document to solicit stakeholder comments regarding data breach requirements under the Personal Information Protection and Electronic Documents Act (PIPEDA).

The highest profile privacy-related story of the year was the Ashley Madison data breach, however. In addition to the ongoing $578 million class-action brought by harmed customers, the Office of the Privacy Commissioner recently released its scathing findings with respect to the data breach and Ashley Madison's failure to meet its obligations under PIPEDA.

The Ashley Madison case serves as an important reminder that companies should have strong Cybersecurity, Information Security and Privacy Compliance Programs in place, including appropriate policies and procedures, training and audits to ensure internal practices align with those policies and procedures. As well, it is vital to provide accurate information to customers on issues such as the security of their personal information, as their consent may be invalid in the absence of such transparency, much less deliberate misinformation. Finally, the involvement of the Australian Privacy Commissioner in the matter demonstrates the cross-border nature of privacy legislation and the need to be cognizant of, and in compliance with, the legislation of the jurisdictions you operate in.

Please contact our Regulatory Compliance Group if you wish to learn more about your privacy obligations

5. CASL Hassle

Canada'a Anti-Spam Legislation (CASL) continued to find its teeth in 2016. Building on fines imposed against Rogers Media in 2015, Kellogg found itself on the wrong end of the CRTC when it sent unsolicited Commercial Electronic Messages (CEMs) without recipients' consent for over 2 months in 2014. By entering into a voluntary undertaking with the CRTC to pay a $60,000 fine and ensure that it (and its third party email marketers) complied with CASL going forward, Kellogg avoided the risk of administrative monetary penalties (AMPs) up to $10 million per violation.

In July, the CRTC published an Enforcement Advisory emphasizing the need to maintain adequate records of client consents to CEMs. Given the sustained regulatory focus and the upcoming private right of action for any person affected by a CASL contravention as of July 1, 2017, it is vital that corporations ensure their CASL Compliance Programs are up to speed.

Finally, the CRTC's first compliance and enforcement decision under CASL was released earlier this month, and meaningfully narrows the conspicuous publication exemption for CEMs. In particular, it was determined that this exemption requires more than a publicly available electronic address, and the CEM must be tailored to the recipient's actual role or function.

Please contact us if you would like to discuss your CASL Compliance Program in light of recent regulatory Guidance as well as the Kellogg undertaking and CRTC decision.

6. Fun Facts About Fund Facts

OK, *fun facts* may be a bit of a stretch, but in 2016 the CSA republished proposals relating to the Fund Facts document mandated for public mutual funds, and continued to propose a specific risk classification methodology for fund managers. In response to comments, however, the CSA loosened its original proposal from requiring a manager to reassess risk level every month, to determining risk level each time a Fund Facts or ETF Facts document is filed, at least annually.

As well, new relief from Fund Fact delivery requirements for automatic switching programs was granted by the OSC to a number of IFMs under the passport program.

Please contact our Investment Funds Group to be kept in the loop on further Fund Fact developments.

7. Developments in AML

It was a busy year for those impacted by the world of AML. On June 17, 2016, the federal government released the final version of the amended Regulations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA). Reporting entities must adopt all of the new measures and requirements set out in the Regulations by June 17, 2017.

On a positive note, the amendments provide for more flexible client identification measures and expand the definition of digital signature.

The amendments also expand the definition (and accompanying due diligence obligations) for politically exposed persons (PEPs) to now include domestic PEPs, close associates and heads of international organizations, amongst other things.

On June 20, 2016, the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) released new accompanying Guidelines relating to methods to ascertain client identification. Reporting entities have until June 2017 to adopt these new identification measures.

It is vital that reporting entities update their AML Compliance Programs now to ensure proper time for compliance. If you have any questions with respect to these regulatory developments, please contact our Regulatory Compliance Group.

8. New Private Placement Forms

Though not the most sensational topic on our Highlights list, the changes to reporting for both investment fund issuers and non-investment fund issuers that distribute securities under certain prospectus exemptions are important! And the transition period to switch from the old form of report to the new form is over for all distributions that occur as of January 1, 2017! Our April 2016 Bulletin provides a handy overview of the new information required for all issuers, as well as tips and reminders, regarding this new report.

Please contact a member of our Investment Funds Group or our Regulatory Compliance Group if you would like to discuss the new requirements further. The clock is officially ticking.

2017 Teaser – Notices Galore

On December 15, 2016, the CSA, IIROC and the MFDA each separately released notices:

- CSA Staff Notice 33-318 Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives
- Managing Conflicts in the Best Interest of the Client – Status Update
- Review of Compensation, Incentives and Conflicts of Interest

(the **Notices**) that identify concerns they have regarding certain compensation arrangements and incentive practices that apply to registered firms' representatives. In general, the securities regulators are concerned about how some of these arrangements and practices may potentially create material conflicts of interest that could ultimately lead representatives to recommend unsuitable products and services to their clients.

Although the regulators have identified some arrangements and practices that seem to be acceptable and/or best practices (e.g., neutral grids), the regulators have identified numerous other arrangements and practices they find potentially problematic, including:

- compensation heavily weighted towards sales activity and revenue generation;
- monetary and non-monetary incentives to favour proprietary products;
- additional incentive of new-issue commissions;
- additional incentives to recommend funds with deferred sales charges;
- higher payout to representatives for fee-based revenue versus commission-based revenue;
- professional titles tied to sales or revenue targets; and

- compensation of the representative's manager is tied to staff sales/revenue targets.

While the Notices are guidance only (i.e., not law), we predict that the regulators will start referencing them in 2017 when identifying deficiencies related to conflicts of interest. As a result, we encourage our clients to identify their use of any of the arrangements and practices identified in the Notices and, if such arrangements and practices are used, that they assess whether they have adequate controls in place to mitigate potential material conflicts of interest that could arise.

In terms of next steps, the regulators explain how these notices tie into ongoing policy work (e.g., the CSA's best interest and mutual fund fees policy projects) and have stated that they will continue to work together to consider their regulatory concerns in this area, publish more detailed analysis (in the case of IIROC), send certain files to Enforcement regarding apparent breaches of NI 81-105 (in the case of the MFDA), suggest expanding NI 81-105 to cover additional products and arrangements, such as exempt products (in the case of the MFDA), and will be including more detailed questions on these arrangements and practices as part of their compliance reviews (IIROC).

If you have any questions or would like assistance in self-assessing whether your approach to representative compensation would be interpreted to be compliant by the regulators in light of the Notices, please contact us.

And One Reminder Before You Go…

Investment funds must file Form 45-106F1 – *Report of Exempt Distribution* (Form 45-106F1) by January 30, 2017, with each applicable provincial securities regulator for distributions under certain exemptions, including:

- Accredited investor exemption
- Minimum amount exemption of $150,000
- Additional investment in investment fund units

Any distributions made by an investment fund that relies on other prospectus exemptions, may need to be reported to the relevant securities authorities within 10 days of the distribution.

An investment fund that is required to file the Form 45-106F1 must file the report and pay the applicable filing fee as follows:

In British Columbia: through BCSC online eServices*
In Ontario: through the online electronic filing portal
In all other jurisdictions: through SEDAR.

*To register a non-reporting issuer on the BCSC online eServices, an advance registration form has to be sent to BCSC 24 hours prior to filing.

Should you require assistance with the filing of Form 45-106F1, please contact us as soon as possible in advance of your filing deadline, and in any event, no later than January 16, 2017.