The Roller Coaster!

From Halloween Hangover, to the day honouring our veterans, to the recent testing of intercontinental ballistic missiles in the Asia-pacific region, November has been a roller coaster of a month. Our November regulatory update follows the same vein – from coverage of Ontario's capital markets to international developments. Here is AUM Law's take on various developments this past month.

In this bulletin:

In Brief: IOSCO Issues Good Practices for Fund Termination ● Whistleblowing ● New Reporting Obligations Related to Terrorist Financing ● Proposed Changes to Mandatory Central Counterparty Clearing

1. OSC Registrant Outreach on Exempt Market Dealers: Key Takeaways

This month, Staff of the OSC hosted a webinar and in-person information session on various topics of interest relating to firms registered as exempt market dealers (EMDs). Here are the key takeaways of what was discussed.

Know your limit and deal within it: what EMDs can and cannot do

Recent amendments to NI 31-103 and its companion policy, which come into force on December 4, 2017, have further clarified that EMDs cannot act as a dealer or underwriter in a distribution of securities *qualified by a prospectus*, including as a selling group member, when acting as agent in a special warrant transaction or once securities originally distributed under a prospectus exemption are no longer subject to resale restrictions. However, as an olive branch, Staff seemed to bless the practice of EMDs having a NI 31-103-compliant referral arrangement with IIROC firms to refer to them any trading that is not in respect of a private placement.

In Brief

IOSCO Issues Good Practices for Fund Termination

The International Organization of Securities Commissions (IOSCO) recently published fourteen recommended good practices for investment funds to follow if they decide to terminate a fund. The recommendations cover topics such as: disclosures at the time of investment and during the termination process, the need to consider investors' best interests in deciding whether to terminate a fund, considerations for fund mergers, and valuation practices.

These recommendations do not have any legal force, but it's likely that Canadian securities regulators will take them into account in their supervisory and rule-making activities.

AUM Law will monitor Canadian regulators' response to these recommendations.

●

OSC staff clarified that EMDs can participate in a distribution by an issuer – including a reporting issuer – under a prospectus exemption (i.e., a private placement), even if the distribution is concurrent with a prospectus offering for the same class or type of securities. Staff noted that in such cases:

- Investors do not receive statutory prospectus protections;
- The securities of the private placement are subject to resale restrictions (typically four months);
- A Form 45-106F1 may be required to be filed;
- If an EMD wishes to use a prospectus as a marketing document (in the situation where there is a separate, concurrent offering of the same securities under a prospectus), the EMD should:
    - explain the implications of this to their client investing in the securities (e.g., investors in a private placement do not receive statutory prospectus protections, securities are not freely tradable, etc.) and
    - treat (at least in Ontario) the prospectus as an offering memorandum (for the private placement) for filing and other purposes under securities regulation.

The good, the bad and the ugly: EMDs and the new prospectus exemptions

As a result of targeted compliance reviews by the OSC of how EMDs are using the new family, friends and business associates (FFBA) and offering memorandum (OM) prospectus exemptions, Staff reminded EMDs of the following:

- OM Exemption
    - It is available to reporting and non-reporting issuers but not investment funds;
    - There is a specified form of offering memorandum and all marketing materials are incorporated by reference into it;
    - It is not available for distributions of specified derivatives and structured finance products;
    - There is a specified risk acknowledgment form;
    - There are very specific investor qualifications and the EMD must ensure that all investors stay within the specified limits;
    - The issuer of the securities has various ongoing reporting requirements, including (for non-reporting issuers) audited annual financial statements, annual notice of use of proceeds, and notice of specified key events (i.e., events that signal a fundamental change to the issuer's business);
    - Common compliance issues:
        - Lack of collection and documentation of information to assess compliance with applicable investment limits;
        - Failure to comply with applicable investment limits; and
        - Lack of compliance with risk acknowledgment forms.

- FFBA Exemption
    - It is available to reporting and non-reporting issuers but not investment funds;
    - Allows issuers to raise capital from investors who are principals of the issuer or within the personal networks (i.e., friends, family or business associates) of principals of the issuer;

In Brief cont'd

Whistleblowing

As we are always looking at ways to keep our clients current on regulatory activities we see in the industry, we wanted to note that registrants are being contacted regarding the status of their whistleblower policies and procedures.

Some of the questions asked during this desk audit relate to the steps being taken to ensure whistle-blowers are protected from reprisals and that employment agreements do not contain provisions precluding employees from whistleblowing. Registrants might also be asked to provide copies of their whistleblower policies, and standard employment / confidentiality agreements.

If you have any questions on the regulatory expectations regarding your whistle-blowing policy and obligations, please contact your usual lawyer at AUM Law.

•

New Reporting Obligations Related to Terrorist Financing

When a registrant submits its monthly UN Suppression of Terrorism Report, it must confirm that none of its clients are "designated persons" listed on a number of UN regulations and the Criminal Code (Canada). Recently, the Canadian legislature added two more sets of regulations that registrants should check when submitting the above-noted report. These two sets of regulations are:

- *Special Economic Measures (Venezuela) Regulations* (**SEM**). For the "listed persons" under SEM in respect of whom Canadians and persons in Canada may not deal

- Who counts as family is defined (e.g., grandchild counts – cousins do not) but who counts as a friend or business associate is not defined (although there is guidance);
- Both the executive officer and the purchaser must sign the specified risk acknowledgment form acknowledging that the eligible relationship exists;
- Common compliance issues:
  - Lack of information or adequate documentation regarding how a client qualified;
  - Processing trades for clients who do not qualify;
  - Ignoring relevant factors (e.g., length of time the investor has known the key individual, nature of relationship between the investor and the key individual);
  - Social media "friends" do not count; and
  - Use of incomplete or incorrect risk acknowledgment form.

In light of the above, Staff had the following suggested practices to ensure compliance with the conditions of the FFBA and OM prospectus exemptions:

- Know, understand and provide training on the conditions of the prospectus exemptions being relied on;
- Have a process in place to monitor transactions for non-eligible investors and eligible investors to prevent transactions exceeding investment limits in Ontario;
- Make inquiries of clients and document information obtained on:
  - Whether the client meets certain definitions;
  - Other investments made under the OM exemption; and
  - Relationship between individuals for reliance on the FFBA exemption;
- Have a process in place to review information obtained from clients for consistency with the terms of exemption relied on:
  - KYC information should align with definition of "eligible investor";
- Document determination of whether transaction is suitable or not; and
- Establish policies and procedures to support compliance with the exemptions.

Finally, Staff outlined some steps EMDs can take to ensure they are compliant with the conditions of the FFBA and OM exemptions:

- Review the conditions of the OM and FFBA exemptions including the relevant regulatory guidance;
- Provide in-house training sessions for dealing representatives;
- Review your policies and procedures manual to confirm it includes sufficient and accurate information about the conditions to use these exemptions and the steps the firm will take;
- Review your KYC process and determine if it demonstrates that your firm is taking reasonable steps to collect and document information about clients to support that they qualify and the basis for their qualification; and
- Review the risk acknowledgement forms used and make sure that you are providing the correct forms to your clients.

(Epic) Fails: common EMD compliance findings

In Brief cont'd

financially, please refer to the "Schedule" at this link: http://lois-laws.justice.gc.ca/eng/regulations/SOR-2017-204/FullText.html

- *Justice for Victims of Corrupt Foreign Officials Regulations* (**Magnitsky Regulations**). For the "foreign nationals" under the Magnitsky Regulations in respect of whom Canadians and persons in Canada may not deal financially, please refer to the "Schedule" at this link: http://www.international.gc.ca/sanctions/countries-pays/victims_corrupt_regulations-victimes_corrompus_reglement.aspx?lang=eng

Please carefully consider the names on the above lists as the penalties for doing business with a listed individual can be severe. *If you determine that you have a client that is listed under these regulations, please contact your usual lawyer at AUM Law.*

- **Proposed Changes to Mandatory Central Counterparty Clearing**

Currently, National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* requires certain large counterparties to clear prescribed derivatives through a regulated clearing agency. Proposed amendments, released in October, would remove some of the types of derivative contracts subject to this clearing requirement (specifically, overnight index swaps and forward rate agreements with variable notional type), as well as the type of counterparties that

OSC Staff highlighted various common findings from their compliance reviews of EMDs, including:

- Inadequate collection, documentation and updating of KYC forms and suitability information (it is the most significant deficiency identified);
- Inadequate documentation to support assessment of products (i.e., not maintaining evidence they have conducted due diligence);
- Individuals trading without proper registration (firm is responsible for conduct of employees);
- Inadequate or misleading marketing material (e.g., exaggerated and unsubstantiated claims);
- Inadequate or no annual compliance report to the board;
- Referral arrangements – inadequate disclosure or lack of agreements; and
- Various errors in EMD and dealing representative applications for registration (e.g., inadequate firm insurance; misleading representative titles).

What is coming down the pipe: Regulatory initiatives impacting EMDs

OSC Staff highlighted the following regulatory initiatives impacting EMDs:

- Staff is currently conducting focused compliance reviews on firms doing business with senior clients;
- Recent review of one-person and other small firms (see findings in CSA Staff Notice 31-350);
- Marketing in public places (EMDs must provide clear, accurate and non-misleading marketing material to clients in ads in public places);
- Recent cybersecurity guidance (see CSA Staff Notice 33-321); and
- Whistleblower review (e.g., firms cannot have restrictive provisions in employment contracts, severance agreements, and confidentiality agreements).

In Brief cont'd

would be subject to the rules. Most notably, investment funds that are affiliates of certain counterparties that would otherwise be subject to the rule would be excluded. In addition, any local counterparty that currently would be subject to the clearing requirement because, together with its affiliates, it exceeds the threshold for clearing (month-end gross notional amount under outstanding derivatives in excess of $500 billion), would no longer be subject to the rule if it alone had a gross notional amount of outstanding derivatives of $1 billion or less. The rules currently impact only the largest Canadian counterparties, but if those counterparties are trusts and investment funds of a larger global organization then they may be impacted by these amendments.

If you require further information or wish to implement any of the suggested practices mentioned by OSC Staff above, please reach out to us.

2. To be Independent, or not to be Independent?

Further changes may be on the horizon for public companies and their boards. While the CSA continues to look at issues such as board diversity, including projects relating to women on boards and in executive officer positions, the CSA is also looking at the meaning of independence with respect to board and audit committee positions. In the recent CSA Consultation *Paper 52-404 Approach to Director and Audit Committee Member Independence* (the "**Consultation Paper**"), the CSA confirmed that it is re-examining its approach to independence.

Current rules involve a determination by a non-investment fund reporting issuer whether a member of its board or audit committee is independent based on a subjective definition, which is then supplemented by bright-line tests. In other words, a board has to first determine if an individual is independent based on whether they have a direct or indirect material relationship with the issuer. This direct or indirect material relationship would be any relationship which, in the view of the board, could be reasonably expected to interfere with the exercise of a member's independent judgement. If the subjective test is met (i.e. there is no such relationship), then the bright-line tests found in National Instrument 52-110 Audit Committees must be applied, which would automatically disqualify someone from being an independent board member or audit committee member.

Some examples of situations where an individual would be disqualified under the current rules, notwithstanding any other decision of independence by the board, include persons who have been employees or executive officers of the issuer within the last three years. Additional bright-line tests exist which relate specifically to the independence of an audit committee member.

Detractors from the current rules have said that there is not enough discretion or flexibility for boards to determine that a different conclusion may be warranted in the circumstances where the individual has the requisite judgment and expertise to serve, but are prohibited from doing so because of the bright-line tests. In the Consultation Paper, the CSA reviews the approach taken in other jurisdictions and asks various questions about the Canadian approach and alternatives.

Please contact us for more information or if you would like assistance in responding to the Consultation Paper, which is open for comments until January 25, 2018.

3. Are You Ready to Serve Clients with Diminished Capacity?

Financial sector regulators are increasingly concerned about seniors because, as a class, they are at greater risk of cognitive impairment and/or social isolation and therefore particularly vulnerable to financial exploitation. As we noted in our September 2017 Bulletin the Ontario Securities Commission (OSC) will focus its compliance reviews this year, at least in part, on firms with a significant number of senior clients. According to its 2017-18 Statement of Priorities, the OSC also plans to publish a Seniors Strategy, setting out a roadmap of targeted approaches to address issues relating to seniors.

We also want to draw your attention to the Final Report on Vulnerable Investors published by FAIR Canada and the Canadian Centre for Elder Law (CELC) earlier this month, after a year-long study of reform initiatives in other countries and consultations in Canada. The report recommends, among other things, that:

1. Firms be authorized to place a temporary hold on transactions in case of suspected abuse;
2. Securities regulators develop a conduct protocol that firms can use to design processes for identifying and protecting vulnerable clients;
3. A legal safe harbour be created so that firms can report possible abuse without facing legal problems;
4. Firms be required to provide mandatory training to their employees on issues relating to abuse of vulnerable clients; and
5. Firms be required to make reasonable efforts to obtain information about a “trusted contact person” for every non-institutional client.

We can assist you in developing or enhancing your policies and procedures for dealing with vulnerable clients and help you prepare for a compliance review.

We will continue to follow these policy initiatives and bring you relevant updates.

4. The Chief Compliance Officer: The Compliance Captain that Steers the Ship

As 2018 approaches, the Chief Compliance Officer (CCO) of registered firms may find themselves having to submit their annual reports to the Board of Directors. According to Canadian securities law, the report of the CCO is meant to assess compliance by the firm, and individuals acting on its behalf, with securities legislation. CCOs are urged to describe in the report, among other things, instances of non-compliance that may impact clients or the capital markets.

The OSC has provided guidance what could be included in the report of the CCO, for example, any deficiencies identified by the firm, key compliance risks facing the firm, training that the firm undertakes on

compliance, how the firm has dealt with recent changes in law, etc. The annual report of the CCO is just one of the tools that assists the CCO in his or her compliance role at the firm.

Of course, the CCO has other specific responsibilities as the compliance captain of the registered firm. The CCO is responsible for monitoring and assessing compliance, reporting to the ultimate designated person instances of non-compliance, and establishing and maintaining policies and procedures, including establishing and testing internal controls, to comply with various regulatory requirements. While compliance systems cannot be ironclad, the CCO has a responsibility to ensure that the compliance systems in place provide reasonable assurance that the firm will meet all requirements of securities laws and manage risks appropriately.

It is important that the CCO, among other things, keeps current of regulatory requirements, have adequate resources to fulfill the forgoing responsibilities appropriately and performs self-assessments of firm's compliance with securities laws.

If you have any questions regarding your responsibilities as CCO please reach out to us on how we can assist.

5. Ontario to Regulate Financial Planners and Strengthen Protection for Investors in Syndicated Mortgages

In its autumn update, the Ontario government reiterated that it plans to develop legislation to regulate financial planners in Ontario to "*ensure that consumers have access to high-quality financial planning services that will benefit their long-term financial well-being*". The government proposes that financial planners would be required to meet certain proficiency requirements, and the use of financial planning titles would be restricted to address "*consumer confusion created by the wide variety of titles used in the industry*". The Ontario government has indicated that it will consult extensively with stakeholders in developing the proposed framework.

The Ontario government also affirmed its commitment towards strengthening protections for investors in syndicated mortgages. The government proposes to expand requirements to ensure that mortgage brokerages provide investors with adequate information to effectively assess the risk level of investing in syndicated mortgage products. The government indicated that it is currently reviewing feedback received through consultations over the last few months on potential changes to regulations under the *Mortgage Brokerages, Lenders and Administrators Act, 2006* that, if enacted, would impose investment limits on syndicated mortgage products to address the government's investment concentration concerns for retail investors, and require mortgage brokerages to document suitability assessments for clients to ensure these products are only offered to investors who can tolerate a high degree of risk. The Ontario government also plans to propose amendments to the *Securities Act* (Ontario) to facilitate the transfer of regulatory oversight of syndicated mortgage investments from the Financial Services Commission of Ontario to the securities regulator.

We would be happy to discuss these implications to any of our clients who offer syndicated mortgage products.

News & Events

AUM Law Team Member Announcements

We are very pleased to announce that **Chris von Boetticher** will be joining our legal team as Senior Legal Counsel. He worked at CI Investments Inc. in a variety of roles for 16 years, most recently as its General Counsel and Secretary. He has a wealth (pardon the pun) of over 20 years of legal experience in the asset management space, and was called to the Ontario Bar in 1997. His experience includes creating and maintaining public and private investment funds, providing advice on compliance and operational matters, as well as running M&A deals and corporate governance matters.

We are also delighted to announce that **Ryan Dias** will be joining our operations team as Assistant Controller. Ryan is a CPA Candidate, and is currently working with TD Securities as an auditor and IT project manager. Prior to joining TD in 2016, Ryan worked as an accountant for a law firm for approximately two years, including through the law firm's merger with DLA Piper. Prior to that, Ryan gained experience as an accountant in an accounting firm for approximately three years.