Riders on the Storm

Like the Doors (and REO Speedwagon), we've been riding out the storms and waiting for the thaw. Reflecting the weather outside, we have experienced flurries of regulatory proposals, occasionally punctuated by loud crashes as the OSC announced significant penalties agreed to by industry participants in settlement agreements.

In this bulletin:

1. Don't Let Your Swag Drag You Down

Earlier this month, two large investment fund managers, Mackenzie Financial Corporation (Mackenzie) and Scotiabank's 1832 Asset Management LP (1832), entered into settlement agreements with the Ontario Securities Commission (OSC) regarding non-monetary benefits and activities that they had provided to participating dealers or dealing representatives over and above what is permitted under National Instrument 81-105 *Mutual Fund Sales Practices* (NI 81-105). NI 81-105 regulates industry participants' sales practices in connection with the distribution of publicly offered securities of mutual funds.

The settlement agreements describe various non-monetary benefits and activities that the fund managers provided to participating dealers and that ran afoul of the restrictions in NI 81-105. These included gifts such as iPad minis, Nespresso machines, and Bose speakers, excessive spending on golf, expensive tickets to

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April Storms Usher in the CSA's Climate Change Disclosure Report

Fittingly, the Canadian Securities Administrators (CSA) published *Staff Notice 51-354 Report on Climate change-related Disclosure Project* (the Report) just in time for the spring ice storm that hit the Toronto region in early April. The report reflects CSA staff's review of large, public issuers' climate change-related disclosures, discussions with market participants, and disclosure standards in other jurisdictions. The Report indicates, among other things, that investors are seeking improved disclosure regarding the financial impact of climate change to a business as well as its impact on the governance processes. The Report also emphasizes that reporting issuers are required, under the current regime, to disclose climate-change related information if they deem such information to be a material risk to the business.

Next steps for the CSA include developing disclosure guidance for issuers, considering whether new disclosure requirements are needed, and continuing to

concerts and sports events, and excessive spending on food, drinks and entertainment at conferences. In both instances the OSC also found failures to maintain adequate systems of controls and supervision around the firms' sales practices to ensure compliance with NI 81-105.

The penalties are substantial. Mackenzie and 1832 agreed to pay administrative penalties of $900,000 and $800,000, respectively. Each firm also is paying $150,000 for investigation-related costs.

AUM Law is experienced at helping firms prepare, implement and assess compliance with policies governing investment fund managers' sales practices and we can guide you with respect to these matters, too. Please contact a member of our Investment Funds Group for assistance.

2. CSA Proposes Registration Framework for OTC Derivatives Dealers and Advisers

On April 19, the Canadian Securities Administrators (CSA) published proposed National Instrument *93-102 Derivatives: Registration* (Registration Instrument) and its Companion Policy for comment. NI 93-102 will establish a new regime for the registration of dealers and advisers transacting in Canadian over-the-counter (OTC) derivatives markets. The Registration Instrument complements proposed National Instrument *93-101 Derivatives: Business Conduct* (Business Conduct Instrument), which was published for comment on April 4, 2017. According to the CSA, the two proposed instruments are intended to create a comprehensive investor protection framework for the regulation of people and companies who are in the business of dealing in or advising on OTC derivatives.

The CSA plans to re-publish for comment the Business Conduct Instrument soon, and has provided for an extended comment period (until September 17, 2018) so that people can consider both proposed instruments when giving feedback.

In developing the Registration Instrument, the CSA leveraged the existing registration regime reflected mainly in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103). Given AUM Law's depth of experience in advising on NI 31-103 and related securities matters, we are ideally suited to help firms navigate the proposed derivatives registration and business conduct regime. We expect to publish a Special Bulletin on this subject in the coming weeks. Please do not hesitate to contact us if you would like to discuss the proposals and their potential impact on your business.

3. Privacy Law Update: Get Ready for Data Breach Notification, Reporting and Record-Keeping Requirements

As we have discussed in prior Bulletins, in June 2015 the *Digital Privacy Act* (DPA) amended Canada's private sector privacy law, the *Personal Information Protection and Electronic Documents Act* (PIPEDA). Some of the provisions are already in force, while others required the Federal Government to take further action before the provisions came into effect. On March 26, 2018, the Federal Government issued an Order-in-Council setting November 1, 2018 as the in-force date for the DPA's "breaches of security safeguards" provisions.

This means that, come November, most private sector firms that experience a data breach will have to, among other things:

- Determine if the breach poses a "real risk of significant harm" to any individual whose information was involved in the breach (Affected Individuals);
- Notify Affected Individuals and the Privacy Commissioner of Canada (Commissioner) as soon as feasible if the firm considers that the breach poses a real risk of significant harm;

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monitor issuers' disclosure practices in Canada and evolving disclosure frameworks globally. AUM Law will keep you informed on developments in this area.

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OSC's Mediation Program for Enforcement Matters to Continue

On April 9, the OSC announced that its pilot project on mediation for enforcement matters, which began in 2015, will become a permanent feature of OSC's enforcement toolkit (the Mediation Program). The goal of the program is to facilitate efficient and effective resolution of matters by negotiating terms of settlement with Staff of the Enforcement Branch through a third party selected from a roster of mediators. Individuals and companies must be represented by counsel before participating in the Mediation Program. The OSC encourages individuals and companies who may benefit from the Mediation Program to engage early in the process for a timely and effective resolution of issues.

AUM Law has extensive experience engaging with the OSC on clients' behalf. Should you become involved in a potential enforcement matter, we can advise you on the pros and cons of participating in the Mediation Program and represent you in such a process.

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CSA Seeks Feedback on Soliciting Dealer Agreements

On April 12, the Canadian Securities Administrators (CSA) published Staff Notice 61-303 and Request for Comment - *Soliciting Dealer Arrangements* (Notice). Soliciting dealer arrangements are agreements

- Notify any other organization that may be able to mitigate harm to Affected Individuals; and
- Maintain records of any data breaches that the firm becomes aware of and provide such records to the Commissioner upon request.

The *Breach of Security Safeguards Regulations*, which set out in more detail what, how and when firms should disclose, report and keep records of data breaches, also comes into effect on November 1.

This phase in the implementation of privacy rules comes as firms, individuals, governments and regulators face challenging scenarios about online privacy and companies' ability to keep individuals' personal data secure. The countdown clock is ticking loudly. Now is the time to assess whether your firm has adequate policies, procedures, and internal controls to meet these new requirements. We are happy to assist you in getting ready for the new regime.

4. Is Bitcoin a Security? Definitely Maybe

In the past few months, a number of securities regulators, including the Ontario Securities Commission (OSC), have taken steps to stop securities-related activity concerning USI Tech Limited (USI Tech), which purported to offer a bitcoin trading platform. In Ontario, a temporary cease-trade order was issued against USI Tech and two Ontario residents because OSC staff were concerned that the individuals might have been engaging in the business of advising on securities without being registered and that USI Tech and the two individuals were distributing securities of USI Tech without a prospectus. Staff's investigation is ongoing and one of the key issues that they will have to address is whether the products offered for sale are "securities" within the meaning of the Securities Act.

This case is just one example of securities regulators' efforts to identify issues and deal with potential regulatory gaps arising from cryptocurrency, initial coin and similar offerings, and blockchain developments. As reflected in the OSC's draft *Statement of Priorities for 2018-19* (discussed below), we expect to see continued regulatory focus on these issues.

5. *Re Mason:* Balancing Investor Protection against Fundamental Freedoms

The Ontario Securities Commission (OSC) recently published reasons for its decision on whether to stay a decision of the OSC's Director of Compliance and Registrant Regulation (Director), pending the OSC's review of that decision. Although the fact situation is unusual, the short case is worth reading because it deals with a fairly common situation: what are your options and potential outcomes if you think a Branch Director's decision goes too far?

In this case, a mutual fund dealing representative (Mason) had become a volunteer, Lay Minister at his church. To address concerns about the potential conflict of interest arising from this outside business activity, the Director prohibited Mason from acting as a dealing representative for any person who was a member of his church's congregation and required terms and conditions to that effect to be included in his National Registration Database (NRD) profile. In light of these terms and conditions, Mason's sponsoring firm required him to ask prospective new clients if they were members of his church. His branch manager also adopted a practice of contacting his prospective clients to confirm they were not members of the church.

Mason recognized the need to have boundaries between his roles, but he challenged the manner in which the Director imposed those boundaries (*i.e.*, the terms and conditions) and the restrictions' impact on his human rights. He sought a review of the Director's decision and asked the OSC to stay that decision and have the terms and conditions removed from his NRD registrant profile in the interim. At the OSC hearing, Mason raised a number of interesting arguments, including that it was

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between issuers and registered investment dealers under which the issuer agrees to pay the dealer a fee for each security successfully solicited from security holders to vote in connection with a take-over bid. Soliciting dealer arrangements also may be used to incentivize dealers to contact security holders to participate in a rights offering or exercise rights to redeem or convert securities. Recently, there also have been instances of soliciting dealer arrangements in connection with contested director elections.

The Notice highlights potential regulatory issues and sets out questions for comment, including with respect to potential dealer conflicts of interest, directors' fiduciary duties, and whether there are different concerns when soliciting dealer arrangements are used in take-over bids, other M&A transactions, or proxy contests. Staff also are seeking comment on whether additional guidance or rules would be appropriate. Comments on the Notice are due June 11, 2018.

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FundSERV Proposes Rules for New Service Providers

FundSERV Inc. (FundSERV), the electronic platform that connects investment fund managers, distributors and intermediaries to facilitate trading of investment products, has published for comment proposed rules for processing applications from new service providers. FundSERV already has written processes for onboarding new manufacturers (*e.g.*, fund managers) and distributors (*e.g.*, dealers and brokers) of financial instruments and products. It also has processes for onboarding new

intrusive for him to ask prospective clients about their religious affiliations and that publishing the terms and conditions on the NRD unfairly put him at a disadvantage compared to other representatives. However, he could not prove that his business was suffering as a result of the terms and conditions.

At the motion hearing, the OSC held that there was a serious issue to be tried. It concluded, however, that the harm that Mason claimed he was suffering was speculative. The OSC ruled that absent any evidence of irreparable harm or damage to the public interest, the terms and conditions would be maintained until the hearing of his case on the merits, which is scheduled for later this spring.

AUM Law has extensive experience representing clients who are dealing with pending or existing terms and conditions. Please contact us if you need assistance with a similar matter.

6. CSA to Ease Resale Restrictions on Privately Placed Securities of Foreign Issuers

Currently, the securities of non-Canadian issuers (Foreign Issuers) that are privately placed into Canada can be resold without being qualified by a Canadian prospectus, provided that:

- the trade is made through an exchange or a market outside of Canada or to a person or company outside of Canada; and
- Canadian residents do not own more than 10% of the Foreign Issuer's outstanding securities or represent more than 10% of the total number of Foreign Issuer's security holders (the "Canadian-Resident Ownership Restriction").

If the Canadian-Resident Ownership Restriction is exceeded, the Foreign Issuer's privately placed securities are not freely tradeable by Canadian security holders outside of Canada. This means that any resale of the securities either needs to be qualified by a prospectus or conducted on the basis of an alternative prospectus exemption.

Capital market participants increasingly have seen the Canadian-Resident Ownership Restriction as an impediment to extending prospectus-exempt offerings by Foreign Issuers into Canada. Although securities regulators have granted relief from the Canadian-Resident Ownership Restriction in some situations, the analysis and time required to obtain that relief has often dissuaded Foreign Issuers from extending a private placement into Canada.

In recognition of the increased globalization of capital markets, the Canadian Securities Administrators (CSA) decided to eliminate these impediments through rule amendments scheduled to take effect on June 12, 2018. In Ontario, the prospectus exemptions and related amendments will be incorporated into Ontario Securities Commission Rule 72-503 *Distributions Outside Canada*, which will consolidate all of the primary distribution and resale exemptions applicable in Ontario to cross-border activities into one instrument. In Alberta, the new exemption will be reflected in Alberta Securities Commission Blanket Order 45-519 *Prospectus Exemptions for Resale outside of Canada*. In the rest of Canada, the exemption will be incorporated into National Instrument 45-102 *Resale of Securities*.

Please contact AUM Law if you would like to understand how the rule changes might affect your portfolio and investment options.

7. OSC Seeks Comment on 2018-19 Priorities

On March 29, the Ontario Securities Commission (OSC) released its draft 2018-2019 Statement of Priorities. Of particular interest to the asset management sector, the OSC plans to:

- Publish rule proposals to create a best interest standard; embed a new client/advisor standard in core, targeted reforms to National Instrument 31-103 *Registrant Requirements, Exemptions and Ongoing Registrant Obligations*; and initiate work on remaining reforms such as titles and proficiency requirements;

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service providers (*e.g.*, third-party administrators and record keepers for investor accounts) but until now it has not published those processes in the form of rules. FundSERV is seeking comment from the public and the Ontario Securities Commission (OSC) on its proposed rule by May 22, 2018. If you would like to know more about FundSERV's role and/or the rule proposals, please contact us.

- Publish recommendations and then adopt policies on embedded commissions to mitigate certain investor protection and market efficiency issues;
- Develop with regulatory colleagues a regulatory framework to address issues of cognitive impairment and financial exploitation;
- Conduct targeted compliance reviews focusing on:
    - New registrants and high risk, problematic (for cause), large/high impact firms identified from the 2018 Risk Assessment Questionnaire;
    - Registrants' sales practices; and
    - Emerging risk areas including evolving business models, online advice and expansion of the exempt market;
- Support fintech innovation and capital formation while emphasizing regulatory compliance, through the OSC Launchpad, and work with the Financial Services Regulatory Authority on the Ministry of Finance's SuperSandbox;
- Continue identifying potential regulatory gaps arising from crypto-currency, initial coin and similar offerings (ICOs) and blockchain developments, which can raise fundamental issues about the scope of securities regulation, and enhance guidance on when ICOs involve securities;
- Implement the orderly transfer of syndicated mortgage investments to OSC oversight, including development of a plan for the registration and oversight of market participants active in offering syndicated mortgages;
- Draft amendments to rules to reduce investment fund disclosure requirements;
- Analyze the impact of the Client Relationship Model (CRM2) and Point of Sale (POS) initiatives on investors and the investment industry to determine whether these policy projects achieved their goals;
- Enhance the over-the-counter (OTC) derivatives regulatory regime by, among other things, publishing a derivatives dealer registration rule, hosting a business conduct roundtable, and republishing the derivatives business conduct rule for comment;
- Conduct reviews of compliance with the OTC derivatives rules for trade reporting, clearing, segregation and portability; and
- Promote cybersecurity resilience through greater collaboration with market participants and other regulators on risk preparedness and responsiveness.

AUM Law will monitor developments with respect to the OSC's priorities for the year and keep you informed.

News & Events

We are proudly sponsoring this year's Annual Focus Event on Registrant Regulation Conduct & Compliance, taking place May 3-4 in Toronto. Our very own Erez Blumberger and Jason Streicher are speaking on panels scheduled for May 4.

Visit the conference page for more details, or to register.

11th Annual Focus Event on
REGISTRANT REGULATION
Conduct & Compliance