Stocking Stuffers

Although staff of the securities regulators have been known to finish up the year in a flurry of regulatory initiatives, December 2018 has so far been relatively quiet. So this month we've decided to present you with a few "stocking stuffer-sized" tidbits of information, accompanied by a recap of the 2018 regulatory highlights that we covered in the past year. As an added bonus, we have included links to the relevant articles, in case you'd like to catch up on your reading.

Happy Holidays and all the best for 2019!

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1. Regulatory Highlights of 2018

A. "A" is for AML-ATF and Alternative Mutual Funds

AML-ATF: The money laundering and terrorist financing environment has evolved substantially in the past few years. Registrants, exempt advisers and exempt dealers must stay on top of their existing compliance and reporting obligations and keep informed of potential changes in the regulatory landscape.

- In February, we wrote about the updated guidance issued by the Canadian Securities Administrators (CSA) on reporting obligations relating to suppression of terrorism and Canadian sanctions, as well as the federal government's discussion paper, which was published to support

In Brief

FSPC's Updated Professional Conduct Standards Take Effect on January 1

On December 11, the Financial Planning Standards Council (FSPC) announced that revised Standards of Professional Responsibility (Standards) have been adopted and will come into effect on January 1, 2019. The Standards will apply to individuals who are CFP Professionals or FPSC Level 1 Certificants in Financial Planning. Among other things, the revised Standards:

- Replace the "client first" standard with a duty of loyalty;
- Prohibit lending to or borrowing from clients;
- Require more detailed disclosure to clients about costs and compensation arrangements;
- Introduce new obligations to prospective clients;
- Require reasonable steps to ensure that any third party to whom the client is referred has the appropriate qualifications to provide the services for which the referral is made; and
- Require reasonable steps to assist any client who ends the engagement by, *e.g.*, ensuring a smooth transition to a new planner.

CSA Proposes Trading Fee Rebate Pilot Study

On December 18, the Canadian Securities Administrators (CSA) proposed a Trading Fee Rebate Pilot Study to examine the effects of prohibiting rebate payments by Canadian

Parliament's five-year review of its anti-money laundering and anti-terrorist financing (AML-ATF) legislation.

- In June, the Federal Government proposed amendments to the AML-ATF regime to help address deficiencies in Canada's regulatory framework and operationalize some of the legislative changes to Canada's regime enacted in 2017.
- In August, FINTRAC updated its guidance on beneficial ownership.
- In November, we discussed the recommendations developed by the House of Commons' Standing Committee on Finance regarding potential reforms to the AML-ATF regime.
- In this month's bulletin, we're advising you that the Federal Government has amended the schedule for the Justice for Victims of Corrupt Foreign Officials Regulations to include seventeen Saudi nationals linked to the murder of Jamal Khashoggi.

Alternative Mutual Funds: In October, we reported on Canada's second most eagerly anticipated legalization of a product line (alternative mutual funds) and followed that article up with a brochure, which you can access online here.

B. "B" is for Best

An all-encompassing "best interest" standard might be off the table for now, but we think the regulatory framework for registrants is fundamentally shifting in that direction anyway.

- In June, we reported on one of the year's most significant regulatory developments, when the CSA proposed changes to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) relating to the know-your-client (KYC), know-your-product (KYP), suitability, conflicts of interest, and relationship disclosure information (RDI) requirements. Although the proposed changes do not include a comprehensive "best interest" obligation, specific best interest-like obligations are incorporated into various provisions in NI 31-103, with some representing new requirements and others codifying what regulators consider to be good practice.
- In the same month, we also reported that the staff of the Ontario Securities Commission (OSC) were pursuing a case against Caldwell Investment Management for allegedly failing to provide best execution for its clients. That case is working its way through the hearing process, and we likely won't learn the outcome until sometime in 2019.
- The 2017-18 annual report published in August by the Compliance and Registrant Regulation (CRR) Branch at the OSC also addressed a range of topics that emphasize the importance of registrants putting clients' interests first.
- This month, we write about the Financial Planning Standards Council's amendments to its Standards of Professional Responsibility, which will, among other things, replace the existing "client first" strategy with a comprehensive duty of loyalty.

In Brief cont'd

marketplaces. Currently, Canadian equity marketplaces typically charge a fee to one party of the trade and pay a rebate to the other party. CSA staff are concerned that the payment of rebates may create hard-to-manage conflicts of interest affecting dealer routing decisions, contribute to the segmentation of order flow, and/or increase intermediation on actively traded securities (where liquidity is least needed). The design and future operation of the Pilot Study are likely to be of interest primarily to Investment Industry Regulatory Organization of Canada (IIROC) dealer members, since they have direct access to exchanges, but also may be of interest to portfolio managers who use direct electronic access.

During the proposed Pilot Study, Canadian marketplaces (including exchanges and alternative trading systems) will be temporarily prohibited from paying trading fee rebates to dealers for executing orders for a sample set of equity securities, including both highly liquid and actively traded, medium liquidity securities. The Pilot Study is expected to run at the same time as a similar study being conducted in the United States by the SEC. The comment period closes on February 1, 2019.

C. "C" is for "Cannabis", Crypto-Commotion and the CCMRS

Cannabis: The much anticipated legalization of cannabis in Canada, combined with the U.S. government's rescission of its forbearance approach to the enforcement of federal laws relating to that controversial weed, led to a bit of reefer madness in 2018.

- In January, we wrote about the implications of the U.S. government's rescission of the Cole Memorandum;
- In February, we reported that the CSA had revised Staff Notice 51-532 – *Issuers with Marijuana-Related Activities* to provide for more specific and prominent risk disclosures, in light of the illegal nature of marijuana under U.S. federal law; and
- In October, we discussed the CSA's review of disclosure practices by reporting issuers in the cannabis industry.

Crypto-Commotion: Crypto assets continued to attract a great deal of attention in 2018 and, as a result, we wrote about the subject frequently.

- In January, we wrote about proposed rule changes in the United States that would facilitate the listing of Bitcoin exchange-traded funds (ETFs), compared the initial coin offering (ICO) process to a traditional initial public offer process, and reported that regulators globally including the International Organization of Securities Commissions (IOSCO) were expressing concern about ICOs;
- In our February article "Fintech Regulation: A Myriad of Things", we reported that the British Columbia Securities Commission (BCSC) was seeking feedback on a range of fintech issues, including regulatory concerns about ICOs and about firms that manage crypto-currency funds;
- In our April article "Is Bitcoin a Security? Definitely Maybe", we discussed a case that illustrates how regulators are dealing with challenges regarding the application of securities laws to crypto-currency;
- We followed up in May with an article about North American securities regulators' coordinated crackdown on fraudulent crypto-currency investment products;
- In June, the OSC issued a report discussing financial consumers' understanding of crypto-assets and its staff published follow-up guidance on token offerings; and
- In November, we noted that the House of Commons Standing Committee on Finance's recommended that the AML-ATF regulatory framework be extended to deal with crypto-exchanges and crypto-wallets.

CCMRA: Will we, or won't we, live long enough to see a national securities regulator?

- In May, the governments participating in the Cooperative Capital Markets Regulatory System (CCMRS) published for comment draft prospectus and related registration exemption regulations under the proposed Capital Markets Act, while also acknowledging that the Capital Markets Regulatory Authority (CMRA) would not be ready for launch by the end of 2018.

- In November, some celebrated and others scorned the Supreme Court of Canada's ruling that the proposed CCMRS is constitutional and that the draft Capital Markets Stability Act (CMSA) falls within the federal Parliament's power to regulate trade and commerce. Although this ruling removes a major obstacle from the path toward a national regulator, political obstacles (including a looming federal election with a Liberal government that wishes to keep its seats in Quebec) remain. We aren't holding our breath waiting for the CMRA to get up and running.

D. "D" is for Data Privacy / Digital Security, Derivatives, and Diminished Capacity

Data Privacy and Digital Security: The countdown clock ticked down loudly to the November 1 in-force date for the "breach of security safeguards" provisions in the Digital Privacy Act (DPA), and firms, individuals, governments and regulators continue to face challenges about what constitutes an acceptable use of personal data and how to keep that personal data secure.

- In April, we wrote about the DPA's data breach notification, reporting and record-keeping requirements, which came into force on November 1;
- In July, we wrote about how the CSA experienced unauthorized access to the National Registration Database (NRD); and
- In October, we wrote about the Privacy Commissioner of Canada's new Guidelines for Obtaining Meaningful Consent to the collection, use, and disclosure of personal data.

Derivatives Regulation: The CSA initiative to modernize the regulatory framework for over-the-counter (OTC) derivatives took a big step forward this year.

- In April, we wrote about the CSA's proposed registration framework for OTC derivatives dealers and advisers; and
- In June, we wrote about the CSA's draft business conduct rules for OTC derivatives.

After the comment period closed, the CSA organized roundtable discussions about the proposed regulatory framework and staff are now considering the feedback they received through the comment and roundtable processes. We expect to see at least one further round of consultations before the OTC derivatives regime is finalized so that, among other things, gaps in the draft registration framework (such as transition provisions) can be filled in. Therefore, we don't expect the regime to be finalized before late 2019 at the earliest.

Diminished Capacity: Financial sector regulators are increasingly concerned about investors with diminished capacity, including seniors in particular, since they are especially vulnerable as a class to financial exploitation. We wrote about the OSC's Seniors Strategy in March and in our August article on the OSC's CRR Annual Report, we highlighted the results of the OSC's sweep of firms with substantial numbers of senior and vulnerable investors.

E. "E" is for Exam Report Cards and Exempt Distributions

Exam Report Cards: The summary reports that regulatory staff publish regularly about their oversight of registrants and issuers are valuable tools that can help firms learn more about recent and proposed regulatory initiatives, what staff consider to be problematic (or, conversely, positive) practices, and how staff interpret legislation and rules. In 2018, we wrote about:

- The Financial Consumer Agency of Canada's review of the big banks' sales practices (March)
- The CSA's 2017-18 Enforcement Report (July)
- The OSC's Continuous Disclosure (CD) Review Program Report (July)
- The OSC's Compliance and Registrant Regulation Branch Report (August)
- The OSC's Corporate Finance Branch Report (October)
- The review by the Québec Autorité des Marchés Financiers (AMF) of investment funds' fund facts disclosures (October)
- The BCSC's Compliance Report Card for registrants (November)
- The OSC's Exempt Market Report for 2017 (November)
- The annual Compliance Exams Report published by the U.S. Financial Industry Regulatory Authority (FINRA) (December)
- The Risk Alert Report published by the U.S. Securities and Exchange Commission (SEC) after its sweep focused on electronic messaging (December)

Exempt Distributions: Elements of the exempt market regime were tweaked this year, and we also saw the regulators pay close attention to whether certain prospectus and/or registration exemptions were used appropriately. In 2018, we wrote about:

- Finalization of OSC Rule 72-503 for distributions outside Canada (January)
- To wrap or not to wrap: offering documents provided to Canadian-resident investors (January)
- Easing the resale restrictions on privately placed securities of foreign issuers (April)
- New custody rules for prospectus-exempt funds, which came into force on June 1 (May)
- An issuer's obligation to prove its entitlement to rely upon a prospectus exemption (as part of our discussion of the Valt.X case in October)
- The OSC's Corporate Finance Branch Report (October)
- Finalization of changes to Form 45-106F1 – Report of Exempt Distribution (July and October)
- Revocation of the "Northwest Exemption" for prospectus-exempt trades (August)
- Delivery of offering documents when issuers are relying on the offering memorandum exemption (August, as part of our discussion of the OSC's CRR Branch Report)
- The OSC's Exempt Market Report for 2017 (November)
- FINRA's Annual Compliance Exams Report for US Broker-Dealers (December)

And last but not least, we have written an article this month to remind investment funds that file some of their Reports of Exempt Distribution on Form 45-106F1 once per year that the filing deadline is January 30, 2019 for distributions made in 2018.

F. "F" is for Fintech

Fintech and its cousin regtech remain popular, even if they're weren't quite as cool as cannabis in 2018.

- In February, we wrote about a grab bag of fintech topics;
- In August, we reported that the OSC and AMF had joined the Global Financial Innovation Network established by a group of financial sector regulators; and
- In September, we discussed FINRA's white paper on regtech.

G. "G" is for Guidance

Guidance: We don't always agree with it, but we're grateful that the regulators share their views on how they interpret securities legislation and rules. In 2018, the CSA published guidance on a wide range of topics including the following:

- AML-ATF compliance and reporting obligations (February);
- Staff Notice 51-532 – *Issuers with U.S. Marijuana-Related Activities* (February);
- Staff Notice 46-308 – *Securities Law Implications for Offerings of Tokens* (June);
- The securities law implications of Canada's bail-in debt regime (August); and
- Staff Notice 51-356 - *Problematic Promotional Activities by Issuers* (November).

In addition, we wrote about:

- The Mutual Fund Dealers Association's principles-based sanction guidelines (May);
- FINTRAC's updated guidance on beneficial ownership (August); and
- The Financial Service Commission of Ontario's guidance for its licensees (including mortgage brokers) on fair treatment of customers (October).

H. "H" is for Housing (because we didn't want to go all the way to "R" to write about real estate)

Recently, investments in real estate (and mortgages on real estate) have become very popular, especially among individuals, and so it's not surprising that financial sector regulators flagged this sector as an area of investor protection concern. In 2018, we wrote about:

- The OSC Investor Office's publication *Investing in Real Estate* (February);
- The changing regulatory framework for syndicated mortgages (March); and
- Real estate investment trends discussed in the OSC's Exempt Market Report for 2017 (November).

We also published two standalone articles: In a Nutshell: Mortgage Investment Corporations (May) and Real Estate Investment Vehicles: Which Make and Model Suit You? (November).

We hope that this recap of regulatory developments in 2018 helps you get ready for 2019. If you would like to have a consolidated and indexed collection of our 2018 bulletins as an electronic desk reference, please contact us to receive a copy, and if you're not already a subscriber to our publications, we'll set you up for 2019.

2. Reminder: Investment Funds Have a January 30 Deadline to File Reports of Exempt Distribution

The New Year is just around the corner, and so investment funds that take advantage of the option in National Instrument 45-106 – *Prospectus Exemptions* (NI 45-106) to file certain Reports of Exempt Distribution on Form 45-106F1 (Form 45-106F1) once a year, instead of after every distribution, have some homework to do.

Background: To rely on many of the exemptions in NI 45-106, issuers must report prospectus-exempt distributions to every securities regulator where a distribution of securities was made to a resident of that province or territory. Generally, the filing deadline is ten days after the date of distribution.

Investment funds, however, can file their forms once year, by January 30, for distributions made in in the preceding year in reliance upon the accredited investor, minimum amount, or additional investment in fund units exemptions. Distributions made by an investment fund in reliance on other prospectus exemptions may need to be reported to the relevant securities authorities within ten days of the distribution.

How to file the reports and pay fees: An investment fund that is required to file Form 45-106F1 must file it electronically as follows:

- In British Columbia, through the online eServices portal of the British Columbia Securities Commission (BCSC);
- In Ontario, through the online Electronic Filing Portal of the Ontario Securities Commission (OSC); and
- In all other jurisdictions, through SEDAR.

If the investment fund is a non-reporting issuer on the BCSC online eServices portal, an advance registration form must be sent to the BCSC 24 hours prior to filing. Likewise, if the investment fund does not currently have a SEDAR profile, it must create one prior to filing Form 45-106F1 on SEDAR.

Each securities regulator charges a separate filing fee for Form 45-106F1. Filing fees for forms filed in British Columbia and Ontario are paid directly online when submitting the form through the regulators' respective online portals. Payment by cheque is possible, but the cheque must be received by the regulator in order for the filing to be considered complete, so electronic payment is preferable. Filing fees payable to other jurisdictions must be made electronically through SEDAR.

Next steps and how we can help: If you haven't already started to collect the required information and prepare your forms, we encourage you to do so as soon as possible. Should you require assistance with annual filings of Reports of Exempt Distribution for investment funds, please contact your usual lawyer at AUM Law as soon as possible and, in any event, no later than January 15, 2019, to ensure that filing deadlines can be met.

3. New Sanctions List for Registrants to Check under Anti-Terrorist Financing Legislation

In late November, Canada implemented targeted sanctions under the Justice for Victims of Corrupt Foreign Officials Act (Act) against seventeen Saudi nationals linked to the murder of Jamal Khashoggi. The Act is one of several, federal legislative measures (Federal Provisions) against terrorist financing. It applies to, among others, registrants, entities engaged in the business of dealing in securities pursuant to exemptions from the dealer registration requirement (exempt dealers) and entities engaged in the business of providing portfolio management or investment counselling services pursuant to exemptions from the adviser registration requirement (exempt advisers). The new sanctions effectively freeze the assets of the listed individuals in Canada.

Registrants, exempt dealers and exempt advisers should consider carefully the names on this list because the penalties for doing business with any individual or entity listed or designated in a Federal Provision (Designated Person) are severe. The Federal Provisions generally require registrants, exempt dealers and exempt advisers to review their records on a continuing basis to determine whether or not they are in possession or control of any property owned or controlled by or on behalf of a Designated Person and report their findings on a monthly basis to their principal securities regulator.

As we discussed in our February 2018 Bulletin, the Canadian Securities Administrators have published a notice and guidance document to assist registrants in understanding their obligations (including compliance and reporting obligations).

AUM Law can assist you with your compliance obligations in this area. Please contact us for more information.

4. FINRA Publishes Compliance Exams Report

On December 7, the U.S. Financial Industry Regulatory Authority (FINRA) published its annual report of its examination findings for broker-dealers. Although the details of FINRA's regulatory framework differ in many ways from the framework that AUM Law's clients face, we believe that some of the Report's findings and recommendations are instructive. In particular, we found FINRA's discussion of suitability for retail customers (pages 2-5) of interest.

The report also includes a section (pages 7-8) focusing on what constitutes reasonable diligence for private placements where firms have suitability obligations to clients. As the proposed amendments to *National Instrument 31-103 – Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103), with their increased emphasis on know-your-product (KYP) obligations, inch forward toward adoption, we can imagine Canadian securities regulators looking south of the border for inspiration on how to refine, interpret and enforce the new Canadian rules.

If you would like to discuss FINRA's report and which findings might have relevance in the Canadian regulatory environment, please contact us.

5. SEC Issues Report on Exam Sweep Focused on Electronic Messaging

On December 14, the Office of Compliance Inspections and Examinations (OCIE) at the U.S. Securities and Exchange Commission (SEC) published a Risk Alert Report about the use of electronic messaging within adviser firms. OCIE noted that the changes in the way mobile and personally owned devices are being used has presented some challenges for advisers in meeting their compliance obligations, including recordkeeping requirements. Although the U.S. regime differs in its details from the Canadian regime, we believe that the short Risk Alert Report provides a useful summary of practices for Canadian firms to consider in this area. Among other things, the OCIE encourages firms to consider:

1. Permitting only those forms of electronic communication for business purposes that the adviser determines can be used in compliance with applicable books and records requirements and expressly prohibiting the business use of apps and technologies that can be readily misused (*e.g.*, by allowing an employee to communicate anonymously);
2. Adopting firm procedures that require an employee who receives an electronic message using a form of electronic communication prohibited by the firm for business purposes to move that message to another electronic system that can be used in compliance with applicable books and records requirements;
3. Soliciting feedback from personnel on what forms of messaging are requested by clients and service providers so that the adviser can assess their risks and how those forms of communication can be incorporated into the adviser's policies;
4. For advisers that permit use of social media, personal email or personal websites for business purposes, contracting with software vendors to: (a) monitor such posts, emails and websites; (b) archive the business communications to ensure compliance with record retention rules; and (c)

ensure they have the capability to identify any changes in content and compare postings to a lexicon of key words and phrases; and

5. Establishing a confidential mechanism for employees to report concerns about a colleague's electronic messaging, website or use of social media for business purposes.

AUM Law can help you develop a social media / electronic messaging policy, assess the effectiveness of your existing policies and procedures and/or provide training to your employees on regulatory expectations in this area.

Practical Advice. Efficient Service. Fixed-Fee Plans.

AUM Law focuses on serving the asset management sector in the areas of regulatory compliance and investment funds. We also support clients in this sector by providing legal advice and services for structuring entities, raising capital, business combinations, and compliance with reporting issuers' and investors' disclosure obligations. Our clients include investment fund managers, portfolio managers, dealers, public and private investment vehicles including real estate funds, alternative funds and private equity funds, investors, and private and public companies.

This bulletin is an overview only and it does not constitute legal advice. It is not intended to be a complete statement of the law or an opinion on any matter. No one should act upon the information in this bulletin without a thorough examination of the law as applied to the facts of a specific situation.