June 2022 | Bulletin

Wimbledon Edition

The Championships, or Wimbledon for short, is the oldest tennis tournament in the world and also regarded as the most prestigious tournament of all. It is played annually in London, England on grass, and to this day it attracts the most attention and remains a favourite amongst the fans.

While our readers are keeping up with the matches this month, AUM wanted to also keep you up to date with important regulatory updates. In this bulletin edition, we discuss some tips relating to the conflicts of interest requirements, amendments to other activity reporting for registrants, the CSA's new business plan, additional derivatives proposals and much more below.

In this bulletin:

1. Conflicts of Interest Rally - Audit Sweep Update

As you may know, many of the provincial regulators including staff at the Ontario Securities Commission (**OSC**), are currently conducting a wide sweep of registrant firms. This sweep is meant to review how the industry has adapted to and applied the conflict of interest requirements brought in by the 2021 client focused reforms.

The provincial regulators have indicated that they are looking to complete the review phase of these sweeps by the end of the summer, with a view to providing further guidance sometime later this year or early in 2023. This means that if you have not yet been selected for the sweep, it appears unlikely that you will be selected in this round of reviews. For those registrant firms who have not yet been subject to review, we thought it would be helpful to provide some of our observations on what regulators have been looking at during these sweeps.

A. **A Conflicts Inventory is Key:** Regulators are drilling down on a registrant firm's methodology in considering and determining materiality and mitigating or avoiding conflicts. This methodology is expected to be documented, and a detailed inventory of all conflicts considered has been a good tool to satisfy regulatory inquiries. If you haven't created an internal conflicts inventory (separate and apart from your relationship disclosure information), this is an item that you should work towards having in the near future.
B. **Training and Policy Accuracy:** Regulators appear to be taking a very detailed look at a registrant's stated conflicts of interest policies to ensure that they address the revised conflict of interest obligations and that the stated policies are reflective of actual practice. Staff also appear to be testing that employees have received training on the new conflicts requirements.
C. **Relationship Disclosure Accuracy:** By June 2021, registrant firms were required to provide each of their clients with conflict of interest disclosure, detailing how the firm mitigates all material conflicts. Similar to the above note on policy accuracy, regulators are taking a close look at this disclosure to ensure that the stated disclosure is reflective of actual practice.
D. **Proprietary Funds:** Where a registrant firm has a proprietary fund, it appears that regulators are approaching this conflict review differently depending on the firm's business model. Where the registrant firm **only** sells proprietary products, regulators appear to be expecting clear disclosure about the firm's business model (e.g. that the shop only sells proprietary products). However, where a registrant firm sells both proprietary products as well as third party products, regulators are expecting that firms have done a comparative analysis of competitor products to their proprietary products.
E. **Compensation and Incentives:** Regulators expect registered firms to have carefully considered their compensation arrangements and incentive practices, both at the firm-level and in respect to their staff, to determine whether they may present any material conflicts of interest and, if so, how such conflicts have been addressed. For example, the regulators are interested in whether firms employed bonuses, tiered compensation, sales contests, sales targets or revenue quotas, and/or whether the firm or its individuals may receive incentives such as embedded commissions, shelf fees, due diligence fees, shares, options, warrants, performance fees, production bonuses, gifts or other monetary or non-monetary benefits.

Disclaimer Time! The summary above is just some observations we have seen while assisting clients with this regulatory sweep. While addressing the above would be a very good idea (where you believe you might have existing deficiencies), we will have to wait for either the written general guidance or formal deficiency letters to know what regulators will officially expect. This summary is meant to provide early indicators of regulatory expectations so that holes can be plugged as soon as possible. If you have any questions, please contact your usual lawyer at AUM Law.

2. Summer is Here! And So Are the Amendments to NI 31-109 and NI 33-103

Identifying OAs: Regulators have been busy with the implementation of the client focused reforms (**CFRs**) and the recent amendments to National Instrument 33-109 *Registration Information* (**NI 33-109**) and National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**). As a result, many registered firms have been inundated trying to navigate these changes.

Recently, BLG and AUM issued an article summarizing some of the key amendments and their impact on registrants, including the introduction of five new categories of reportable outside activity (**OA**), which replaces the prior concept of an OBA. All OAs must be formally assessed – first to determine if an OA qualifies as one of the five reportable OA categories – and the OA must be approved (or denied) by the firm. If approved and reportable, the OA must be reported via the NRD. Firms are also expected to continue to monitor and supervise a registrant's outside activities. Registrants should pay particular attention to the position of influence category (category #5) of an OA, because Section 13.4.3 of the Companion Policy to NI 31-103 indicates that firms must restrict the client base of a registrant whose OA is deemed to be a position of influence over said clients.

Regulators have provided guidance outlining what firms must implement (if not already in place), including an internal reporting system through which registrants can submit their OA requests for approval. Prior to approving (or denying) the OA, firms are expected to assess the information provided and determine whether:

(a) The activity impacts existing conflicts of interest, or the OA may create a potential material conflict of interest and/or potential client confusion; and

(b) The firm's internal controls are sufficient to address a material conflict of interest in the best interest of the client and any other issues that could arise from an OA. If the firm does not have sufficient controls in place, then the OA should not be permitted.

Firms are required to disclose material conflicts of interest to clients before opening an account or at least in a timely manner after a material conflict is identified.

Training, Training, Training! The regulators expect firms to provide training and education sessions for employees on the new OA and conflicts of interest requirements. These sessions convey to employees what their obligations are and help demonstrate to regulators that there is an effective compliance system in effect at a firm.

A Few Other Items You May Have Missed: NI 33-109F1 is now called the *Notice of End of Individual Registration or Permitted Individual Status* - but why? The regulators want the final day an individual is authorized to work in a registered capacity on behalf of their (former) firm captured in the NRD. In the past, some firms used the last day a registrant was paid by the firm as their "termination" date, even though the person has no capacity to act on behalf of the firm as at a different date. The regulators want the cessation date to be the last day that a registrant is authorized to act on behalf of the firm or the last day on which an individual was a permitted individual of their sponsoring firm.

Standard of Conduct: NI 33-109 introduces this term, which requires firms to confirm for registrants leaving whether the firm or an affiliate investigated the individual relating to possible material violations of fiduciary duties, regulatory requirements or the compliance policies and procedures of the firm or an affiliate (e.g. engaging in undisclosed outside activities). NI 33-109F4 further requires a prospective registered individual to disclose all allegations that existed against the person at the time of their last resignation or termination, including any allegation of a failure to meet any standard of conduct of the sponsoring firm or professional body. The required internal reporting system, and updated policies and procedures (to include this language, as well as the aforementioned amendments) will be beneficial to firms as they operate under the new regime.

Updating the NRD: There are new questions and sections of the relevant registration forms to accommodate the amendments. Required updates to individual registration forms must be done by the earlier of **(i)** the deadline related to the change to the registration information and **(ii)** June 6, 2023. For anyone currently trying to update any of the forms, you may have noticed some of these changes, particularly if the previous response recorded in the NRD stated "there is no response to this question". A response must now be provided to these questions to complete the filing. If it has been determined that a new OA creates a conflict that requires a change or update to previously reported responses to prior Item 6.2 Conflicts of Interest of Form 33-109F6, then the firm will have 30 days to report this change via the NRD.

Finally, titles and designations must be reported via the NRD. This requirement is complementary to new CFR rules which prohibit misleading business titles and designations. Your AUM contact would be happy to discuss any or all of these changes with you.

3. New Proposed Climate Risk Management Guideline: Will OSFI's Next Step Be an Ace?

On May 26, 2022, the Office of the Superintendent of Financial Institutions (**OSFI**) issued a draft version of Guideline B-15: *Climate Risk Management* (**Guideline**). The Guideline represents the latest in a series of developments that demonstrate OSFI's forward-looking approach to managing plausible risks of climate change facing federally regulated financial institutions (**FRFIs**) and more broadly, the economy.

The Guideline broadly categorizes climate-related financial risks into two spheres: physical and transition risks. Physical risks refer to those financial risks that may derive directly from gradual and acute changes in climate (including extreme weather events). Transition risks relate to financial risks deriving from growing regulatory and social pressures to adjust to a low-greenhouse gas economy. To manage these climate-related risks, the Guideline focuses on two areas: **(i)** governance and risk management expectations; and **(ii)** climate-related financial disclosures.

The Guideline's governance and risk management expectations sets out governance principles expected to be incorporated into the business model, policies and procedures of FRFIs. These include the need to consider the impact of climate change on an FRFI's short-term and long-term financial plans, and that climate-related risks should factor into senior management compensation. Risk management principles include the need to mitigate the physical impact of climate change and the potential for such disasters on its critical operations, including through developing a business continuity and disaster recovery plan. Alongside operational preparedness and resilience, OSFI highlights the need for FRFIs to develop their capabilities in climate risk monitoring, and to aggregate and internally report climate risk data to address certain risk concentrations (e.g., geographies or products).

The Guideline's climate-related financial disclosure regime sets out a requirement for *annual* disclosure. The principles to guide the disclosure include the need for relevant information (e.g., potential impact on cash flows and markets, and degree of exposure), which should also be presented in a manner that is clear, balanced, specific, and complete (i.e., comprehensive, by including both historical and future-oriented information). "Boilerplate" or generic disclosures should be avoided.

FRFIs will be expected to implement the disclosures required under the Guidelines for fiscal periods ending on or after October 1, 2023, and are expected to make the disclosures public (e.g., on the company's website) no later than 180 days after the FRFI's fiscal year-end. There is no prescribed form for the disclosure and as such a 'flexible' approach suited to the FRFI may be taken to present the information. The location for the disclosure is likewise discretionary, and may be included in, for example, a report to the shareholders.

The comment period for the draft Guideline will close on August 19, 2022, with the final version expected to be released by early 2023.

If you have any questions or are interested in learning more, please contact us.

In Brief

CSA Has a Game Plan – 2022-2025 CSA Business Plan

The Canadian Securities Administrators (**CSA**) released its 2022-2025 Business Plan on June 27, 2022. As noted in the message from the new CSA Chair, Stan Magidson, the plan sets out six strategic goals which focus on investor confidence in the Canadian capital markets and facilitating their efficient operation.

The strategic goals set out in the plan are to:

- Strengthen the capital markets regulatory system (including by implementing a single SRO, modernizing IT National Systems and incorporating Indigenous issues and perspectives in CSA policy work);
- Optimize investors' ability to contribute to policymaking and expand investor education outreach (including through the completed launch of the CSA Investor Advisory Panel);
- Improve investor protection by enhancing investors' ability to obtain redress and strengthening the advisor-client relationship (this will include supporting OBSI as an independent dispute resolution service with a focus on developing and recommending a binding authority framework);
- Address emerging issues and trends (including ESG issues and emerging technologies and business models);
- Deliver smart and responsive regulation protecting investors while reducing regulatory burden; and
- Promote integrity and financial stability through effective market oversight.

One item that was specifically noted with respect to the goal of delivering smart and responsive regulation is work toward simplifying relevant information for investors in investment fund issuers. The CSA intends to propose amendments to remove certain non-IFRS content that has not been found useful and is looking for new ways to organize other disclosure in a way that is more helpful to investors in a fund's management report of fund performance, material change and conflict of interest reporting requirements. Under the 6th goal, the CSA stated that it will consult on potential options to address issues that have been raised regarding access to Canadian real-time market data.

Not Yet Game, Set, Match - Additional OTC Derivatives Proposals

The Ontario Securities Commission (**OSC**) released a request for comment on June 9th relating to derivatives data reporting requirements in OSC Notice and Request for Comment – Proposed

Amendments to OSC Rule 91-507 *Trade Repositories and Derivatives Data Reporting* (and its companion policy) and *91-506CP Derivatives: Product Determination* (**91-506CP**). Similar but separate proposals were also released by the Manitoba Securities Commission, the Autorité des marchés financiers and the securities regulators in other Canadian jurisdictions.

The purpose of the proposed amendments are to harmonize over-the-counter derivatives data reporting standards in order to align with global standards that have been developed by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions (**IOSCO**). These standards include the data elements that need to be reported and their definition, format, and usage. Such harmonized data elements include a unique identifier for each transaction and a unique identifier for each product. Certain structural changes will also be made including a more flexible reporting hierarchy for non-dealers, and a harmonized threshold in the commodity derivatives exclusion for non-dealers. Other proposed amendments include improvements to enhance data accuracy (e.g. data verification). Updated requirements for trade repositories are also proposed, and new technical manuals have been drafted to assist market participants with the new reporting requirements. The proposed changes to 91-506CP (the "product determination changes") clarify that, similar to other financial commodities that are not excluded from the product determination rule, certain crypto assets that are financial commodities also do not fall under the relevant exclusion of the product determination rule.

Comments are due on the proposals by early October.

No Interference - IIROC Sets Priorities for 2023

As we reported in our May 2022 Bulletin, the Canadian Securities Administrators (**CSA**) are consulting on the application to consolidate the Investment Industry Regulatory Organization of Canada (**IIROC**) with the Mutual Fund Dealers Association of Canada (**MFDA**) by the end of the year. Within the context of this transaction, IIROC released a notice summarizing the initiatives it intends to prioritize in the next year, which includes advancing commitments related to investor protection, supporting industry transformation, and working towards the closing of the amalgamation and creating a new, enhanced self-regulatory organization.

Amongst other activities relating to investor protection, IIROC is looking at the potential to return disgorged funds collected from disciplined firms and advisors to harmed investors and anticipates publishing a proposal later this year. A working group has also made recommendations on how to improve IIROC's current arbitration program and plans to seek stakeholder comments on issues such as increasing the award limit and publication of decisions later on this year. Staff are also continuing their review of order-execution only services, particularly the point at which interrupted access would become an explicit investor protection issue. IIROC has paused its work on its Expert Investor Issues Panel in light of the new, proposed Investor Advisory Panel that will be established by the new SRO.

With respect to supporting industry innovation, IIROC created a new membership intake team to review new member applications (including with respect to crypto asset trading platforms) with the intent to increase review process efficiencies. IIROC has similarly created a compliance modernization group to look at ways to streamline activities across compliance teams. IIROC has also created cybersecurity self-assessment checklists for IIROC firms to assist them in building operational resilience.

Other previously announced priorities that IIROC will continue to work on include its derivatives rule reform, proposed competency profiles for supervisors, portfolio managers, associate portfolio managers and traders, and its EDI and Anti-Racism programs.

Got Game? Independent Evaluation of OBSI Released

On June 13, 2022, the Independent Evaluation of the Ombudsman for Banking Services and Investments (**OBSI**) [investments mandate] was released. In accordance with its Terms of Reference and a Memorandum of Understanding between the Canadian Securities Administrators (**CSA**) and OBSI (the **MOU**), OBSI must have an independent evaluation for its investment-related complaints function every five years. The purpose of the review, which was conducted by Professor Poonam Puri, was to determine whether OBSI is fulfilling its obligations as outlined in the MOU and whether any operational, budget and/or procedural changes in OBSI would be desirable. We discussed the evaluation late last year in our November Bulletin.

The evaluation report concluded that OBSI had met or exceeded its obligations under the MOU overall. The evaluators were particularly impressed with OBSI's handling of cases in a timely matter and with the skill and candidness of the case investigators. Mention is also made of significant improvements in operation since the last review in 2016, and that OBSI managed a high case volume during the pandemic without delays in investigations. In addition, OBSI's reasons for decision were stated to be fair, proportionate and explained in plain language, with conclusions flowing from the evidence.

Despite the positive conclusions, the report does contain 22 recommendations for improvement relating to some of the aforementioned areas. Some of these recommendations relate to a review of its governance structure, to ensure that key stakeholder interests are effectively considered in board oversight and decision making. Specific recommendations are made with respect to the content of closing letters to complainants, such as a clearer description of limitation periods for further action. Still other recommendations relate to OBSI's identification of systemic issues and indicates that OBSI should report annually on the number of such potential issues it has identified with a generic description, with the goal of working with regulators to issue a public report on what steps have been taken to deal with the potential systemic issues they've identified.

The report ultimately suggests that OBSI should be given authority to render binding decisions (with a higher compensation limit of $500K), which would increase legitimacy and be more consistent with international best practices for dispute resolution services.

Important Reminders

Succession Planning – Avoiding No Man's Land

What would happen to your firm and clients in the event your registered individuals are no longer able to perform their registerable duties? That is a question that is top of mind for regulators and one which staff is likely to ask about in the course of a regulatory audit, in particular for smaller firms. For example, firms with only one advisor with segregated accounts or proprietary pooled funds would face a significant business interruption in the event the sole advising representative were unable to perform the role.

Section 11.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* requires firms to establish, maintain and apply policies and procedures that establish a system of controls and supervision to ensure compliance with securities legislation and manage the risks associated with their business in accordance with prudent business practices. One such risk would be business interruption. For example, in CSA Staff Notice 31-350 *Guidance on Small Firms Compliance and Regulatory Obligations*, it provides that "in most cases of business interruption, there is a period where the client's portfolio is not being managed, which could be a significant issue for clients who need to generate income to meet their cash flow needs".

Registered firms should have a documented succession plan in place that contemplates ongoing management, transition or wind-down of client portfolios in the event the existing firm is no longer able to provide registerable services. They can, for example, consider reaching out to a friendly registrant who may be able to contact clients in the event the first firm is no longer able to provide services. Firms should also consider how a new registrant would be appointed in their absence to protect their clients. Note that while a registered person is usually prohibited from acting for two firms at once, in this case their role would be limited to acting in an administrative capacity and facilitating transition and communication. Note also that this issue may be something requiring explanation in relationship disclosure documentation, and that privacy concerns can arise in respect of sharing personal information of clients.

Please feel free to contact your usual lawyer at AUM to discuss these types of arrangements further.

Don't Double Fault: F4 Updates and Exempt Trade Reports Take Time

As referenced in our article above, the amendments to National Instrument 33-109 *Registration Information* (**NI 33-109**) are now in force. As a result, any changes required to be made to an individual registrant's Form 33-109F4 must be done no later than June 6, 2023. However, if a change to the form is required to be reported prior to such time, the entire form must be reviewed, updated and filed within the relevant filing deadline. This may include completing answers to questions that could previously be left blank on the form. As a result, we are recommending that clients (especially those with a large number of registrants and permitted individuals) have a plan to download, review and update such forms well in advance of the June 2023 deadline to avoid filing delays.

There are other frequently filed forms in a different context that may also take some time to complete. For example, exempt trade reports are often required to be filed for exempt distributions of securities (other than investment funds under certain prospectus exemptions) within 10 days of the distribution. These forms can be complicated to complete and require detailed information about the issue, the investors, compensation paid to dealers, etc. It may also take some time to set up the issuer's filing profile on SEDAR, the OSC's Electronic Filing Portal or, if required, on the BCSC e-services profile (the later usually takes at least 24 hours to set up a profile). These reports and profiles should be completed and set up as early as possible, again to avoid possible delays and late filing fees.

BLG's Resource Corner

Our colleagues at BLG have written the following articles we thought might interest our readers:

- Fund Total Cost Reporting – Coming to Investor Statements by 2025?
- Cullen Commission Final Report Makes Sweeping Recommendations for Anti-Money Laundering Regulation in B.C.
- Canada's Consumer Privacy Protection Act (Bill C-27): Impact for Businesses
- Financial Institutions and Climate Change: OSFI Guidance on Climate Risk Management
- Crypto Alternative Trading System: Notice of Operations and Request for Comment

For more information, please visit the BLG website.