

# Start to finish: Getting through an OSC compliance review

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# OSC

ONTARIO SECURITIES COMMISSION

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# Agenda

- Overview of the Compliance & Registrant Regulation Branch (CRR)
- Compliance review process
- Key areas of review and common deficiencies
- How to prepare for a review
- Outcomes of a compliance review
- Role of the Registrant Conduct team
- Resources

# Overview of the CRR Branch

- Portfolio Manager (PM) Team
- Investment Fund Manager (IFM) Team
- Dealer Team
- Registrant Conduct and Risk Analysis Team

# Compliance Review Process

- Selecting registrants for review
- Types of Reviews
  - Full compliance review
  - Targeted (sweeps, desk reviews)
  - For cause reviews

# Compliance Review Process

- Contact Registrant
- Send list of books and records
- Entrance meeting with senior management
- On-site field work

# Compliance Review Process

- Exit meeting
- Issue compliance deficiency report
- Closing letter

# Compliance Review Process - what's new

- Calling investors
- Non-significant deficiencies follow up
- More proactive approach to non-compliance



# Key Areas of IFM Reviews

- Fund accounting
- Trust accounting
- Transfer agent function
- Oversight of service providers
- Sales practices
- Financial condition and custody

# Common IFM deficiencies

- Oversight of service providers
  - Inadequate oversight
  
- Offering documents
  - Inadequate disclosure
  
- Expenses charged to funds
  - Inappropriate expense allocation
  - Inappropriate expenses

# Key Areas of PM Reviews

- Portfolio management and contracts
- Trading
- Conflicts of interest
- Portfolio valuation and reporting
- Marketing
- Financial condition and custody

# Common PM deficiencies

- Portfolio management
  - Inadequate KYC collected
- Trading
  - Cross trades between prohibited accounts
  - Soft dollars
- Conflicts of interest
  - Referral arrangements
  - Personal trading

# Key areas of EMD reviews

- KYC, KYP, and suitability
- Disclosure
- Marketing
- Financial condition and custody
- Client accounts (statements & confirmations)

# Common EMD deficiencies

- Misuse of the accredited investor exemption
- Unsuitable investment and failure to meet KYC, KYP and suitability obligations

# Common EMD deficiencies

- Conflicts of interest when selling securities of related or connected issuers
- Inappropriate use of investor money
- Inadequate supervision of dealing representatives

# Common deficiencies – all registrants

- Inadequate compliance systems/CCO or UDP not adequately performing responsibilities
- Marketing
  - Inaccurate/misleading material
  - Use of hypothetical performance data
- Inadequate insurance coverage



# Common deficiencies – all registrants

- Excess working capital
  - Incorrect calculation
  - Untimely calculation
- Dealing/advising without registration

# How to prepare for a review

- Perform a self-assessment
- Organized books and records
- Review risk assessment questionnaire and prior deficiency reports
- Prepare for initial meeting
- Ongoing dialogue

# Outcomes of a compliance review

- Deficiency report
- Terms and conditions
- Referral to the Enforcement Branch
- Suspension

# Role of Registrant Conduct Team

- To review, assess and appropriately sanction registrant misconduct
- To review and analyze applications for registration where conduct or risk issues arise
- To represent Staff's position before the Director during opportunities to be heard (**OTBH**)
- To provide investigation and litigation support to Enforcement Branch
- To refer matters to Enforcement Branch where registration-related tools in the Act are inadequate to address specific misconduct

# How Team 4 Supports the Compliance Review Process

- Team 4 typically does not assume carriage of compliance reviews
- Instead, Team 4's involvement in the compliance review process usually comes at the end, when a Director's remedy (*i.e.*, terms and condition or suspension) is sought by Staff, or if the matter is considered appropriate for a referral to the Enforcement Branch

# Compliance Deficiencies Triggering Team 4 Involvement

- Compliance deficiencies of a more serious nature may result in regulatory action
- Some that often do are:
  - inadequate compliance system
  - capital deficiencies
  - inappropriate sale of registrant's own securities to clients
  - failure to avoid, manage or disclose conflicts of interest

# The Director's Remedies

- Section 28 allows the Director to suspend or revoke registration, or to impose terms and conditions.
- The Director cannot impose certain sanctions (included suspensions, revocations, and terms and conditions), without first giving the registrant an OTBH.
- Other regulatory tools, such as warning letters and undertakings, are not prescribed by statute and do not involve the Director or the OTBH process.

# The Director's Remedies

- Assess misconduct against fundamental criteria for registration as set out in the Act:
  - **Integrity**, which includes honesty and good faith, particularly in dealings with clients, and compliance with Ontario securities law
  - **Proficiency**, which includes prescribed proficiency and knowledge of the requirements of Ontario securities law; and
  - **Solvency**, which is considered relevant because it is an indicator of a firm's capacity to fulfill its obligations and can be an indicator of the risk that an individual will engage in self-interested activities at the expense of clients



# Assessing Misconduct – Other Considerations

- We also consider the:
  - nature of the conduct (intent, significance)
  - degree or extent of conduct (harm, patterns of non-compliance, activity occurring over long periods of time)
- The type of recommended regulatory action (if any) depends on this assessment

# Reasons for Recommending Terms and Conditions

- Non-compliance by a firm not rising to level requiring suspension
- Significant compliance deficiencies that can be remedied with improved practices
- Monitoring of operations prior to sale or wind up

# Examples of Terms and Conditions – Firms

- Compliance consultant
- Compliance monitor
- Special audit reports
- Monthly filing of Form 31-103F1s (excess working capital calculations)

# Third Party Consultants and Monitors

- Consultants are designed to strengthen compliance systems
  - provide plan to OSC manager for approval
  - implement plan and provide regular progress reports
- Monitors are designed to ensure compliance immediately
  - may call clients to ensure suitability
  - may call clients to ensure clients understand features, risks and costs

# Reasons for Recommending Suspensions

- Rarely recommended remedy
- Permanent/indefinite suspension:
  - evidence of fraud or misappropriation
  - failure to deal fairly, honestly or in good faith with clients
  - compliance deficiencies so significant that immediate action must be taken to protect investor clients
  - persistent failure to respond (or adequately respond) to identified compliance deficiencies
- Term-limited suspensions
  - suspension proceedings resolved through settlement

# OTBHs

- OTBHs may be conducted as an exchange of written submissions, or as an in-person appearance.
- OTBHs are governed by *Procedures for Opportunities to be Heard Before Director's Decisions on Registration Matters*.
- Staff is represented at OTBHs by one of two lawyers on Team 4. OTBHs are not hearings before the Commission, but CRR makes reasonable efforts to ensure that procedural fairness commensurate with the nature of the matter is observed, and accordingly Team 4 lawyers have a background in litigation.

# OTBHs

- OSC homepage
  - Information for Dealers, Advisers, and Investment Fund Managers
    - Opportunity to be Heard
      - Director's Decisions

# Notable OTBH Decisions Arising out of Compliance Reviews

- A number of firms have been suspended or have otherwise ceased operations following a compliance review:
  - *Re Carter Securities Inc.* (2010), 33 O.S.C.B. 8691
    - Paid “returns” to investors in related party issuer with other investors’ capital
  - *Re Waterview Capital Corp.* (2011), 34 O.S.C.B. 5059
    - Failed to meaningfully respond to any of Staff’s compliance concerns
  - *Re Royal Securities Corp.* (2011), 34 O.S.C.B. 8043
    - Used abusive sales tactics to distribute proprietary fund
  - *Re Blueport Capital Corp.* (2012), 35 O.S.C.B. 681
    - Used investor capital to pay personal debts
  - *Re Morgan Dragon Development Corp.* (2012), 35 O.S.C.B. 1753
    - Sold related party securities without due regard to suitability or eligibility of investors for prospectus exemptions



# Notable OTBH Decisions Arising out of Compliance Reviews

- *Re New Solutions Capital Inc.* (2012), 35 O.S.C.B.
  - Failed to disclose true financial health of related issuer or true use of funds
- *Re White Capital Corporation* (2012), 36 O.S.C.B. 81
  - Failed to disclose conflict of interest with issuer to clients and Staff, and failed to demonstrate compliance with obligations
- *Re Investment Allocation International Inc.* (2013), 36 O.S.C.B. 5986
  - Sold securities of related start-up venture to portfolio clients to whom fiduciary duty was owed
- *Re FCPF Corporation* (2013), 36 O.S.C.B. 9855
  - Sold securities while suspended (due to lack of CCO) and violated registration and prospectus requirements

# Referrals to Enforcement

- Director has the power to suspend registration or impose terms and conditions, subject to an OTBH
- Commission has more tools than Director, including issuer- or security-specific tools
- Files may be referred to Enforcement where concerns raised with issuer or client funds are unaccounted for
- Enforcement will seek receiver if required

# Resources

- Navigating an OSC Compliance Review  
[http://www.osc.gov.on.ca/en/Dealers\\_ro\\_navigating-compliance-review.htm](http://www.osc.gov.on.ca/en/Dealers_ro_navigating-compliance-review.htm)
- 2013 Annual Summary Report For Dealers, Advisers and Investment Fund Managers  
*coming soon*
- CSA Staff Notice 31-325 – *Marketing Practices of Portfolio Managers*  
[http://www.osc.gov.on.ca/en/SecuritiesLaw\\_csa\\_20110705\\_31-325\\_marketing-practices.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20110705_31-325_marketing-practices.htm)
- CSA Staff Notice 31-334 – *Relationship Disclosure Practices*  
[http://www.osc.gov.on.ca/en/SecuritiesLaw\\_csa\\_20130718\\_31-334\\_review-disclosure-practices.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20130718_31-334_review-disclosure-practices.htm)
- KYC and suitability guidance  
*coming soon*

# Contact information

If you have any questions regarding the contents of this presentation, please contact:

## **Registrant Outreach program**

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# Questions

