

Compliance Requirements for Exempt Market Dealers and COVID-19 Regulatory Impacts on Registrants

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Agenda

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Part 1: COVID-19 Regulatory Impacts on Registrants

Background

- Coronavirus disease 2019 ("COVID-19") outbreak - declared a pandemic by the World Health Organization on March 11, 2020.
- As a result of COVID-19, there has been:
 - disruptions to travel,
 - limited or no access to office facilities, and
 - reduction in the availability of personnel and resources
- All potential effects may present challenges to meet obligations under Ontario securities law.

Overview of operational changes within CRR

- Core operations, including compliance reviews, are being delivered remotely
- Compliance activities will continue as planned, however we will be flexible on deadlines for information
- Risk Assessment Questionnaire – June 11, 2020

Summary of certain temporary exemptions

- Listing of regulatory relief and guidance available at <https://www.osc.gov.on.ca/en/covid-19-update.htm>
- May 25, 2020: Ontario Instrument 31-513 [*Temporary Exemption from Certain Financial Statement and Information Delivery Requirements for Registrants and Unregistered Capital Markets Participants, No. 2*](#)
- March 20, 2020: Ontario Instrument 31-510 [*Temporary Exemption from Certain Financial Statement and Information Delivery Requirements for Registrants and Unregistered Capital Markets Participants*](#)
- April 15, 2020: Ontario Instrument 31-512 [*Relief in respect of Client Focused Reforms Relationship Disclosure Information Provisions of National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations*](#)

Summary of certain temporary exemptions

- April 15, 2020: Ontario Instrument 31-511 [Relief in respect of Client Focused Reforms Conflict of Interest Provisions of National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations](#)
- May 29, 2020: Ontario Instrument 13-506 [Temporary Relief from Accrual of Late Fees Charged under Ontario Securities Commission Rule 13-502 Fees, No. 2](#)
- April 17, 2020: Ontario Instrument 13-504 [Temporary Relief from Accrual of Late Fees Charged under Ontario Securities Commission Rule 13-502 Fees](#)

Extension of certain due dates

- Ontario Instrument 31-513
 - extension of up to 60 days where the delivery deadlines fall during June 2, 2020 to September 30, 2020.
- Ontario Instrument 31-510
 - extension of up to 45 days where the delivery deadlines fall during March 23, 2020 to June 1, 2020.
- Applies to certain documents such as:
 - annual financial statements,
 - interim financial information,
 - Form 31-103F1 *Calculation of Excess Working Capital*, and
 - Form 31-103F4 *Net Asset Value Adjustments*

Temporary waiver of certain late fees

- Ontario Instrument 13-506
 - applies to certain late fees during the periods of June 2, 2020 to September 30, 2020, and June 2, 2020 to August 31, 2020.
- Ontario Instrument 13-504
 - applies to certain late fees during the period from April 17, 2020 and ending June 1, 2020

Client Focused Reforms blanket orders

- Ontario Instrument 31-511
 - effective date to comply with the Client Focused Reforms relating to conflicts of interest in Part 13 of NI 31-103 postponed by 6 months.
 - June 30, 2021 – new implementation date for conflicts of interest requirements in Client Focused Reforms.
- Ontario Instrument 31-512
 - effective date to comply with the RDI requirements in Client Focused Reforms in Part 14 of NI 31-103 postponed by 12 months.
 - December 31, 2021 – new implementation date for RDI amendments.

COVID-19 related issues and impacts

Business continuity plan (BCP)

- While many firms are working under BCP conditions, use this as an opportunity to update BCPs for activities being performed but not captured within the current BCP
- Consider whether the BCP included procedures for extended periods of work under the BCP, or procedures for the business to respond and continue during a pandemic
- Provide clear and transparent communication to clients and regulators on activities the firm has employed to manage the impact of the pandemic

COVID-19 related issues and impacts

KYC and client interaction

- Update KYC information to reflect any changes in the client's circumstance. For example:
 - Changes in financial circumstances (e.g. loss of employment or reduced income)
 - Time horizon changes (e.g. shorter time horizon)
 - Changes in investment needs and objectives (e.g. greater need for liquidity)
 - Risk tolerance changes (e.g. lower tolerance for risk)

COVID-19 related issues and impacts

KYC and client interaction

- Firms should review and update KYC information before trades to confirm whether clients meet bright line tests for income and assets to qualify as an eligible or accredited investor.
 - Declines in the value of financial assets (e.g. securities) may impact whether the client meets the financial assets test (e.g. financial assets > \$1M)
 - Loss of income or employment may impact whether the client meets the income test (e.g. net income > \$200,000)
 - Consider whether the acquisition cost of exempt securities represents the current value of those securities

COVID-19 related issues and impacts

KYC and client interaction

- Consider how representatives should communicate with clients to update KYC information as firms respond to social distancing guidelines
 - Methods to meet with clients (e.g. videos calls, conference calls, etc.)
 - Resources approved for use (e.g. video-call software)
 - Acceptable methods to verify an individual's identity - firms can refer to FINTRAC guidance
 - How to communicate with clients who have special needs or clients with limited access to technology

COVID-19 related issues and impacts

KYC and client interaction

- Suitability assessments may be impacted by changes in the client's KYC information
 - Investments previously recommended or traded may no longer be suitable when recommending new trades
 - Different investments or products may need to be considered to address the client's needs and objectives
 - Concentration in certain products, industries or asset classes may need to be revised
 - Consider whether investment policy statements or asset allocations should be revised

COVID-19 related issues and impacts

Know your product

- Consider the impact of changes in the structure, features and risks of securities sold or recommended.
 - Have clear procedures on the firm's process to obtain updated information on issuers and how training will be provided to the firm's representatives
 - Issuers experiencing financial hardship or solvency issues may impact the risk of the security
 - Consider how changes in a security will impact what is suitable for clients and which securities are approved for sale or recommendation to clients

COVID-19 related issues and impacts

Liquidity and redemption requests

- IFMs that are also PMs should continue to monitor the liquidity of their investment funds to facilitate potential increases in redemption requests
- IFMs and PMs should closely focus on monitoring how their respective liquidity risk management policy and procedure is being implemented and executed
 - IFMs should monitor this closely for sub-advisers/PMs of their respective investment funds.

COVID-19 related issues and impacts

Liquidity and redemption requests

- Redemptions of certain types of investment funds may have increased
 - Some private investment funds in the real estate space have suspended redemptions
- Borrowing limits to accommodate redemption request for mutual funds
 - Ontario Instrument 81-504 [Temporary Exemption from Borrowing Limits to Accommodate Redemption Requests of Mutual Funds](#)

COVID-19 related issues and impacts

Service providers

- Firms should continue to ensure that all outsourced services comply with regulatory requirements
- Examples of operational areas that may be impacted by operational impact to a service provider include:
 - Valuation of investment funds and assets in managed accounts
 - Striking of the net asset value for an investment fund
 - Preparing trade confirmations and client statements

COVID-19 related issues and impacts

Service providers

- The BCP of service providers may have an impact on a firm meeting its regulatory requirements
- Consider increasing the frequency of communication with service providers to help with the timely identification of potential issues

COVID-19 related issues and impacts

Excess working capital

- Continue to monitor excess working capital for potential capital deficiencies
 - Factors which may decrease excess working capital:
 - Decrease in cash or investment balances
 - Increase in short term borrowing
 - Decrease in revenues – cash and receivables impacted
 - Firms are required to know their excess working capital at all times and provide notification as soon as possible if at any time the excess working capital is less than zero
 - The frequency of working capital calculations depends on many factors – firms may consider performing excess working capital calculations more frequently to ensure they are not capital deficient

COVID-19 related issues and impacts

Supervision

- Individuals in supervisory roles may encounter challenges in supervising for compliance while employees work remotely
- Best practices for firms:
 - Follow the firm's policies and procedures on supervisory practices (revise if necessary)
 - Communicate regularly with team members
 - Review reports regularly (e.g. trade blotters, clients onboarded, non-compliance or warnings from portfolio management systems)
 - Continue to maintain fulsome records to demonstrate compliance with policies and procedures

COVID-19 related issues and impacts

Cybersecurity

- Employees may be working remotely on an-going basis – this may result in a greater need to have robust cybersecurity systems in place to deal with cybersecurity threats
- Consider the cybersecurity controls of software solutions, technologies or service providers which are being used
- Monitor the firm's network to detect unauthorized access or access to websites unrelated to business use
- For further guidance – refer to CSA Staff Notice 33-321 [Cyber Security and Social Media](#)

COVID-19 related issues and impacts

Marketing

- Firms may need to review their marketing material to ensure that statements or claims are not misleading given the current operational environment.
- Review statements or claims regarding product performance (e.g. returns) and consider whether updates are required to incorporate changes made by the firm to respond to the impact of COVID-19
- Questions?

Part 2: Compliance requirements for Exempt Market Dealers

A: Overview of the OSC compliance review process

What does the Compliance and Registrant Regulation Branch do?

- CRR registers and oversees firms and individuals in the business of trading or advising, or firms that manage investment funds
- Responsibilities include:
 - Conduct compliance reviews
 - Develop and implement policy
 - Evaluate applications for exemptive relief
- CRR has a focused dealer team that oversees:
 - Exempt market dealers (EMD)
 - Restricted dealers
 - Scholarship plan dealers

How are EMDs selected for review?

- CRR staff routinely perform compliance reviews of EMDs
- There are various methods firms are selected for a review:
 - Risk assessment questionnaire
 - Theme or sweep
 - Random
 - Tips, complaints or referral from other regulators
 - New registrant

If your firm is selected for review

- OSC staff will contact the firm before the review
- We may:
 - Interview management and key employees
 - Examine books and records of the firm
 - Assess compliance system and internal controls
- At conclusion of the review, we may send the firm a deficiency report outlining areas of non-compliance

B: Effective compliance systems

Ultimate Designated Person

- Each EMD is required to designate an ultimate designated person (UDP)
- The ultimate designated person is responsible for:
 - Supervising the EMD's activities
 - Promoting compliance

Legislative Reference: Sections 5.1 and 11.2 of NI 31-103

Chief Compliance Officer

- Each EMD is required to designate a Chief Compliance Officer
- A Chief Compliance Officer (CCO) is responsible for:
 - Establishing policies and procedures for assessing compliance
 - Monitoring and assessing compliance
 - Reporting to the UDP as soon as possible of non-compliance with securities legislation
 - Submitting an annual report

Legislative Reference: Sections 5.2 and 11.3 and Part 3 of NI 31-103

Compliance systems

- Each EMD is required to establish, maintain and apply a compliance system sufficient to:
 - (a) Provide reasonable assurance that the firm and individuals acting on its behalf comply with securities legislation
 - (b) Manage the risks associated with the firm's business in accordance with prudent business practices

Legislative Reference:

- Subsection 32(2) of the *Securities Act* (Ontario)
- Section 11.1 of NI 31-103

Elements of an effective compliance system



C: Financial condition, insurance and custody requirements

Financial condition

- Working capital calculations:
 - Firms need to be aware of their working capital at all times
 - Form 31-103F1 – *Calculation of excess working capital*
 - The minimum working capital for a sole EMD is \$50,000
 - Typically prepared and reviewed at least monthly
 - Must notify OSC if working capital calculation is negative
 - Sole EMDs must submit 31-103F1 annual to OSC
- Financial statements – sole EMDs must deliver to the OSC within 90 days of its year-end audited financial statements

Legislative Reference: Sections 12.1, 12.2 and 12.12 of NI 31-103

Excess Working Capital

	Component	Current period	Prior period
1.	Current assets		
2.	Less current assets not readily convertible into cash (e.g., prepaid expenses)		
3.	Adjusted current assets Line 1 minus line 2 =		
4.	Current liabilities		
5.	Add 100% of non-current related party debt unless the firm and the lender have executed a subordination agreement in the form set out in Appendix B of National Instrument 31-103 <i>Registration Requirements, Exemptions and Ongoing Registrant Obligations</i> and the firm has delivered a copy of the agreement to the regulator or, in Québec, the securities regulatory authority. See section 12.2 of National Instrument 31-103 <i>Registration Requirements, Exemptions and Ongoing Registrant Obligations</i> .		

Recoverability of related party receivables

Subordination agreement to OSC for review

Excess Working Capital (cont'd)

8.	Less minimum capital		
9.	Less market risk	← Refer to Schedule 1 of 31-103E1	
10.	Less any deductible under the bonding or insurance policy required under Part 12 of National Instrument 31-103 <i>Registration Requirements, Exemptions and Ongoing Registrant Obligations</i>		
11.	Less Guarantees		
12.	Less unresolved differences		
13.	Excess working capital		

Insurance requirements

- EMD must maintain bonding or insurance in the highest of the following amounts:
 - a) \$50k per employee, agent and dealing representative or \$200k, whichever is less
 - b) 1% of total client assets that the dealer holds or has access to or \$25m, whichever is less
 - c) 1% of dealer's total assets or \$25m, whichever is less
 - d) Amount determined by the firm's board of directors
- Insurance must provide for a double aggregate limit or a full reinstatement of coverage

Legislative Reference: Sections 12.3 of NI 31-103

Custody requirements

- Custody:
 - Insurance requirements vary depending on whether firm holds or has access to client assets.
 - Examples of when considered to hold or have access:
 - ✓ Hold client securities or cash for any period
 - ✓ Accept funds from client – e.g. cheque made payable to the EMD
 - ✓ Accept money from a custodian
 - ✓ Have ability to gain access to client assets
 - ✓ Have legal ownership or access to client funds/securities
 - ✓ Have authority to withdraw funds or securities from client account

Legislative Reference: Part 14 – Division 3 of NI 31-103

Custody requirements (cont'd)

- Custody:
 - Sole EMDs typically do not hold client assets
 - If an EMD holds or has access to client assets (e.g. cash, physical possession of gold):
 - Hold assets separate and apart from registrant assets
 - Hold in a designated trust account with Canadian financial institution
 - If an EMD holds securities on behalf of a client – must be held by qualified custodian

Legislative Reference: Part 14 – Division 3 of NI 31-103

D: Know-your-client (KYC)

When does KYC apply?

- Under NI 31-103, a registrant is required to have current KYC information whenever a suitability determination is required
- An EMD is required to make a suitability determination before they make a recommendation to or accept instruction from a client to buy or sell a security

Legislative Reference: Section 13.2 of NI 31-103

Overview of KYC information

- Registrants are required to take reasonable steps to:
 - Establish identity (and reputation) of client
 - Establish whether client is an insider
 - Ensure they have sufficient information to meet suitability obligation
- Additional requirements if client is a corporation, partnership or trust:
 - Nature of the client's business
 - Identity of any individual who:
 - Corporation – person who owns or controls more than 25% of voting securities of the corporation
 - Partnership or trust – person who exercises control

Legislative Reference: Section 13.2 of NI 31-103

KYC information collected

- Registrant must take reasonable steps to ensure that it has sufficient information of a client's:
 - **Investment needs and objectives** – including time horizon for their investments and their investment knowledge
 - **Financial circumstances** – including net worth, income, current investment holdings, employment status, age, etc.
 - **Risk tolerance** – clients ability and willingness to accept risk
- Obligation to take reasonable steps to keep the information collected current
 - Generally - at least annually
 - If become aware of significant change – update info

KYC information – guidance and tips

- ✓ Engage in meaningful discussions with clients
- ✓ Develop an investor friendly KYC form – use plain language and define terms for clients such as investment objectives and risk tolerance
 - Clients may need assistance articulating responses
 - Some responses may be unclear – further enquiries
- ✓ Review the KYC information with the client to ensure it is accurate and complete
- ✓ Additional care to vulnerable or less sophisticated clients
- ✓ Sign/date the KYC information – both client and registrant
- ✓ Maintain thorough notes from client discussions

KYC information – examples of unacceptable practices

- Delegate the KYC obligation to an unregistered individual
- Process a trade with missing or conflicting KYC information
- Use outdated KYC information to assess suitability
- Collect KYC information solely by asking client to tick boxes to best describe their investment objectives and/or risk tolerance
- Use a KYC form that contains inappropriate disclaimer language

E: Know-your-product (KYP)

Know-your-product (KYP)

- EMDs are expected to have an understanding of the securities that are purchased and sold for, or recommended to, their clients, obtained through a robust know-your-product process in order to make the suitability determination
- EMDs should consider whether their know-your-product process covers the following:
 - ✓ Each security the firm makes available to clients
 - ✓ Securities of related or connected issuers
 - ✓ Securities as a result of a client directed trade

Additional Resources: Companion policy to NI 31-103

Know-your-product

- Elements to consider
 - ✓ General structure and features of the security
 - ✓ Conflicts of interest
 - ✓ Parties involved
 - ✓ Risks of the security
 - ✓ Initial and ongoing costs

Additional resources: Companion policy to NI 31-103

F: Prospectus exemptions

Prospectus exemptions

- EMDs may only act as a dealer or an underwriter in the “exempt market”
- EMDs may:
 - Trade or underwrite securities if the trade is a distribution made under a prospectus exemption
 - Participate in the resale of securities that are subject to resale restrictions
 - Participate in the resale of securities, if a prospectus exemption would be available to the seller if the trade were a distribution and the class of securities is not listed, quoted or traded on a marketplace

Legislative References:

- Section 7.1 of NI 31-103
- National Instrument 45-106 *Prospectus Exemptions*

Prospectus exemptions

- EMDs should consider:
 - ✓ Procedures to verify that the purchaser meets the criteria
 - ✓ Whether there is consistency between the KYC information and the information in the subscription agreement
 - ✓ Retention of relevant and detailed documentation
 - ✓ Training dealing representatives on the criteria
- Common prospectus exemptions:
 - Accredited Investor
 - Offering Memorandum
 - Family, Friends and Business Associates

Legislative References:

- Section 11.1 of NI 31-103
- National Instrument 45-106 *Prospectus Exemptions*

Prospectus exemptions

- Lessons learned from past compliance reviews:
 - Inadequate collection of information and documentation to support compliance with the conditions of the prospectus exemptions
 - Incorrect or incomplete risk acknowledgement form
 - Accepting client directed trades that exceed the prescribed investment limits
 - Processing trades that exceed the prescribed investment limits
 - Processing trades for clients who are not family members, close personal friends or close business associates

Additional Resources: Compliance and Registrant Regulation Annual Report

G: Suitability

Suitability

- Who:
 - A registrant
- What:
 - Take reasonable steps to ensure that the purchase or sale is suitable for the client
- When:
 - Before the Registrant makes a recommendation to, or accepts an instruction from, a client to buy or sell a security

Legislative Reference: Section 13.3 of NI 31-103

Suitability

- Suitability obligations cannot be:
 - Delegated to anyone else
 - Satisfied simply by disclosing the risks of the trade
 - Waived (except by investors that are “permitted clients” as defined in NI 31-103)
- Exclusions:
 - Client is a registered firm, a Canadian financial institution or a Schedule III bank
 - A permitted client has waived the requirement in writing

Legislative Reference: Section 13.3 of NI 31-103

Suitability

- Some elements to consider in a suitability determination:
 - ✓ The registrant's understanding of the product (i.e., know-your-product)
 - ✓ The client's know-your-client information
 - ✓ Concentration
 - ✓ Liquidity

Additional resources: Companion policy to NI 31-103

Suitability

- If a client instructs a registrant to buy, sell or hold a security and in the registrant's reasonable opinion following the instruction would not be suitable for the client, the registrant must inform the client of the registrant's opinion and must not buy or sell the security unless the client instructs the registrant to proceed nonetheless
- Elements to consider:
 - ✓ Registrant has conducted a suitability assessment
 - ✓ Investor has been informed of the reason(s) why the investment would not be suitable for the investor
 - ✓ The investor instructs in writing the registrant to proceed

Legislative Reference: Section 13.3 of NI 31-103

Additional Resources: CSA Staff Notice 31-336 *Guidance for Portfolio Managers, Exempt Market Dealers and Other Registrants on the Know-Your-Client, now-Your-Product and Suitability Obligations*

Suitability

- Lessons from past compliance reviews:
 - Improper assessment of suitability.
 - Inadequate collection, documentation and maintenance of KYC information.
 - Inadequate suitability assessments due to not having all the information necessary, such as a client's income or risk tolerance.
 - EMDs selling securities to non-accredited investors (with no other exemption available).
 - Inadequate suitability assessments due to over-concentration.
 - Improper delegation of KYC and suitability obligation to third parties.

Additional Resources: Compliance and Registrant Regulation Annual Report

H: Conflicts of interest

Conflicts of interest – what is it and what is your obligation?

- What is a conflicts of interest?
 - Includes any circumstance where the:
 - Interests of client and registrant are inconsistent
 - Registrant may be influenced to put their own interests ahead of a client
 - Benefits available to a registrant may compromise the trust that a client has in the registrant
- Registrant's obligation – take reasonable steps to:
 - Identify existing or potential conflicts of interest
 - Respond to identified conflicts of interest
 - Control the conflict through policies and procedures, or avoid if not possible to control

Legislative Reference: Sections 13.4 and 13.6 of NI 31-103

Conflicts of interest – disclosure

- Must disclose, in writing, the material conflict to the client:
 - Nature and extent of the conflict of interest
- Disclosure must be prominent, specific and plain language
- Disclosure to a client of the conflict of interest before opening an account for the client
- A registrant cannot satisfy addressing material conflicts of interest by disclosure alone

Conflicts of interest – examples of material conflicts of interest

- Companion Policy to NI 31-103 provides examples of material conflicts of interest under section 13.4
- Some examples include, conflicts arising from:
 - ✓ Sale of proprietary products
 - ✓ Sale of third party products
 - ✓ Internal compensation arrangements and incentive practices
 - ✓ Conflicts at the supervisory level
 - ✓ Referral arrangements
- Please review the companion policy for a more thorough discussion of these conflicts

I: Marketing practices

Marketing practices

- When reviewing marketing practices, we look to section 2.1 of OSC Rule 31-505 – *Conditions of registration*
 - Rule requires registered dealers and advisers to deal fairly, honestly and in good faith with its clients
 - Rule applies to registrants generally – expect dealers and advisers to apply it to all areas of activities, including marketing practices, marketing materials (including any use of social media)

Marketing issues identified during compliance reviews

- Exaggerated and unsubstantiated claims:
 - Statements made without evidence to support claims
 - Often relate to performance, skills, experience or services
- Disclosure documents:
 - Information contained in material is out of date
 - No disclosure of the source of third party information
 - Inadequate/inconsistent disclosure in offering memorandum (OM) or other offering documents

Marketing issues identified during compliance reviews

- Social media:
 - Includes: twitter, Facebook, LinkedIn, Instagram
 - Dealing rep activity not being monitored by the firm
 - Aggressive claims and statements being made
- Policies, procedures and internal controls:
 - No or inadequate written policies and procedures governing marketing materials
 - Lack of review of marketing material by compliance
 - Inadequate books and record to record marketing activities conducted

Marketing material – examples of deficiencies, guidance and tips

- Examples of exaggerated and unsubstantiated claims:
 - “experts” in a particular area, such as real estate
 - “top investment product the last two years”
 - “we lend to stable and recession proof industries”
 - ✓ Claims should be substantiated
 - ✓ Should include a reference to information supporting claims
- Client testimonials on website or other material – ensure current with adequate disclaimers

Marketing material – examples of deficiencies, guidance and tips

- Disclosure documents:
 - Using an OM that is over a year old
 - Marketing material or website that is not current
 - Information in OM that is inconsistent with other marketing material
 - ✓ Information should be meaningful and up to date
 - ✓ Disclose source of third party information
 - ✓ Adequate disclaimers regarding past performance
 - ✓ Font size – should not be difficult to read

Marketing material – examples of deficiencies and guidance & tips

- Social media:
 - Aggressive claims and statements made regarding performance or services offered
 - ✓ Have DRs and other staff disclose all work related social media to compliance of the firm
 - ✓ Monitor DR/staff social media sites on a frequent basis
- Policies, procedures and internal controls:
 - Without them - risk misleading statements communicated to investors unless procedures in place to review and approve
 - ✓ Prepare, review and approve marketing materials
 - ✓ Separate the tasks of preparing and reviewing marketing material if possible

J: Referral arrangements

What is a referral arrangement?

- What is a referral arrangement?
 - Any arrangement in which a registrant agrees to provide or receive a referral fee to/from another person/company
- Permitted referral arrangements – a registered firm or individual must not participate in a referral arrangement with another person/company unless:
 - Before client is referred, the terms of the referral arrangement are set out in written agreement
 - Registered firm records all referral fees
 - Registered firm provides required disclosure to client

Legislative Reference: Sections 13.7 – 13.11 of NI 31-103

Referral arrangements – guidance and tips

- ✓ Records of referral payments should include:
 - Name of client referred
 - Amount of the fee
 - Person/company paying or receiving the fee

- ✓ Referral agreements should include:
 - Roles and responsibilities of each party
 - Limitations of any party that is not a registrant
 - Disclosure to be provided to referred clients
 - Who provides the disclosure

- ✓ Cannot use a referral arrangement to assign, contract out of or otherwise avoid your regulatory obligation (e.g. KYC)

Referral arrangements – guidance and tips

- ✓ Disclosure to clients – take reasonable steps to ensure client:
 - Understands with which entity they are dealing with
 - Purpose and terms of agreement – nature of services
 - Method of calculating referral fee – amount if possible
 - Registrants key responsibilities
 - What they can expect the parties to provide to them
 - Nature of any existing or potential conflict of interest that may arise from the referral arrangement

K: Client disclosures and statements

Relationship disclosure information

- Who:
 - Every registered firm
- What:
 - Deliver to a client all information that a reasonable investor would consider important about the client's relationship with the registrant
- When:
 - Before the first purchase or sale for the client or the first advice provided to purchase, sell or hold a security
 - If there is a significant change in the information delivered, before the next purchase or sale for the client or next advice provided to purchase, sell or hold a security

Legislative Reference: Division 5 of Part 14 of NI 31-103

Trade Confirmations, Client Statements and Reports

- Prescriptive requirements
- Depends on whether a registered firm has a "client" at the relevant point in time
- Factors:
 - Type of security
 - Trailer fee or ongoing compensation
 - Holding client assets
 - Firm expectation of further transactions with or services for the client
 - Client expectation of continued services from the EMD

Additional resources: *CSA Staff Notice 31-345 Cost Disclosure, Performance Reporting and Client Statements – Frequently Asked Questions and Additional Guidance*

Trade confirmation

- Who:
 - Every registered dealer who acting in connection with the purchase or sale of a security or derivative
- What:
 - Is required to deliver a trade confirmation that contains certain information to the client
- When:
 - Promptly

Legislative Reference:

- Section 36(1) of *Securities Act* (Ontario)
- Division 5 of Part 14 of NI 31-103

Account statements

- An account statement has two principal elements
 1. Transactional information
 2. Account position information

- Transaction information
 - Always required where there has been a transaction
 - At least quarterly

Legislative Reference: Division 5 of Part 14 of NI 31-103

Account statements

- Account position information
 - Required if:
 - EMD holds client securities or
 - EMD does not hold client securities but
 - receives continuing payments (e.g., trailing commissions) or
 - is the dealer of record for securities issued by a mutual fund or certain labour-sponsored investment vehicles
 - At least quarterly
 - Provided through “other additional information” on the account statement or through “additional statement”.

Legislative Reference: Division 5 of Part 14 of NI 31-103

Position Cost Information

Security position cost information

- Required if the EMD is required to provide account position information
- At least quarterly

Legislative Reference: Division 5 of Part 14 of NI 31-103

Annual reports

Annual Reports

1. Annual report on charges and other compensation
 2. Annual investment performance report
- Required if:
 - The EMD is required to provide account position information
 - There is an ongoing client relationship
 - No nil Report on Charges and other Compensation required
 - No nil Investment Performance Report required if market value cannot be determined for any securities under s. 14.14(5) or s. 14.14.1(2)

Legislative Reference: Division 5 of Part 14 of NI 31-103

L: Examples on applying prospectus exemptions

Example 1 – Individual investor

- Income:
 - Current year - \$550K
 - Previous year - \$500K
 - 2nd prior year - \$450K
- Assets:
 - Cash - \$200K
 - Stocks and bonds - \$1.3M
 - House - \$7M
 - Mortgage - \$1M
 - Other assets - \$1.5M
 - Other liabilities - \$700K

Accredited investor prospectus exemption – meets accredited investor definition

- Net financial assets at \$1.5M are greater than \$1M
- Net income for 2 most recent calendar years and current calendar year exceeds \$200K
- Net assets at \$8.3M exceeds \$5M

Offering memorandum prospectus exemption – meets eligible investor definition by being an accredited investor

Example 2 – Individual investor and spouse

- Individual's income:
 - Current year - \$90K
 - Previous year - \$90K
 - 2nd prior year - \$85K
- Spouse's income:
 - Current year - \$50K
 - Previous year - \$45K
 - 2nd prior year - \$45K
- Assets:
 - Cash - \$10K
 - Stocks and bonds - \$40K
 - House - \$400K
 - Mortgage - \$300K
 - Other assets - \$40K
 - Other liabilities - \$10K

Offering memorandum prospectus exemption – meets eligible investor definition

- Individual's net income for 2 most recent calendar years and current calendar year exceeds \$75K
- Combined net income for 2 most recent calendar years and current calendar year exceeds \$125K

(Does not meet the net assets test because the combined net assets at \$180K is less than \$400K)

Example 3 – Individual investor

- Income:
 - Current year - \$75K
 - Previous year - \$55K
 - 2nd prior year - \$50K
- Assets:
 - Cash - \$5K
 - Stocks and bonds - \$45K
 - House - None
 - Mortgage – N/A
 - Other assets - \$25K
- Nephew of the issuer's founder
- Cannot rely on the family, friends and business associates prospectus exemption
 - Is not a spouse, parent, grandparent, brother, sister, child or grandchild of: (i) founder of issuer; or (ii) spouse of the founder of issuer.
- Cannot rely on the accredited investor prospectus exemption
 - Is not an accredited investor - does not meet the net income, net financial assets, or net assets test.
- Cannot rely on the offering memorandum prospectus exemption
 - Is not an eligible investor - does not meet the net income or net assets test

M: Summary of published guidance

Summary of published guidance

- CSA staff notice 31-343 - *Conflicts of interest in distributing securities of related or connected issuers:*
https://www.osc.gov.on.ca/documents/en/Securities-Category3/csa_20151119_31-343_sn-conflicts-of-interest.pdf
- CSA Staff notice 31-325 – *Marketing practices of portfolio managers:*
<https://www.osc.gov.on.ca/documents/en/Securities-Categ>
- CSA Staff Notice 31-336 – *Guidance for Portfolio Managers, Exempt Market Dealers and Other Registrants on the Know-Your-Client, Know-Your-Product and Suitability Obligations*
https://www.osc.gov.on.ca/documents/en/Securities-Category3/csa_20140109_31-336_kyc-kyp-suitability-obligations.pdf

Summary of published guidance

- CRR annual summary reports for dealers, advisers and investment fund managers

https://www.osc.gov.on.ca/en/Dealers_reports-staff-notices_index.htm

- CSA Staff Notice 31-354 - *Suggested Practices for Engaging with Older or Vulnerable Clients*

https://www.osc.gov.on.ca/documents/en/Securities-Category3/csa_20190621_31-354_suggested-practices-for-engaging-with-older-or-vulnerable-clients.pdf

- CSA Staff Notice 31-350 – *Guidance on Small Firms Compliance and Regulatory Obligations*

https://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20170517_31-350_guidance-on-small-firms.htm

Other helpful resources

- OSC website for Dealers, Advisers, and Investment Fund Managers
https://www.osc.gov.on.ca/en/Dealers_index.htm
- Navigating an OSC Compliance Review
https://www.osc.gov.on.ca/en/Dealers_ro_navigating-compliance-review.htm
- Sample of books and records request to Exempt Market Dealers:
https://www.osc.gov.on.ca/documents/en/Dealers/da_20100409_emd-books-records.pdf

Other helpful resources

- Topical guide for registrants

https://www.osc.gov.on.ca/en/Dealers_topical-guide-for-registrants.htm

- Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms)

https://www.osc.gov.on.ca/documents/en/Securities-Category3/ni_20191003_31-103_reforms-enhance-client-registrant-relationship.pdf

Questions?