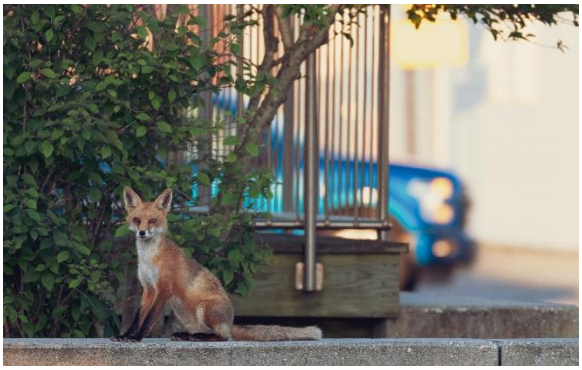
AUM LAW

# May 2020 Bulletin

## Taking Care of Business Edition

These days Toronto might be quiet enough for foxes to frolic among the skyscrapers, but its inhabitants are still busy taking care of what's important. This month, we report on the OSC's progress on its burden reduction initiatives, FSRA's guidance concerning mortgage-based investments during market turbulence, and what registrants can expect from the OSC's Compliance and Registrant Regulation Branch in the coming months.



### In this bulletin:


1. The RAQ is Back on Track
2. OSC Issues Progress Report on Its Burden Reduction Initiatives
3. OSC Staff Share Compliance Program Updates during PMAC's Spring Regulatory and Compliance Webcast
4. FSRA Issues Guidance Concerning Mortgage-Based Investments during Market Disruptions
5. IIROC Publishes Its Annual Enforcement Report
6. CSA Renews Exemptive Relief from Filing Deadlines for Investment Funds, Other Issuers, Registrants and Certain Other Capital Markets Participants

**FAQ Corner:** May an associate advising representative work remotely or in a one-person branch office?

**In Brief:** OSC Takes Enforcement Action against Representative Who Agreed to Serve as Executor for Client's Will ▪ Issuers' Undertakings to ASC Highlight the Importance of Effective Controls to Ensure Compliance with Prospectus Exemptions

**News and Events:** Updated Real Estate and Mortgage Investment Vehicles Publications ▪ AUM Law Speaks at PMAC Spring Regulatory and Compliance Webcast


### 1. The RAQ is Back on Track

In March, the Ontario Securities Commission (OSC) announced that due to COVID-19, it was postponing the 2020 Risk Assessment Questionnaire (RAQ) cycle until further notice. On May 28, chief compliance officers (CCOs) of registrants were notified that they will receive the RAQ on June 11, with responses due on August 6. The 2020 RAQ will ask for information for the periods ending December 31, 2018 and December 31, 2019.

In our January 2020 bulletin, we highlighted a number of changes that the OSC is introducing for the 2020 RAQ, including pre-population of the questionnaire with some of the answers from firms' 2018 RAQ responses and data security enhancements.

**But wait, there's more:** Because the 2020 RAQ will not cover the period when registrants were dealing with COVID-19, the OSC also will send out a short survey (Survey) on July 9, 2020 to gather information from January 1 to June 30, 2020 regarding COVID-19's impact on each registered firm. The Survey will be sent to firms domiciled in Ontario, as well as to some firms where the OSC is not the principal regulator because the OSC is collecting the information for those other regulators. The deadline for completion also will be August 6, 2020.

We encourage firms to re-start their planning for this exercise now, if they haven't already done so, and to schedule time with key individuals including the ultimate designated person (UDP) to review and sign off on the completed questionnaire. AUM Law has had extensive experience helping firms prepare their RAQs. If you would like us to help you complete this year's RAQ and the Survey, please contact us for a fixed-fee quote.

## 2. OSC Issues Progress Report on Its Burden Reduction Initiatives

Last November, we wrote about the Ontario Securities Commission (OSC) report *Reducing Regulatory Burden in Ontario's Capital Markets*. On May 27, the OSC published a progress report (Report) on these initiatives. Of the 107 initiatives described in the original report, 27% have been completed, 36% are on track, and 37% of them are delayed (nine of them due to COVID-19). We think the following updates will be of particular interest to our readers:

**Registrant Regulation:** The good news is that 23 of the 30 registrant-related initiatives are complete (14) or in progress and on-track (9). All the initiatives relating to compliance reviews are complete. Delayed initiatives include:

- Developing a rule to exempt international dealers, advisers and sub-advisers from registration under the *Commodity Futures Act* (Ontario) (CFA); and
- Evaluating options to reduce duplication in certain regulatory processes for firms that are members of the Investment Industry Regulatory Organization of Canada (IIROC).

**Investment Funds:** Unlike the registrant regulation-related initiatives, a majority (16) of the 24 investment funds-related initiatives have been delayed, while five have been completed and four are in progress and on-track. The delayed items include changes to the investment funds prospectus regime and some of the continuous disclosure initiatives. Most of the completed items relate to discrete projects such as:

- Finalizing an exemptive relief precedent to allow an investment fund to have more than one custodian;
- Codifying relief to allow any body corporate that is an investment fund manager (IFM) to act as a trustee of any pooled fund organized as a mutual fund trust in Ontario that it manages; and
- Adopting an internal process at the OSC to ensure the use of sunset clauses in exemptive relief decisions only where appropriate.

**Derivatives Participants:** Of the eighteen initiatives concerning derivatives participants, only two are complete, while eight are in progress and on-track, and eight are delayed. Among other things, the OSC expects to:

- Complete its review of how proficiency requirements apply to registered advising representatives (ARs) advising in recognized options and determine whether to provide clarification (Fall 2020); and
- Complete its review of the existing registration regime to determine whether regulatory gaps can be addressed by measures less burdensome than an over-the-counter (OTC) derivatives registration rule (Spring 2020).

AUM Law will continue monitoring the progress of the OSC's burden reduction initiatives and keep you informed.

### 3. OSC Staff Share Compliance Program Updates during PMAC's Spring Regulatory and Compliance Webcast

As we mention in this bulletin's News and Events section below, lawyers from AUM Law spoke at a webinar organized by the Portfolio Management Association of Canada (PMAC) on May 27. In one of the conference sessions, a member of the Compliance and Registrant Regulation Branch (Branch) at the Ontario Securities Commission (OSC) updated attendees on the Branch's programs and what registrants can expect in the coming months. We think that our readers will be interested in the following:

- **Compliance audits re-booted:** The Branch is re-starting regulatory compliance audits this week. They will be conducted remotely, and firms can expect to have more time (e.g. 45 days as opposed to 30 days) to respond to deficiencies.
- **Privacy and cyber security risks** arising from the shift to remote work during the pandemic will be an area of regulatory focus in compliance audits. (See our March 2020 and April 2020 bulletin articles, which discussed these risks.) Among other things, if firms haven't already done so, they should consider arranging for secure document removal from employees' homes and destruction of files as appropriate.
- **Working capital**: Registered firms should stay on top of their working capital. If there are potential issues resulting from COVID-19, firms should engage proactively with their regulators.
- **Post-COVID work arrangements:** Currently, Branch staff do not expect firms to register remote work locations (such as home offices) as branches during the pandemic. Post-COVID-19, however, if any of a firm's individuals permanently re-locate to home offices or another location that isn't already approved as a branch office, the firm should consider whether it needs to register new branch offices.
- **Are you registered everywhere you need to be?** Branch staff have observed an uptick in registrable activity by registrants in jurisdictions where the firms and relevant individuals are not registered. OSC staff will report such activity to the local regulator.
- **Some CCO reports need improvement:** Branch staff have observed that some chief compliance officers (CCOs) are not complying with the requirement in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Requirements* to provide the registrant's board of directors with an annual compliance report (CCO Report) or are preparing only a cursory report. Branch staff expect all firms, even one-person firms, to produce comprehensive CCO Reports every year describing how their firms are meeting their securities law obligations.

- **Registration of client relationship managers:** We expect the OSC to announce very soon a protocol for registering client relationship managers as Associate Advising Representatives subject to certain terms and conditions.

As the OSC moves toward a "business almost as usual" state, AUM Law stands ready to help registered firms meet their existing obligations and address emerging risks and evolving regulatory expectations. For example, we can conduct focused compliance risk assessments in areas of interest to the regulators and help draft (or improve) your CCO Report. We are also helping firms and individuals with registration applications, and we can help you, too. Please do not hesitate to contact us.

### 4. FSRA Issues Guidance Concerning Mortgage-Based Investments during Market Disruptions

On May 12, the Financial Services Regulatory Authority of Ontario (FSRA) issued guidance (Guidance) for mortgage administrators (Administrators) and mortgage brokers (Brokers) regarding their disclosure and other obligations in respect of mortgage-based investments during significant market disruptions, such as the COVID-19 pandemic.

The first notice, Mortgage Administrators – Responses to Market Disruptions (Administrator Notice), sets out FSRA's interpretation of Administrators' obligations under *Mortgage Brokerages, Lenders and Administrators Act 2006* (MBLAA) to protect investors/lenders in mortgages/mortgage investments during significant market disruptions. For example:

- **Notify investors/lenders:** The Administrator must promptly notify investors/lenders of a borrower defaulting under the mortgage or any significant change to circumstances affecting a mortgage. If an investor/lender is a mortgage investment corporation (MIC) or other mortgage investment entity (MIE), the Administrator must notify that entity. The Administrator Notice includes examples of events that trigger this disclosure requirement, such as potential forbearance, a material delay in the development of a project being funded by the mortgage, or a change in the ability of investors or lenders to redeem prior to the mortgage investment's maturity. The Administrator Notice also describes good practices that an Administrator should follow to keep current on the financial status of the mortgages and underlying properties in the portfolio and to communicate effectively with investors/lenders.
- **Adhere to administration agreements:** During the COVID-19 pandemic, more borrowers are requesting modifications to their mortgage terms. Administrators should review their administration agreements to confirm the scope of any discretion that they have to modify mortgage terms and they must adhere to those terms. They also should carefully document any exercise of such discretion. If the agreement does not authorize them to modify mortgage terms, an administrator faced with a request from the borrower to modify terms must review the requirements under the MBLAA and related regulations regarding the notice to be provided to the investors / lenders and obtain approval for the modifications.

The second notice, Mortgage Brokerage Disclosure and Suitability Assessments for Non-Qualified Syndicated Mortgage Investments (SMIs) – Responses to Market Disruptions (Broker Notice), discusses Brokers' obligations to:

- Disclose material risks arising from the current market disruption to investors in non-qualified syndicated mortgage investments (NQSMIs); and

- Consider the current market disruption when assessing the suitability of an NQSMI to an investor.

The Broker Notice includes a non-exhaustive list of risks associated with a market disruption that FSRA considers material. These are similar to the "significant changes in circumstances" outlined in the Administrator Notice. The Broker Notice also emphasizes that Brokers must consider whether any property appraisals prepared for syndicated mortgage investments (SMIs) before the market disruption reflect the property's market or current value and make investors/lenders aware of the risks of relying on any appraisal that either pre-dates the market disruption or does not consider the market disruption's impact on the property valuation. Also, if the appraisal contains any limitation statements, the Broker must bring those statements to the attention of the investor/lender. The Broker Guidance also states that Brokers must take into account the potential impacts of a market disruption on an SMI, its probable future performance, and the investor/lender's unique circumstances when they assess the suitability of an SMI for an investor-lender.

Although not directly applicable to exempt market dealers (EMDs), the Guidance also may be useful to firms conducting suitability assessments with respect to MIE securities. Likewise, firms that operate MIEs might want to consider the Guidance when assessing whether to update the descriptions in their offering documents regardig risk factors, descriptions of the MIE's mortgage portfolio, and/or changes to redemption rights.

AUM Law can help you assess the impact of the Guidance on your business, advise you on your disclosure obligations and help you prepare the required disclosures, as well as update your policies and procedures to incorporate these publications. Please do not hesitate to contact us for assistance.

### 5. IIROC Publishes Its Annual Enforcement Report

On May 11, the Investment Industry Regulatory Organization of Canada (IIROC) published its 2019 Enforcement Report (Report). Although the Report will be of greatest interest to IIROC members, we think that other registered firms will find certain parts of the Report relevant. We have summarized below some of the Report's enforcement case studies, which highlight some areas of continuing concern for regulators.

- **Unauthorized Discretionary Trading:** A father and son team at BMO Nesbitt Burns executed at least 7,000 discretionary trades in approximately 100 client accounts, even though the father did not have IIROC's approval to manage discretionary accounts and BMO had not authorized any of the accounts for discretionary trading. The duo also took steps to prevent the Compliance Department from spotting the unauthorized activity. The settlement provided for, among other things, fines ($40,000 and $30,000, respectively), prohibition of approval (30 months and 16 months, respectively), close supervision (12 months and 6 months, respectively), and costs of $2,500 each.
- **Facilitated Suspicious Trading:** Two advisors at Hampton Securities facilitated suspicious trading by a group of related accounts and insiders of two TSXV-listed issuers. The advisors received unsolicited orders either from an insider or family member of the issuers, with frequent deposits of large quantities of securities certificates of the two issuers followed by a subsequent sale. The related clients engaged in frequent same-day trading (including trading on opposite sides of the market), which sometimes resulted in no economic benefit. According to IIROC, numerous red flags generated by the trading should have caused the advisors to

question the trading or request explanations from their clients about the trades' legitimacy. As a result, they breached their gatekeeper responsibilities. The settlement provided for, among other things, fines ($50,000 and $20,000, respectively) and costs of $7,500 each.

- **Non-Disclosure to Firm of Profit-Sharing and Loan Arrangement with Client:** A representative (R) arranged with one of the firm's clients to loan him $3 million so that he could participate in a bought deal involving his firm. The loan provided for profit-sharing on the transaction. When R's supervisor questioned him about the source of $3 million, he stated that the funds were a loan collateralized against his condo and didn't disclose the lender's identity or the profit-sharing arrangement. In the disciplinary hearing, the panel found that the profit-sharing and loan arrangement created an actual or potential conflict of interest between the client and R and between the client and the firm, that R's statements to his supervisor were false and misleading, and that failing "to provide true and complete disclosure prevents a firm from being able to fulfil its obligations to respond to existing or potential conflicts of interest." The Ontario Securities Commission (OSC) dismissed R's appeal of IIROC's decision and the sanctions (including a fine of $30,000, disgorgement of approximately $25,000, costs of $24,500, and suspension of approval for two years).
- **Is It or Isn't It an OBA?** A representative (T) provided funds to acquire an interest in a trust, which acquired the sole interest in a limited partnership (LP), which then used the funds to acquire interests in oil and gas wells. Revenue from the well was eventually distributed up through this structure to T and other investors. The hearing panel also found that he had misled Enforcement Staff regarding his interest, and a family member's interest, in the vehicle. During the initial disciplinary hearing, the panel concluded that T did not engage in an unauthorized outside business activity (OBA) because it viewed his involvement as a passive investment. On appeal, however, the British Columbia Securities Commission (BCSC) disagreed with the IIROC hearing panel's interpretation of the law and held that it wasn't necessary to find that T managed the OBA in order to find a breach of IIROC's rules. When the matter was referred back to the IIROC hearing panel, it concluded that the activity was not disclosed to or approved by T's firm. He was fined $75,000, required to disgorge over $100,000 and pay costs of $80,000. He also had his approval suspended for twelve months and made subject to close supervision for six months upon his re-instatement.

Enforcement case studies like these can serve as a training tool to help compliance and supervisory staff spot red flags and raise awareness among all employees of how the law is interpreted. AUM Law can provide compliance training (including virtual sessions) tailored to your business operations and compliance risk areas. Please contact us find out how we can help.

### 6. CSA Renews Exemptive Relief from Filing Deadlines for Investment Funds, Other Issuers, Registrants and Certain Other Market Participants

On May 20, the Canadian Securities Administrators (CSA) issued substantially harmonized blanket orders giving investment funds and other issuers temporary relief from certain regulatory and filing obligations. The conditions of relief are similar to the blanket orders issued in late March, except that the relief applies only to issuers with filing deadlines as noted below:

- **Investment fund issuers:** The OSC's blanket order for investment funds (Funds Blanket Order) provides a 60-day extension for certain filing, delivery and prospectus renewal requirements normally required to be made between June 2 and September 30, 2020. If an investment fund wishes to rely on the Funds Blanket Order, it must, as soon as reasonably practicable and in

advance the relevant delivery, filing or renewal deadline: (a) notify its regulator by email that it is relying upon the Funds Blanket Order and each requirement for which it is relying upon that order; and (b) post a statement on its public website or public website of its investment fund manager indicating that it is relying upon the Funds Blanket Order and listing each requirement for which it is relying on upon that order.

- **Non-investment fund issuers** have a 45-day extension for certain filing, delivery and base shelf prospectus renewal obligations normally due or required to be made between June 2 and August 31, 2020.
- **Issuers can't further extend pre-June 2 deadlines:** An issuer cannot rely on the blanket relief to further extend a deadline occurring before on or before June 1.

On May 29, the CSA issued substantially harmonized blanket orders giving registrants and certain unregistered capital markets participants relief from certain financial statement and information delivery deadlines. The blanket orders provide a 60-day extension for periodic filings normally required to be made between June 2, 2020 and September 30, 2020 by registrants and, in Ontario, unregistered capital markets participants that rely upon certain registration exemptions such as unregistered investment fund managers (IFMs) and unregistered exempt international firms. The extension applies automatically, without any terms and conditions. Registrants and unregistered capital markets participants that have already used the prior relief to extend their deadline for any financial statement or information delivery requirements occurring on or before June 1, 2020, cannot use this relief to further extend that deadline.

Please contact us if you have any questions about the blanket orders described above. We can help you assess your options and, if necessary, engage with regulators on your behalf.

## FAQ Corner

### May an associate advising representative work remotely or in a one-person branch office?

**Answer:** National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) prohibits an associate advising representative (AAR) from advising on securities unless that advice has been pre-approved by an advising representative (AR) designated by the firm to review that AAR's advice.

There is no requirement for an AAR and the AR reviewing that AAR's advice to work "side by side" in the same office. However, there are potentially greater compliance risks associated with having them work from separate locations, such as in the current environment where many people are working remotely from home. For example, the AR and AAR might be working somewhat different hours as they juggle professional and family responsibilities, and clients concerned about market volatility might be calling them at all hours for reassurance. These factors can make it more challenging for the AR to pre-clear the AAR's advice to the client. Maintaining organized client files including documentation of the AR's pre-approval of the AAR's advice can also be more difficult when people are accessing files remotely.

Nevertheless, it is critical for the firm to have and maintain adequate controls and supervision to ensure compliance with the pre-clearance rule described above. The firm also should document how it has considered and addressed the risks that arise from the AAR and AR working from separate locations, as well as documenting on an ongoing basis the AR's review and pre-approval of any advice to be provided by the AAR.

The COVID-19 pandemic continues to present regulatory challenges for firms as they operate in this "new normal". AUM Law is helping clients assess whether their existing policies, procedures and controls address the emerging risks and we can help you too. Please do not hesitate to contact us.

## In Brief

### OSC Takes Enforcement Action against Representative Who Agreed to Serve as Executor for Client's Will

In January, we published an FAQ discussing the risks that advising representatives face if they accept an appointment as an executor of a client's estate. We noted that securities regulators have concerns about the potential conflicts of interest arising in such arrangements. These kinds of concerns are reflected in the recent announcement by the Ontario Securities Commission (OSC) that it is taking enforcement action against a mutual fund dealing representative (M) who agreed to act as his elderly and terminally ill client's attorney for personal care and property and as executor of her estate, even though he is alleged to have known that he was also a beneficiary under her will.

According to the statement of allegations, M did not comply with his employer's specific prohibition on accepting powers of attorney from clients such as the client in this case or its requirement to disclose to the firm any actual or potential conflict of interest. The OSC is alleging, among other things, that M failed to deal honestly, fairly and in good faith with the client contrary to subsection 2.1(2) of OSC Rule 31-505 *Conditions of Registration* and that his conduct was contrary to the rules of the Mutual Fund Dealers Association (MFDA), his employer's policies and procedures, and the public interest.

AUM Law can assess and, if necessary, help you enhance your firm's policies, procedures and practices regarding potential conflicts of interest like this. We can also conduct training with your employees to sensitize them to the legal, regulatory and reputational risks associated with accepting such appointments. Please do not hesitate to **contact us**.

### Issuers' Undertakings to ASC Highlight the Importance of Effective Controls to Ensure Compliance with Prospectus Exemptions

On May 26, the Alberta Securities Commission (ASC) published undertakings (Undertakings) from two issuers who agreed to certain controls, training and other requirements to ensure the issuers' compliance with National Instrument 45-106 *Prospectus Exemptions* (NI 45-106) The Undertakings are a useful reminder for issuers and their advisers of securities regulators' continued focus on non-compliance with the terms and conditions of prospectus exemptions in the exempt market.

Pursuant to the Undertakings, the issuers agreed, among other things, to designate several directors, officers or employees (Designated Persons) as responsible for determining whether investors meet the terms and conditions of NI 45-106. The Designated Persons will:

- Attend training on how to determine whether an investor meets the terms and conditions of the accredited investor (AI) and/or friends, family and business associates (FFBA) prospectus exemptions;
- Take reasonable steps to confirm that every investor meets the terms and conditions of the applicable exemption being relied upon at the time of distribution; and

- Make detailed written notes outlining the steps taken to determine whether an investor meets the terms and conditions of the applicable exemption, including the date and time of all relevant communications and any documents reviewed or relied upon.

If they haven't already done so, issuers that access (or plan to access) the exempt market may wish to consider training and controls similar to those described above. AUM Law has substantial experience helping clients navigate the exempt market and we can help you, too. Subscribe to our publications to obtain a copy of our Exempt Market Roadmap and contact us to discuss your financing plans.

## News and Events

### Updated Real Estate and Mortgage Investment Vehicles Publications

Are you interested in creating a vehicle to invest in real estate or mortgages secured by real estate, or are you currently managing one or more such vehicles? With our focus on serving the asset management sector and our expertise in regulatory compliance and investment funds, AUM Law is well-equipped to work seamlessly with real estate lawyers and tax advisers to help clients establish and operate real estate investment vehicles. To learn more about how we can support you, please contact us to receive our updated brochure on these vehicles and an updated version of our popular publication *Mortgage Investment Corporations in a Nutshell*.

### AUM Law Speaks at PMAC Spring Regulatory and Compliance Webcast

On May 27, the Portfolio Management Association of Canada (PMAC) hosted a virtual regulatory and compliance webcast. AUM Law's Kevin Cohen and Chris von Boetticher participated as panellists in a session for small to mid-sized asset managers to discuss the impact of COVID-19 and recent market turbulence on compliance, client service, disclosure and more.

**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.

AUM LAW