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Securities
Commission

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**In the Matter of Staff's Recommendation
To Impose Terms and Conditions on the Registration of
Acker Finley Asset Management Inc.**

**Opportunity to be Heard by the Director
under Section 31 of the *Securities Act* (Ontario)**

Decision

1. For the reasons outlined below, my decision is to impose the terms and conditions on the registration of Acker Finley Asset Management Inc. (**AFAM** or the **Firm**) as recommended by staff (**Staff**) of the Compliance and Registrant Regulation Branch (**CRR**) of the Ontario Securities Commission (**OSC** or **Commission**) with the following changes noted below:
 - a) delete paragraph 1 (a) (ii), and replace it with the following:
 - (ii) provide a written report to the Firm and to Staff that explains how the Firm will establish a system of controls and supervision that achieves best execution for its clients, identifies and values soft dollar arrangements and complies with its conflicts of interest obligations on a go-forward basis.
 - b) delete paragraph 1 (a) (iii), and replace it with the following:
 - (iii) assist AFAM in comparing trade execution options and arrangements between NBCN, AFI and any other dealer to determine the most advantageous execution terms reasonably available on a go-forward basis.
2. The terms and conditions as amended to reflect these changes are set out in Appendix A.
3. My decision is based on the written submissions of Mark Skuce, Senior Legal Counsel, CRR and Michael Burns, of McMillan LLP., counsel for AFAM, the supporting affidavit evidence and other supporting materials, and responses to questions from the Director.

Background

4. AFAM is registered under the *Securities Act* (Ontario) (the **Act**) as a portfolio manager and an investment fund manager. The Firm's office is located in Toronto, and AFAM is registered only in Ontario.
5. AFAM states that it has a relatively small operation. According to AFAM's submissions, AFAM has approximately 50 clients with approximately 180 total accounts (the **Managed**

Accounts)¹ with assets under management (**AUM**) of approximately \$76 million.² In addition to the Managed Accounts, AFAM also operates two investment funds (the **AFAM Funds**) with an AUM of approximately \$78 million.³

6. AFAM generally uses the services of a related dealer, Acker Finley Inc. (**AFI**), for trade execution purposes. AFAM is related to AFI by common ownership. AFI is registered under the Act as an investment dealer and is a member of the Investment Industry Regulatory Organization of Canada (**IIROC**). AFAM and AFI operate out of the same office, and according to AFAM, the operations of the two firms are fully integrated for all intents and purposes.⁴

Compliance review

7. Beginning in September 2016, AFAM was the subject of a compliance review (the **Compliance Review**) by Staff, which was conducted pursuant to section 20 of the Act. The Compliance Review covered the period from September 1, 2015 to August 31, 2016.
8. The Compliance Review identified a number of deficiencies in AFAM's compliance with Ontario securities law, which are set out in the Compliance Field Review Report dated April 13, 2017 (the **Report**). The Report included nine significant deficiencies and 12 additional deficiencies for a total of 21 deficiencies. Among the issues identified as significant deficiencies were the following:⁵
 - Failure to meet best execution obligation;
 - Inadequate policies and procedures for conflicts of interest and inadequate response to conflicts of interest;
 - Inadequate documentation of know your client (**KYC**) information and KYC information not current;
 - Investments not in line with statement of investment objectives and policies (**SIOP**); and
 - Inadequate compliance system, and Chief Compliance Officer (**CCO**) and Ultimate Designated Person (**UDP**) not adequately performing responsibilities.

Proposed regulatory action

9. As a result of the findings of the Compliance Review, on April 13, 2017, Staff informed AFAM that they intended to recommend to the Director that terms and conditions be imposed on AFAM's registration (the **Regulatory Action Letter**).
10. In its Regulatory Action Letter, Staff advised AFAM that its recommendation was based on its view that the Firm had failed to comply with Ontario securities law, and that it lacked the requisite proficiency for unconditional registration. Staff's letter stated that the recommendation was based on all of the findings of the Compliance Review, but it also outlined the specific compliance deficiencies that were of greatest concern to Staff, which it

¹ Written submissions of Acker Finley Asset Management Inc. (9 June 2017) at 1 [AFAM Response].

² Written submissions of Staff of the Ontario Securities Commission (19 May 2017) at 2 [OSC Staff Submission].

³ *Ibid.*

⁴ *Ibid.*

⁵ *Ibid* at 3.

grouped into three categories: (i) deficiencies relating to AFAM's process for trade execution, (ii) deficiencies relating to AFAM's portfolio management, and (iii) AFAM's overall deficient compliance system.⁶

11. The proposed terms and conditions would require AFAM to retain an independent compliance consultant (**Consultant**) to assist the firm in developing a plan to rectify the deficiencies that had been identified through the Compliance Review.
12. This remediation process, as proposed by Staff, would expressly require a calculation and repayment of amounts that AFAM – through its use of AFI as its dealer – has allegedly overcharged clients by reason of its alleged failure to comply with its obligations relating to conflicts of interest and best execution.⁷
13. Pursuant to section 31 of the Act, AFAM is entitled to an opportunity to be heard (**OTBH**) before the Director decides whether to accept Staff's recommendations to impose the proposed terms and conditions. Counsel for AFAM subsequently advised Staff that it wished to request an OTBH before the Director under section 31 of the Act.

The Opportunity to be Heard

14. In May 2017, Staff submitted a memorandum with supporting materials to the Director in support of its recommendation that certain terms and conditions (the **Terms and Conditions**) be imposed on the registration of AFAM. The Terms and Conditions would require, among other things, AFAM to retain a Consultant and to perform specified remedial activities.
15. The Terms and Conditions as proposed by Staff are set out in Appendix A to this decision, but without consideration of the changes that I have reflected through the blacklining.
16. In Staff's submissions, Staff focused primarily on certain of the significant compliance deficiencies because in Staff's view these deficiencies represent high risk areas that AFAM has not properly addressed. However, Staff wished to reiterate that these are not the only deficiencies identified during the Compliance Review. The high-risk areas identified are:
 - (a) AFAM's trade execution process appears to be non-compliant with at least three statutory obligations: best execution, responding to conflicts of interest and fair dealing with clients;
 - (b) AFAM failed to comply with KYC and suitability obligations; and
 - (c) AFAM's overall compliance system lacks the proper system of controls and supervision.

AFAM's response

17. AFAM advised that it considers compliance to be an integral element of its business and is eager to address any issues identified by Staff during the Compliance Review. However,

⁶ *Ibid* at 4.

⁷ *Ibid*.

AFAM does not believe that the imposition of terms and conditions and the requirement to retain a compliance consultant would be beneficial in addressing Staff's concerns. AFAM claims that it has an experienced compliance team in place and believes that it can make all required changes to its compliance system to satisfy Staff's concerns with the help of its external legal counsel who is already familiar with the operations of AFAM, AFI and its client base.⁸

18. AFAM further submits that, having regard to the size and nature of its business, the most effective way to accomplish the remediation of the compliance deficiencies and an overall enhancement to their compliance systems is for AFAM to work with its external legal counsel to address the relevant points identified in the Compliance Review without the need for the appointment of a compliance consultant or the imposition of terms and conditions on its registration.⁹

The Director's authority to impose Terms and Conditions

19. The Director's authority to impose terms and conditions is found in section 28 of the Act. Section 28 of the Act establishes three distinct grounds upon which the Director may impose terms and conditions: (i) if the company is not suitable for registration, (ii) if the company has failed to comply with Ontario securities law, and (iii) if the registration of the company is otherwise objectionable.
20. In *Re Argosy Securities Inc. and Keybase Financial Group Inc.* (2016), 39 OSCB 4040 at para 49, the Commission said of the statutory grounds in section 28: "Each one of these tests, if satisfied, is a sufficient basis by itself for the imposition of terms and conditions."
21. The Commission has stated that when deciding whether to impose terms and conditions under section 28 of the Act, the Director is not conducting an enforcement proceeding, and this informs the level of proof required by the Director:

[T]he Director (and by extension the Commission) may impose terms and conditions upon a registration if "it appears" that the registrant has failed to comply with Ontario securities law. This is not an enforcement proceeding, and we are not necessarily being asked to conclude, on a balance of probabilities, that the Applicants have contravened Ontario securities law. It is sufficient for us to conclude, as we do, that it appears that there has been a failure to comply with Ontario securities law. *Ibid* at para 179.

Issues

22. Accordingly, the questions before me are as follows:
 - (a) Based on my review of the entire record, does it appear that AFAM has failed to comply with Ontario securities law?
 - (b) If yes, does it appear that the Firm lacks the necessary proficiency for unconditional registration? In other words, is it necessary and appropriate to impose the Terms and Conditions as proposed by Staff to bring the Firm into compliance with Ontario

⁸ AFAM Response, *supra* note 1 at 1.

⁹ *Ibid* at 15.

securities law and to protect investors from the harm that may result from these failures to comply with Ontario securities law?

- (c) If it is necessary and appropriate to impose the Terms and Conditions requiring the Firm to retain a Consultant, then should there be any restrictions on who can perform the duties of this role? For example, are there any concerns with the Firm's external legal counsel performing the duties of a Consultant?
23. While I have taken note of the other deficiencies identified by Staff in the Report, I have chosen to focus on the alleged high-risk significant deficiencies in this decision. These significant deficiencies include:
- (a) AFAM's trade execution process, including compliance with the statutory obligations of best execution, responding to conflicts of interest and fair dealing with clients;
 - (b) AFAM's compliance with KYC and suitability obligations; and
 - (c) AFAM's overall compliance system, and its system of controls and supervision.

Reasons for the Decision

a) AFAM's trade execution process

Best execution requirements

24. AFAM places its trades for individual clients with one of two dealers: AFI or NBCN Inc. (NBCN), and it places all of the AFAM Funds' trades with AFI. If an AFAM client has a brokerage account at AFI, which most do, trades in their account will be placed with AFI (which then settles and clears them with NBCN). If an AFAM client does not have an AFI account, their trades will be placed with NBCN directly.¹⁰
25. As noted above, AFAM is related to AFI by common ownership. AFAM and AFI operate out of the same office, and according to AFAM, the operations of the two firms are fully integrated for all intents and purposes.
26. Staff has submitted information that appears to demonstrate that AFAM clients paid higher commissions during the Compliance Review period from September 1, 2015 to August 31, 2016 because AFI trade commission costs are higher than NBCN.¹¹
27. Staff calculated the commission charges that would have been paid by the AFAM Funds had their trades been placed with NBCN instead of AFI, and found the amount to be \$148,120 (versus the \$177,892 actually charged by AFI),¹² an estimated difference of \$29,772.
28. Staff estimated that there was a potential monetary impact for Managed Account clients estimated to be \$2,600, depending on which commission schedule is used and whether commissions were charged for the trades.¹³

¹⁰ OSC Staff Submission, *supra* note 2 at 2.

¹¹ *Ibid* at 2.

¹² *Ibid* at 4.

29. AFAM disputes Staff's assertion that the commissions paid to AFI are materially higher than those paid to NBCN.¹⁴ AFAM also argues that, to the extent they are higher, AFAM clients are not disadvantaged by paying a higher commission because AFAM receives research reports from AFI. Effectively, the higher commissions represent "soft dollars" as that term is used in National Instrument 23-102 *Use of Client Brokerage Commissions* (**NI 23-102**).

30. Section 4.2 of National Instrument 23-101 *Trading Rules* (**NI 23-101**) states:

A dealer and an adviser must make reasonable efforts to achieve best execution when acting for a client.

31. Section 1.1 of NI 23-101 defines the term "best execution" as follows:

"best execution" means the most advantageous execution terms reasonably available under the circumstances;

32. Section 4.1 of the Companion Policy to NI 23-101 further describes this obligation as follows:

4.1 Best Execution

(2) Section 4.2 of the Instrument requires a dealer or adviser to make reasonable efforts to achieve best execution (the most advantageous execution terms reasonably available under the circumstances) when acting for a client. The obligation applies to all securities.

(3) [Although] what constitutes "best execution" will vary depending on the particular circumstances... to meet the "reasonable efforts" test, a dealer or adviser should be able to demonstrate that it has, and has abided by, policies and procedures that (i) require it to follow the client's instructions and the objectives set, and (ii) outline the process it has designed toward the objective of achieving best execution. The policies and procedures should describe how the dealer or adviser evaluates whether best execution was obtained and should be regularly and rigorously reviewed. The policies outlining the obligations of the dealer or adviser will be dependent on the role it is playing in an execution ... An adviser should consider a number of factors, including assessing a particular client's requirements or portfolio objectives, selecting appropriate dealers and marketplaces and monitoring the results on a regular basis.

33. The rule requires a "reasonable efforts" test and the Companion Policy sets out guidance on some of the factors to be considered when determining if the dealer or adviser engaged in a reasonable effort to obtain best execution. Therefore, the determination of whether AFAM met the reasonable efforts test is dependent on a facts-and-circumstances analysis.

34. In order to assess whether AFAM complied with its regulatory best execution requirements, I first considered whether AFAM had policies and procedures (**Policy**) in place. Yes, AFAM has a very basic Policy that states that the Firm will select a broker based on best execution and price.¹⁵

¹³ Supplementary Affidavit of Susan Pawelek, sworn June 16, 2017, at para 16 [Pawelek Affidavit].

¹⁴ AFAM Response, *supra* note 1 at 1, 3-6.

¹⁵ OSC Staff Submission, *supra* note 2 at 2.

35. Next, does the Policy outline a process designed to achieve best execution? Does the Policy describe how the adviser evaluates whether best execution was obtained and does it provide for a regular and rigorous review? Does it explain how appropriate dealers and marketplaces are selected?
36. No, AFAM's Policy does not describe the process it uses to evaluate best execution. It does not include any provision about selecting dealers or marketplaces, and it does not detail how to review trading to determine if best execution has been achieved. Finally, AFAM does not have a system to monitor results on a regular basis, let alone on a rigorous basis as suggested in the Companion Policy.
37. In support of AFAM's claim that it meets its best execution obligations, AFAM's advising representative stated in his affidavit that he
- ...prefers to use AFI as a broker. This is a result of: (a) AFI's good execution; (b) AFI's provision of continuous access to the QSA system database...; (c) AFI's provision of access to their "Advent Axyx" system, which is portfolio management software used for, among other things, the production of client holding summaries, performance reporting and billing; and (d) Freedom of delivery against payment problems which may exist with other institutions.¹⁶
38. I am not prepared to accept, without any evidence or supporting analysis, the bald assertion that AFI provides best execution (or "good execution" in the words of AFAM's advising representative). AFAM has not submitted any information to demonstrate that it has conducted any kind of analysis or evaluation of trading to determine whether best execution has been obtained on any trade executed for AFAM clients.
39. Counsel for AFAM claims that
- Staff conducting the Compliance Audit only requested and received information concerning the trading commissions at AFI, NBCN and other brokers used by AFAM. The questions related to the amounts of the trading commissions, not research goods or services provided by AFI to AFAM.
- AFAM strongly disagrees with Staff's position that it has not complied with its best execution obligation. The research goods and services provided by AFI form an integral element of AFAM's investment decision making process. AFI is not merely executing trades on behalf of AFAM. The additional amounts over the base execution commission charged by NBCN and others cited in the Staff Submissions (which amount to an aggregate of \$29,772 over the 12 month period of the Compliance Review) relate to the research goods and services provided to AFAM during that period.¹⁷
40. There is no dispute that the provisions of NI 23-101 make it clear that one must consider a number of factors, including, but not limited to, price, when considering whether the best execution obligation of an adviser has been met. However, Staff has submitted that "at no time during the compliance review did anyone from AFAM refer to QSA as the basis upon

¹⁶ Affidavit of John Charles Cushing, sworn June 6, 2017, at para 16 [Cushing Affidavit].

¹⁷ AFAM Response, *supra* note 1 at 10.

which AFAM was complying with its best execution obligations.¹⁸ Further, Staff asked the Firm's CCO "...whether AFAM had any soft dollar arrangements and she said it did not."¹⁹

41. Further, AFAM does not have a Policy relating to soft dollars, so there is no ability to assess AFAM's compliance with NI 23-102.
42. Paragraph 3.1(2)(b) of NI 23-102 states that an adviser must ensure that "a good faith determination is made that the client or clients receive reasonable benefit considering both the use of the goods or services and the amount of client brokerage commission paid."
43. AFAM has not provided any evidence to support that they made any determination that the value of the research goods and services provided by AFI has been fairly valued, and that clients are receiving reasonable benefit from the goods and services to support a higher commission cost.
44. Also, section 4.1 of NI 23-102 sets out a list of items that must be disclosed to clients if a firm enters into soft dollar arrangements. AFAM has not provided any evidence to demonstrate that they complied with this disclosure obligation.
45. AFAM's advising representative, in his affidavit, stated that "... the difference in prices charged by AFI over the price charged by NBCN for execution-only services is explained by the value of the research goods and services supplied by AFI."²⁰
46. Again, I am not prepared to accept, without any evidence or supporting analysis, the assertion that the difference in prices charged by AFI over the price charged by NBCN for execution-only services is explained by the value of the research goods and services supplied by AFI.
47. In order to address AFAM's claim that Staff did not request the relevant information during the Compliance Review, I put the following question to AFAM's counsel:

"... Please provide a yes or no answer and an explanation to the following questions:

Prior to the commencement of the compliance review, did AFAM conduct a review/analysis of their business operations/practices to determine if they were in compliance with Ontario securities laws in the following areas:

- a. best execution,
- b. soft dollar payments and approvals,
- c. conflicts of interest relating to all matters relating to its affiliated dealer Acker Finley Inc. (AFI),
- d. standard of care under section 116 of Securities Act (Ontario); and
- e. common law fiduciary duty for discretionary managed accounts.

¹⁸ Pawelek Affidavit, *supra* note 13 at para 20.

¹⁹ *Ibid* at para 21.

²⁰ Cushing Affidavit, *supra* note 16 at para 17; AFAM Response, *supra* note 1 at 3.

If a review/analysis was conducted prior to the commencement of the review period, please provide the specific date that the review was completed and documentation of the review that was created at the time of the review. Please do not re-submit materials that have already been provided in this OTBH.”²¹

48. AFAM’s response to this particular question is:

“No, AFAM did not conduct a formal review or analysis of its business operations and practices that focused specifically on matters enumerated in Question 2 to determine if they were in compliance with Ontario securities laws.

AFAM is aware of the regulatory requirements and its obligations as a registrant under applicable Ontario securities laws and is vigilant in ensuring that its conduct with respect to best execution, soft dollars, conflicts of interest and standard of care are in compliance with Ontario securities laws.”²²

49. Based upon the entirety of the record provided, I am not satisfied that AFAM has complied with its obligations under section 4.2 of NI 23-101 to make reasonable efforts to achieve best execution for any trade made during the Compliance Review period.

50. Similarly, I am not satisfied that AFAM has complied with its obligations under paragraph 3.1(2)(b) of NI 23-102 to ensure that a good faith determination is made that clients receive reasonable benefit, considering both the use of the goods or services and the amount of client brokerage commission paid. Therefore, I conclude that AFAM’s failure to comply with the requirements in NI 23-101 and NI 23-102 is a breach of Ontario securities law.

Potential monetary impact on clients resulting from failure to comply with best execution obligations

51. Staff and AFAM’s counsel have submitted conflicting information as to whether there has been an adverse monetary impact on AFAM’s clients for failing to comply with the best execution obligations.

52. Staff has provided evidence that alleges that AFAM Funds and Managed Account clients may have been overcharged by approximately \$29,772 and \$2,600, respectively, over the 12-month period of the Compliance Review.²³

53. Staff provides that “Trades made by AFAM for most [of] its clients are executed by AFI as an introducing broker (if the client has an AFI account), or by NBCN (if the client does not have an AFI account). Even where a trade is executed by AFI, it is still settled and cleared by NBCN as AFI’s carrying broker. In all of these cases, AFAM clients are ultimately receiving trading services from NBCN, but if the client also has an AFI account, AFI performs the trade execution, at what appears to be a higher commission than what NBCN charges. In this

²¹ Email from Director Debra Foubert to Michael Burns and Mark Skuce re “Confidential – Acker Finley Asset Management Inc. OTBH,” dated August 8, 2017.

²² Written submissions of Acker Finley Asset Management Inc. (22 August 2017) at paras 7-8 [AFAM Response to Director Questions].

²³ See paras 27-28, *above*.

way, AFI has interposed itself as an unnecessary and expensive middleman between the client and NBCN, which has resulted in a potential overcharge to clients.”²⁴

54. As noted above, AFAM disputes Staff’s methodology in making this comparison and also asserts that this comparison ignores the “vitaly important research and other informational services provided by AFI that warrants the higher commissions charged for trades directed through AFI.”²⁵
55. On the basis of this contradictory evidence, I am not able to determine whether and to what extent there may have been an adverse monetary impact on clients as a result of the AFAM’s failure to comply with its best execution obligations. There is a possibility that, notwithstanding AFAM’s failure to make reasonable efforts to achieve best execution for its clients, there may have been little or no monetary impact on these clients. In the specific circumstances of this case, it is possible that the research goods and services provided by AFI, if fairly valued, could justify the higher commission costs, as permitted by NI 23-102.
56. However, I also accept that it is possible that there may have been an adverse monetary impact on clients, and potentially a significant adverse monetary impact, as a result of AFAM’s failure to comply with its best execution obligations.
57. In the face of the contradictory submissions and evidence, I cannot make a finding that AFAM’s clients sustained an adverse monetary impact. Considering the lack of review and analysis completed by AFAM regarding their trade execution practices, I am not confident that AFAM will be able to conduct a review and analysis of their trade execution practices without the assistance of a qualified Consultant.
58. Accordingly, I believe it is necessary to impose terms and conditions requiring AFAM to engage a Consultant to assist the Firm in comparing trade execution options and arrangements between NBCN, AFI and any other dealer to determine the most advantageous execution terms reasonably available on a go-forward basis.
59. Through the course of the comparative analysis review, if there is evidence that AFAM’s clients have sustained an adverse monetary impact, then AFAM, acting reasonably, should take steps to remediate the adverse impact.

Conflicts of interest requirements

60. As noted above, Staff has also argued that AFAM’s trade execution process, and in particular its practice of directing client trades to a related dealer, AFI, and paying higher commissions to the related dealer than would otherwise be payable to a dealer operating at arm’s length from the Firm, represents a failure on the part of AFAM to respond to conflicts of interest with its clients.
61. As noted above, AFAM is related to AFI by common ownership. AFAM and AFI operate out of the same office, and according to AFAM, the operations of the two firms are fully integrated for all intents and purposes.

²⁴ OSC Staff Submission, *supra* note 2 at 4.

²⁵ AFAM Response, *supra* note 1 at 8.

62. According to AFAM's Policy, AFAM will select a broker based on best execution and price.²⁶ In addition, AFAM provides disclosure to clients in both the investment management agreements (the **IMAs**) for Managed Accounts and in the offering memoranda for the AFAM Funds stating that AFAM may direct the execution of portfolio transactions through AFI, provided that the services of AFI are delivered at prices and on terms that are comparable to those available elsewhere to AFAM and its clients.²⁷
63. In practice, AFAM places its trades for individual clients with one of two dealers: AFI or NBCN, and it places all of the AFAM Funds' trades with AFI. If an AFAM client has a brokerage account at AFI, which most do, trades in their account will be placed with AFI (which then settles and clears them with NBCN). If an AFAM client does not have an AFI account, their trades will be placed with NBCN directly.
64. The material conflict is that AFAM appears to be conferring a benefit on its related dealer through the payment of commissions from its Managed Account clients and AFAM Funds, which ultimately confers a benefit on their common shareholder. Accordingly, directing trades to AFI gives rise to a material conflict of interest between AFAM and its client.
65. Section 13.4 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103)* requires a registered firm to take reasonable steps to identify and respond to existing and potential material conflicts of interest that may arise between the firm and a client. Section 13.4 of NI 31-103 provides as follows:
- 13.4 Identifying and responding to conflicts of interest**
- (1) A registered firm must take reasonable steps to identify existing material conflicts of interest, and material conflicts of interest that the registered firm in its reasonable opinion would expect to arise, between the firm, including each individual acting on the firm's behalf, and a client.
- (2) A registered firm must respond to an existing or potential conflict of interest identified under subsection (1).
- (3) If a reasonable investor would expect to be informed of a conflict of interest identified under subsection (1), the registered firm must disclose, in a timely manner, the nature and extent of the conflict of interest to the client whose interest conflicts with the interest identified.
66. The Companion Policy to NI 31-103 explains that there are generally three methods of responding to a conflict of interest: avoidance, control, and disclosure.
67. In the IMAs for AFAM's Managed Account clients, AFAM did disclose the fact that it will permit its affiliated dealer, AFI, to execute trades for discretionary managed accounts and provide clients with the option to designate another broker to execute the trades at the client's direction. Similarly, in the offering memoranda for the AFAM Funds, AFAM did disclose that it is expected that brokerage services for the AFAM Funds will be provided by the AFAM affiliated dealer, AFI.

²⁶ OSC Staff Submission, *supra* note 2 at 2.

²⁷ *Ibid* at 6; AFAM Response, *supra* note 1 at 11.

68. In both instances, there is language to state that the services of AFI will be provided at prices and upon terms that are comparable to those available elsewhere to AFAM and its clients.²⁸
69. Although AFAM did correctly identify the material conflict as required in subsection 13.4(1) of NI 31-103 and has provided limited disclosure about the conflict in the relevant documents, AFAM does not appear to have taken any other steps to respond to the conflict as required in subsection 13.4(2) of NI 31-103.
70. In particular, I note that the IMAs include disclosure that suggests that AFAM's Managed Account clients may choose to have trades in their portfolio conducted by a dealer other than AFI:²⁹

AFAM will permit Acker Finley Inc. to execute portfolio transactions with respect to accounts managed on a discretionary basis by AFAM, provided that a client does not object to same and has not given specific instructions as to whom is to undertake brokerage activities in respect of that client's portfolio and provided further than Acker Finley Inc. has adequate capability to execute such portfolio transactions and provides its services at prices and on terms that are comparable to those available elsewhere to AFAM and its clients.

71. In my view, where a material conflict of interest exists, and where AFAM's clients may be paying higher commissions than would otherwise be payable to an unrelated dealer, it is not sufficient to simply disclose to clients that an affiliated dealer will execute portfolio transactions unless the client objects.
72. AFAM has not provided any evidence to show that the potential consequences of the material conflict, namely, potentially higher commission rates, have been explained to the client. On the contrary, clients have been assured in the IMAs and the offering memoranda that the services of AFI are delivered at prices and on terms that are comparable to those available elsewhere to AFAM and its clients.
73. There was conflicting evidence put forward that NBCN charged commission fees that could be less than the fees charged by AFI, and AFAM appears to have conceded that this could be the case, in some cases at least, since it has sought to justify the difference in commissions by reference to the "vitally important research and other informational services provided by AFI that warrants the higher commissions charged for trades directed through AFI."³⁰
74. AFAM has not been able to provide any evidence to support its position that AFI does in fact provide services at prices and upon terms that are comparable to those available elsewhere to AFAM and its clients.
75. Further, while there has been disclosure of the relationship between AFAM and AFI, there does not appear to have been any disclosure to clients that, in some cases, they may benefit from a lower commission rate by having their trades placed with NBCN directly.
76. Finally, AFAM's advising representative's assertion that AFI is providing "good execution" is not a reasonable response to a material conflict of interest.

²⁸ OSC Staff Submission, *supra* note 2 at 6.

²⁹ *Ibid.*

³⁰ AFAM Response, *supra* note 1 at 8.

77. Under the circumstances, I am not satisfied that a simple disclosure stating that AFI will execute trades unless the client objects is an effective response to a material conflict of interest. I am concerned that AFAM is simply relying on a limited “boiler plate”-type disclosure of the material conflict as a way to respond to the material conflict, and has not turned its mind as to whether this disclosure is an effective response to the conflict.
78. Based on the evidence presented throughout this OTBH, I am not satisfied that AFAM has effectively responded to this material conflict of interest, and have determined that AFAM has failed to comply with its obligation in subsection 13.4(2) of NI 31-103. Therefore, I conclude that AFAM’s failure to comply is a breach of Ontario securities law.

Fair dealing requirements

79. Staff has also submitted that, by directing client account trades to a related dealer that appears to charge a higher commission for the same services as other dealers, AFAM failed to comply with its obligation to deal fairly, honestly and in good faith with its clients, as required by subsection 2.1(1) of OSC Rule 31-505 *Conditions of Registration*.
80. In the recent case of *Pro-Financial Asset Management et al*, 2017 ONSEC 9, (2017) 40 OSCB 3903, the constituent elements of this fundamental registrant obligation were described in paragraph 27 as follows:

As the phrase "fairly, honestly and in good faith" is not defined in the Act, Staff points to the following definitions of "fairly" and "honest" found in *Webster's Encyclopaedic Dictionary* and the definition of "good faith" found in *Black's Law Dictionary* which provide a useful context for the discussion which follows:

Fairly: in a just and equitable manner.

Honest: never deceiving, stealing or taking advantage of the trust of others, sincere, truthful.

Good faith: a state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage. [internal citations omitted].

81. As noted above, I have concluded that AFAM has failed to comply with:
- its obligations under section 4.2 of NI 23-101 to make reasonable efforts to achieve best execution;
 - its obligations under subsection 3.1(2) of NI 23-102 to make a good faith determination that its clients receive a reasonable benefit from the use of client brokerage commissions; and
 - its obligation in subsection 13.4(2) of NI 31-103 to respond to a material conflict of interest in an effective manner.
82. In addition, as described further below, I am not satisfied that AFAM has complied with its obligations under section 11.1 of NI 31-103 to “establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to ... (a) provide

reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation.”

83. Based on the findings above, AFAM has not established, maintained or applied policies and procedures that establish a system of controls and supervision sufficient to provide reasonable assurance that the Firm and each individual acting on its behalf complies with the Firm’s best execution obligations, use of client brokerage commissions or its obligation to respond to conflicts of interest.
84. In view of the foregoing, I believe it is reasonable to conclude that, in relation to its trade execution activities and conflicts of interest obligations, AFAM has not complied with its obligation to deal fairly with its clients. There is insufficient evidence to draw a conclusion on whether AFAM has dealt honestly and in good faith with its clients so I will not make a finding regarding those elements of this fundamental registrant obligation.

b) KYC and suitability obligations

85. During the Compliance Review, Staff identified missing or out-of-date KYC and suitability information, and investments not in line with the SIOP for a number of managed client accounts advised by one of AFAM’s advising representatives.
86. AFAM stated that the clients with the out-of-date KYC and suitability information have been clients of one advising representative for decades and that, due to this longstanding relationship, the advising representative knows the clients intimately. That is all well and good, but that is not an appropriate means for complying with AFAM’s KYC and suitability obligations.
87. In its submission, “AFAM acknowledges the importance of its KYC and suitability obligations.”³¹ Also, AFAM acknowledges that there is missing or out-of-date KYC and suitability information, and that they need to maintain records to demonstrate compliance with these requirements.³²
88. AFAM has advised that it will undertake to address all KYC and suitability-related inconsistencies, and that AFAM will conduct a review and update of its Policy. It will also communicate its Policy to its advising representatives and staff to ensure that it complies with its KYC, suitability and record-keeping obligations.³³
89. I accept AFAM’s acknowledgement that there are deficiencies in their KYC and suitability processes, and accept their statements that they will remediate the deficiencies and implement a system of controls to maintain the appropriate records. So, it is unnecessary for me to make a finding on this ground.
90. Reporting on the progress of remediating AFAM’s KYC and suitability deficiencies will be included in the Consultant’s plan.

³¹ *Ibid* at 12.

³² *Ibid* at 12-13.

³³ *Ibid* at 13.

c) *Compliance system*

91. Section 11.1 of NI 31-103 sets out the requirements for a registered firm's compliance system as follows:

11.1 Compliance system

A registered firm must establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to

- (a) provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation, and
- (b) manage the risks associated with its business in accordance with prudent business practices.

92. AFAM has adopted a basic policy in relation to its best execution obligations, but it does not appear that AFAM has complied with it. Specifically, section 3.1 of AFAM's *Policies & Procedures Manual* states that all orders are to be placed with a qualified broker. Determination and selection of the broker is based on the broker's ability to provide the best price and best execution for the transaction. This must be evaluated and determined by the PM [portfolio manager].

93. AFAM has not provided any evidence to show that it or its portfolio manager conducted an evaluation of any broker used by AFAM. The only evidence that has been submitted is an assertion by one of AFAM's advising representatives that AFI provides "good execution."

94. Further, AFAM submits that the higher commission costs that it pays to its related dealer are permitted because NI 23-102 provides that client commission can be used to pay for research goods and services. However, AFAM does not have a soft dollar policy. Also, AFAM has not determined if the value of the research it receives from AFI provides reasonable benefit to its clients. Finally, some of the services it has identified as receiving from AFI may not qualify as permissible research goods and services.

95. As provided above, in response to the Director's question of whether AFAM had conducted a review and analysis of the areas that are covered in this decision to determine if it was in compliance with Ontario securities law, the response provided was:

"No, AFAM did not conduct a formal review or analysis of its business operations and practices that focused specifically on matters enumerated in Question 2 to determine if they were in compliance with Ontario securities laws.³⁴

96. In addition, and while not discussed in this decision, I have also considered the other deficiencies identified in the Report, which AFAM will need to remediate in order to satisfy the Terms and Conditions.

97. Based on my review, I am satisfied that there is sufficient evidence to determine that AFAM has failed to establish a system of controls and supervision sufficient to provide reasonable assurance that the Firm and each individual acting on its behalf are in compliance with

³⁴ See para 48, *above*.

securities law as required by section 11.1 of NI 31-103. Therefore, I conclude that AFAM has failed to comply with Ontario securities law.

Is it necessary to impose Terms and Conditions?

98. AFAM contends that “the correction of these issues can be accomplished by AFAM with the assistance of legal counsel and without the need for the appointment of a compliance consultant or the imposition of terms and conditions on its registration.”³⁵
99. On the other hand, Staff recommends that a Consultant be retained, as set out in the Terms and Conditions provided in Appendix A.
100. Terms and conditions are not intended to punish a registrant, but are a means of establishing a structured program for registrants to remediate the identified deficiencies and breaches of Ontario securities law. It is important that terms and conditions be made public so that any client or prospective client of the registrant has access to the information and is aware of the restrictions under which a firm is operating.
101. Based on the totality of information provided throughout this OTBH, the findings I have made regarding the breaches of Ontario securities law, including the failings of AFAM’s compliance system, I accept Staff’s recommendation to impose the Terms and Conditions with the changes provided above and blacklined in Appendix A.
102. It is well established through Commission decisions that registration is a privilege and not a right.³⁶ While I am sympathetic to AFAM’s claims that its operations are reasonably small and it will incur costs to remediate the deficiencies identified in the Report, I believe that it is appropriate for a Consultant to be hired to assist AFAM in remediating all of the deficiencies identified in the Report, in developing a compliance system to respond to conflicts of interest, and in developing a system to monitor best execution and the use of soft dollars.

Who can perform the duties of a compliance consultant?

103. AFAM’s counsel submits that they are qualified and appropriately placed to help AFAM remediate the compliance deficiencies since they are already familiar with the operations of AFAM, AFI and its client base. They also submit that it would be costly for AFAM to engage a compliance consultant to assist the firm when AFAM can work diligently with its legal counsel to address all of the agreed upon deficiencies to Staff’s satisfaction.³⁷
104. When a compliance consultant is required as part of terms and conditions, the compliance consultant must have relevant securities knowledge and experience to assist a registrant with establishing, implementing and maintaining a system of controls and supervision that is required by section 11.1 of NI 31-103. The compliance consultant must have a strong understanding of internal controls as well as depth of knowledge of the relevant securities law and national instruments that are applicable to the registrant’s business. The compliance consultant’s knowledge and experience must be specific to the registrant’s category of registration. This will enable the compliance consultant to assist the registrant with

³⁵ AFAM Response, *supra* note 1 at 14.

³⁶ *Re Istanbul* (2008), 31 OSCB 3799 at para 60.

³⁷ AFAM Response to Director Questions, *supra* note 22 at 13.

developing an effective internal control environment, strong supervisory procedures and tailored policies and procedures resulting in an effective compliance system.

105. Further, the compliance consultant's experience must include the development and implementation of comprehensive project plans that, once completed, will remediate the identified deficiencies. The project plan should describe the corrective action to address the identified deficiencies, detail the testing that will be completed to demonstrate that the corrective action is working effectively, and include expected completion dates and reporting timelines to Staff. The compliance consultant is expected to provide progress reports to Staff that summarize the results of the testing, procedures implemented, and how each deficiency has been rectified. Finally, the compliance consultant must be able to provide Staff with an attestation letter verifying that all identified compliance deficiencies have been rectified, and that the compliance consultant's recommendations have been implemented, tested, and are working effectively.
106. As part of the terms and conditions, a registrant is required to provide written authorization giving consent to unrestricted access by Staff to communicate with the compliance consultant regarding the registrant's progress with respect to any matter in relation to the terms and conditions.
107. An experienced securities law counsel may be qualified to perform the duties of an independent compliance consultant. However there are issues to consider if counsel, who is proposed as a compliance consultant, has an existing solicitor-client relationship with the registrant. There are concerns over whether the counsel may be truly independent and able to perform the duties of a compliance consultant. Issues to consider are whether solicitor-client privilege or the duty of loyalty to his/her client would prevent legal counsel from acting in the capacity of a compliance consultant. Or, would counsel be prohibited from providing the required information to Staff and/or completing the attestation that verifies the remediation of the compliance deficiencies.
108. A possible way to address these issues and others that may arise is for the law firm to designate another lawyer within the firm who is otherwise qualified to perform the duties of a compliance consultant, and who has not previously acted for the registrant.
109. If the law firm is able to demonstrate that it has established appropriate information barriers and ethical walls between the legal counsel representing the firm in the regulatory matter and legal counsel acting as the compliance consultant, and if the legal counsel has the requisite knowledge, experience and ability to perform the duties of a compliance consultant and is able to address the issues identified, then I am not opposed to legal counsel from the same firm being engaged as a compliance consultant. However, it will be the decision of the OSC Manager, after due consideration of all the factors that she/he considers relevant, to approve the appointment of a compliance consultant.
110. Regardless of whom AFAM proposes as the Consultant, it is my opinion that AFAM must engage a person that has expert knowledge regarding best execution and soft dollar practices to assist AFAM with establishing an effective compliance system.

Registrant's responsibility during a compliance review

111. AFAM has taken considerable effort in its submissions to attempt to call into question Staff's knowledge, understanding, judgment and accuracy on a number of matters. For

example, AFAM contends that Staff did not take into account the value of research goods and services relating to best execution,³⁸ and that Staff had a fundamental misunderstanding of the dealer's commission schedule.³⁹

During a compliance review, it is the registrant's responsibility to respond to Staff's information requests fully and in a diligent manner. This includes providing documents to support its practices. If a registrant does not have the information that was requested or is unable to explain the information, then the registrant cannot reasonably later complain that Staff did not consider or understand all relevant information before completing their review.

112. In the present matter, I do not believe AFAM's comments towards Staff are warranted or productive.

113. Finally, while I have not considered this as part of my decision, I nevertheless believe it is important for AFAM to be cognizant of its potential obligations to its clients under common law and under section 116 of the Act as the fund manager to the AFAM Funds. I will not comment on these potential obligations further, and have limited my decision to a consideration of AFAM's potential obligations under the sections of Ontario securities law cited in this decision.

"Debra Foubert"

Debra Foubert, J.D.
Director, Compliance and Registrant Regulation Branch
Ontario Securities Commission

September 26, 2017

³⁸ AFAM Response, *supra* note 1 at 11.

³⁹ Written surrepley submissions of Acker Finley Asset Management Inc. (23 June 2017) at 2.

Appendix A – Staff Proposed Terms and Conditions

The proposed terms and conditions are as follows:

The registration of Acker Finley Asset Management Inc. (the “**Firm**”) under the *Securities Act* (Ontario) (the “**Act**”) is subject to the following terms and conditions, which were imposed by the Director pursuant to section 28 of the Act.

Compliance Consultant

1. Within ten business days of the date these terms and conditions are imposed, the Firm shall retain, at its own expense, the services of an independent [compliance] consultant (the “**Consultant**”) that is acceptable to a Manager or Deputy Director in the Compliance and Registrant Regulation Branch of the Ontario Securities Commission (the “**OSC Manager**”) to:

(a) Prepare and assist the Firm in implementing a plan (the “**Plan**”) to strengthen the Firm's "compliance system" within the meaning of section 11.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“**NI 31-103**”), including the expected dates of completion and person(s) responsible for the implementation.

In the Plan, the Consultant will:

(i) examine the Firm's operations, internal policies, practices and procedures and make recommendations for rectifying all identified compliance deficiencies in the compliance field review report dated April 13, 2017;

~~(ii) identify and implement a methodology for determining how much money clients of the Firm (both individual/corporate accounts and investment funds) have been overcharged as a result of the Firm's non-compliance with its obligations relating to conflicts of interest in section 13.4 of NI 31-103, and its best execution obligation in section 4.2 of National Instrument 23-101 Trading Rules since September 1, 2014;~~

~~(iii) identify and implement a methodology for the Firm to notify affected clients that they have been overcharged and the amount of that overcharge, and to repay the overcharge amount to the affected clients;~~

(ii) provide a written report to the Firm and to Staff that explains how the Firm will establish a system of controls and supervision that achieves best execution for its clients, identifies and values soft dollar arrangements and complies with its conflicts of interest obligations on a go-forward basis.

(iii) assist AFAM in comparing trade execution options and arrangements between NBCN, AFI and any other dealer to determine the most advantageous execution terms reasonably available on a go-forward basis.

(iv) assess whether sufficient resources have been allocated to compliance, including whether the compliance personnel have the proficiency to perform the activity competently, and make any recommendations regarding such resources, as may be necessary.

(b) Review the Firm's progress with respect to implementation of the Plan.

(c) Submit written progress reports ("**Progress Reports**") to the OSC Manager detailing the Firm's progress with respect to the implementation of the Plan and stating whether the specific recommendations included in the Plan have been implemented, and if not, the expected date of completion and person(s) responsible for the implementation.

2. The Firm shall immediately submit to Staff written authorization from the Firm giving consent to unrestricted access by Staff to communicate with the Consultant regarding the Firm's progress with respect to any matter in relation to these terms and conditions.

3. The Consultant shall provide the Plan to the OSC Manager for approval no later than 30 days from the date the Firm is notified by the OSC Manager that the Consultant retained by the Firm is acceptable to the OSC Manager.

4. The Plan and the Progress Reports must be reviewed and approved by the ultimate designated person ("**UDP**") and chief compliance officer ("**CCO**"), and signed by the UDP and CCO as evidence of their review and approval.

5. The Plan shall identify the date by which it is to be fully implemented, and shall also include a schedule pursuant to which the Consultant will submit Progress Reports to the OSC Manager. The Progress Reports shall be submitted no less frequently than every three months.

6. The Firm understands and acknowledges that Staff expects that substantial progress towards the implementation of the Plan will be demonstrated in each of the Progress Reports.

7. Upon the full implementation of the Plan, the Consultant shall submit an attestation letter for approval by the OSC Manager verifying that all identified compliance deficiencies have been rectified, and that the Consultant's recommendations have been implemented, tested, and are working effectively.

8. Until the OSC Manager has approved of the attestation letter submitted in accordance with paragraph 7 above, the Firm shall not terminate the Consultant's retainer without prior written approval by the OSC Manager.

These terms and conditions of registration constitute Ontario securities law, and a failure by the Firm to comply with these terms and conditions may result in further regulatory action against the firm, including a suspension of its registration.