OSC

ONTARIO SECURITIES COMMISSION

Summary Report for Dealers, Advisers and Investment Fund Managers

Compliance and Registrant Regulation

OSC Staff Notice 33-750

August 8, 2019

CONTENTS

Director's message

We are happy to publish this year's Summary Report for Dealers, Advisers and Investment Fund Managers (**Summary Report**) that provides an overview of our work during the 2018-2019 fiscal year.

In addition to the work set out in this year's Summary Report, the Compliance and Registrant Regulation Branch (**CRR**) is actively engaged in the Ontario Securities Commission's new Burden Reduction Task Force. We understand the frustration of duplicative, unclear or inconsistent requirements and are moving as an organization to tackle these issues. Through the Burden Reduction initiative, we are evaluating stakeholder comments to identify areas that CRR can focus on to reduce burden. It's important that compliance with our requirements is not unduly burdensome and does not stand in the way of economic growth and innovation.

As an operational branch, we monitor and consistently meet our service standards for registration and exemptive relief applications. The service standards apply to routine applications and the clock starts ticking once we receive a complete application. However, applications that are incomplete or raise novel matters may take longer than the expressed service standards. We will continue to respond as promptly as feasible and assist our registered firms and individuals (collectively, **registrants**) wherever possible.

While we strive for strong and open lines of communication with registrants, we heard that you want a contact person to call who is familiar with your type of business. We continue to provide a contact list with the names and phone numbers of all CRR team members. This year we've also provided information to clarify our CRR team structure which is focused on each of our primary direct registrant categories. If you have a question, comment or want to discuss regulatory policy, compliance practices, registration processes or any matter impacting your business model, you'll have the tools to know who to contact!

We continue to update our Registrant Outreach program which includes educational seminars, the Topical Guide for Registrants and a listing of Director's Decisions by topic and year.

This year, our compliance reviews will focus on the following areas:

- suitability assessments, including concentration and prospectus exemptions,
- firms that have recently acquired another firm to assess the compliance structure of the newly integrated firm,
- high-risk registrants that were identified through "Registration as the First Compliance Review" program, and
- high-impact and high-risk firms.

We continue to receive positive feedback from registrants on our Summary Report and are open to suggestions that would further enhance its usefulness for you. As always, we look forward to engaging with our registrants in the upcoming year.

Debra Foubert
Director, Compliance and
Registrant Regulation

Introduction

Who we are

The CRR Branch of the Ontario Securities Commission (**OSC**, the **Commission**) is responsible for the registration and ongoing regulation of firms and individuals who are in the business of trading in, or advising on, securities or commodity futures and firms that manage investment funds in Ontario. The OSC's mandate is to:

- provide protection to investors from unfair, improper or fraudulent practices,
- foster fair and efficient capital markets, and
- contribute to the stability of the financial system and the reduction of systemic risk.

CRR's activities are integral to the OSC's vision of being an effective and responsive securities regulator, fostering a culture of integrity and compliance and instilling investor confidence in the capital markets.

The purpose of this report

This Summary Report prepared by staff of the CRR Branch is designed to assist registrants with information on the following:

- **Education and outreach**
  Part 1 of this report provides links and information to the registration and ongoing educational resources and outreach opportunities available to current and prospective registrants.

- **Regulatory oversight activities and guidance**
  Part 2 of this report can be used by registrants as a self-assessment tool to strengthen compliance with Ontario securities law and, as appropriate, to make changes to enhance their systems of compliance, internal controls and supervision.

- **Impact of upcoming initiatives**
  Part 3 of this report provides insights into some of the new and proposed rules and other regulatory initiatives that may impact a registrant's operations.

- **Registrant conduct activities**
  Part 4 of this report is intended to enhance a registrant's understanding of our expectations and our interpretation of regulatory requirements. This section also provides insight into the types of regulatory actions the CRR Branch may take to address non-compliance.

Structure

The following page sets out the organizational structure of the CRR Branch. We encourage registrants to reach out to staff with any inquiries they may have. Contact information for directors, managers and staff within the branch can be found in the Staff directory presented at the end of this report.

DEBRA FOUBERT
DIRECTOR

416-593-8101

FELICIA TEDESCO
DEPUTY DIRECTOR
OPERATIONS

416-593-8273

ELIZABETH TOPP
MANAGER
PORTFOLIO MANAGER TEAM

416-593-2377

VERA NUNES
MANAGER
INVESTMENT FUND MANAGER TEAM

416-593-2311

DENA STAIKOS
MANAGER
DEALER TEAM

416-593-8058

The Operations Unit is comprised of three teams of lawyers and accountants and is responsible for conducting compliance field reviews and reviewing applications for exemptive relief.

The members of this unit also act as subject matter experts in support of registration files.

If you have compliance questions, please contact the managers, based on your registration category, as follows:

- Portfolio Managers
  - Elizabeth
- Investment Fund Managers
  - Vera
- Exempt Market or Scholarship Plan Dealers
  - Dena

ELIZABETH KING
DEPUTY DIRECTOR
REGISTRANT CONDUCT

416-204-8951

MICHAEL DENYSZYN
MANAGER
REGISTRANT CONDUCT

416-595-8775

The Registrant Conduct Team handles files referred from other CRR teams and other OSC branches for matters that require further regulatory action to remediate registrant misconduct.

Registrant misconduct may be addressed by applying terms and conditions to registration, suspension of registration, or being referred to the Enforcement branch.

If you have conduct matter questions, please contact Mike.

JEFF SCANLON
MANAGER
REGISTRATION

416-597-7239

The Registration Team focuses on the initial and ongoing registration of firms and individuals. The team also performs financial analysis of registrants' interim and annual financial statements and capital calculations. This team is also responsible for processing registration-related applications for exemptive relief.

If you have registration-related questions, please contact Jeff.

PAT CHAUKOS
DEPUTY DIRECTOR
LAUNCHPAD & POLICY

416-593-2373

The LaunchPad & Policy Unit is responsible for:

- providing assistance to novel online and fintech businesses as they navigate the regulatory requirements, and
- coordinating the policy initiatives for CRR.

If you have LaunchPad-related questions, please contact Pat.

LOUISE BRINKMANN
MANAGER
DATA STRATEGY & RISK

416-596-4263

The Data Strategy & Risk Team is responsible for supporting the branch's data requirements, conducting data analytics, and leading the business planning process.

This team also maintains CRR's risk register, conducts risk analysis and coordinates all branch reporting.

If you have questions about CRR's data, reporting or risk operations, please contact Louise.

Advisory committees

Established in January 2013, the Registrant Advisory Committee (**RAC**) is currently comprised of 11 external members. The RAC's objectives include:

- advising on issues and challenges faced by registrants in interpreting and complying with Ontario securities law, including matters related to registration and compliance, and
- providing feedback on the development and implementation of policy and rule-making initiatives that promote investor protection and fair and efficient capital markets.

The RAC meets quarterly, with members serving a minimum two-year term and is chaired by Debra Foubert. Topics of discussion over the past fiscal year included:

- the OSC's whistleblower initiative,
- CSA Staff Notice 61-303 and Request for Comment *Soliciting Dealer Arrangements*,
- CSA Staff Notice 23-320 *Consideration of the Markets in Financial Instruments Directive (MiFID II) Unbundling Requirements on the Regulatory Requirements in Canada*,
- MFDA Bulletin #0748-P *Discussion Paper on Expanding Cost Reporting*,
- sales practices and the OSC's recent enforcement proceedings, and
- regulatory burden reduction and the cost of compliance.

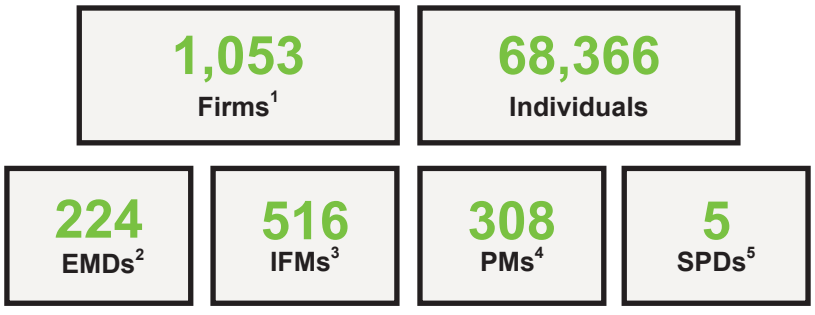
The Fintech Advisory Committee (**FAC**) was established in 2017 to advise OSC staff on developments in the fintech space as well as the unique challenges faced by innovation businesses. The current FAC includes key players from a broad spectrum of the fintech community, ranging from start-ups, auditors, lawyers, and representatives from regulated entities and industry organizations.

The FAC meets quarterly, with members serving a minimum one-year term and is chaired by Pat Chaukos. Topics of discussion over the past fiscal year included:

- investment limits,
- crypto-asset trading platforms and custody of client assets,
- resale of coins/tokens,
- open data, and
- artificial intelligence in financial services.

Who this report is relevant to

This Summary Report provides information for registrants that are directly regulated by the OSC. These registrants primarily include exempt market dealers (**EMDs**), investment fund managers (**IFMs**), portfolio managers (**PMs**) and scholarship plan dealers (**SPDs**). At present, registrants overseen by the OSC include:



[1] This number excludes firms registered as mutual fund dealers or firms registered solely in the category of investment dealer or other registration categories (commodity trading manager, futures commission merchant, restricted PM, and restricted dealer).

[2] This number includes firms registered as sole EMDs.

[3] This number includes firms registered as sole IFMs and IFMs also registered in other registration categories.

[4] This number includes firms registered as sole PMs and PMs also registered as EMDs, and in other registration categories.

[5] This number includes firms registered as sole SPDs and SPDs also registered as IFMs.

In general, firms must register with the OSC if they conduct any of the following activities in Ontario:

- are in the business of trading in, or advising on, securities (this is referred to as the "business trigger" for registration),
- act as an underwriter or as an IFM, or
- conduct trading and advising activities involving commodity futures contracts or commodity futures options.

Individuals must register if they trade, advise or underwrite on behalf of a registered dealer or adviser, or act as the Ultimate Designated Person (**UDP**) or Chief Compliance Officer (**CCO**) of a registered firm.

There are seven dealer and adviser categories for firms trading in or advising on securities, or acting as an underwriter, as applicable:

- EMD,
- SPD,
- restricted dealer,
- PM,
- restricted portfolio manager,
- investment dealer (**ID**), who must be members of the Investment Industry Regulatory Organization of Canada (**IIROC**), and
- mutual fund dealer (**MFD**), who must, except in Quebec, be members of the Mutual Fund Dealers Association of Canada (**MFDA**).

There are four dealer and adviser categories for firms trading in or advising on commodity futures:

- commodity trading adviser,
- commodity trading counsel,
- commodity trading manager, and
- futures commission merchant.

There is a separate category for firms that direct the business, operations, or affairs of investment funds:

- IFM.

The OSC also registers firms and individuals in the category of MFD and dealing representatives, and firms in the category of ID; however, these firms and their registered individuals are directly overseen by the self-regulatory organizations (**SROs**): the MFDA and IIROC, respectively. Although this report focuses primarily on registered firms and individuals directly overseen by the OSC, firms directly overseen by the SROs should review Part 2 of the Summary Report as certain information is applicable to them as well.

Applications for registration are reviewed by CRR staff, nonetheless, we remind firms seeking registration in the category of ID, MFD or futures commission merchant to also apply separately for membership with the relevant SRO.

Service standards

The CRR Branch is committed to accountability and transparency and to ensuring services are delivered in the most efficient and effective ways possible. For information about CRR's service standards and timelines, refer to the **OSC Service Commitment** webpage.

Part 1 OUTREACH

1.1 Outreach program and resources

Registrant Outreach since inception

62
In-person and webinar seminars held

5,117
Web replays viewed

12,529
Individuals that have attended outreach sessions

>10,000
Topical Guide for Registrants - page views annually

We continue to interact with our stakeholders through our Registrant Outreach program, which was launched in 2013. The objectives of our Registrant Outreach program are to strengthen communication with Ontario registrants that we directly regulate and with other industry participants (such as lawyers and compliance consultants), to promote stronger compliance practices and to enhance investor protection.

Interested in attending an upcoming Registrant Outreach seminar?
Click here for our calendar of upcoming events.

Looking for information about regulation matters?
Take a look at our Registrant Outreach webpage or our Topical Guide for Registrants for help with key compliance issues and policy initiatives.

Want to be informed about newly released guidance?
Register to receive our e-mail blasts here.

Looking for a listing of recent e-mail blasts and links to each?
Refer to the OSC Compliance Reports, Staff Notices & E-mail blasts webpage.

Interested in reading previously published Director's Decisions?
Refer to the Director's Decisions webpage.

If you have questions related to the Registrant Outreach program or have suggestions for seminar topics, please send an e-mail to RegistrantOutreach@osc.gov.on.ca.

1.2 Registration

National Registration Database access best practices for Authorized Firm Representatives

In January 2019, the Canadian Securities Administrators (**CSA**) sent the Authorized Firm Representative (**AFR**) Account Management Best Practices Checklist (the **AFR Guide**) to each firm's Chief Authorized Firm Representative (**CAFR**).

The AFR Guide is designed to help firms better manage and protect the data of firms and individuals maintained in the National Registration Database (**NRD**).

The security of the data contained in NRD is paramount. The CSA conducts regular reviews of NRD to ensure that necessary protections and controls are in place to safeguard the data. The CSA also uses industry-recognized security services to monitor and protect NRD and the data contained in the system from malicious activity.

Despite the safeguards in place at the system level, the failure of a firm to adequately manage its users' access to NRD can lead to the unauthorized modification, destruction, or disclosure of firm or individual specific information contained in NRD.

The AFR Guide was prepared by the CSA based on ISO 27002 best practices for information technology. Although firms are expected to have their own security policies and procedures already in place, the CSA recommends that firms review their existing internal processes and controls against these best practices.

For more information, please refer to the **AFR Guide**.

Data analytics and Natural Language Processing

The CRR Branch uses a variety of data analytics, text mining and reporting tools to assist with the review of various filings and other documents. For example, we use Natural Language Processing (**NLP**) to sift through filings and comment letters to discover common themes. We also use NLP to determine overall sentiment and assess the tonality of comments. These tools and techniques allow us to map and gain insights about the registrant population, including trends and risks.

As we gain more experience with these tools, we expect that our data strategy will further enhance our evidence-based decision making and allow us to work more efficiently. By combining data and connecting the dots, we will be able to use data analytics to achieve appropriate regulatory outcomes and also aid in reducing regulatory burden. In terms of regulatory burden, we know that filers want to "tell the regulator once", and that filers would appreciate receiving forms that have some data pre-populated. To be responsive, we are trying to identify situations where this might be possible, as part of our regulatory burden reduction plan.

1.3 OSC LaunchPad

Modernizing regulation to support fintech innovation

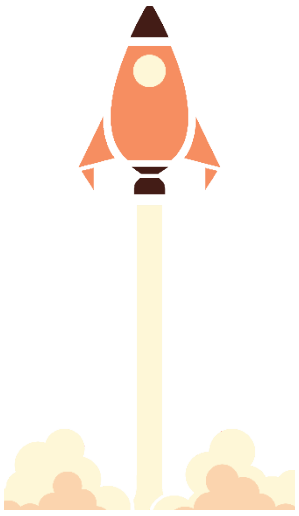
OSC LaunchPad seeks to support the development of innovative financial business models by deepening engagement with novel fintech businesses and creating flexible, timely and proportionate regulatory approaches.

OSC LaunchPad is comprised of a core team that is exclusively focused on fintech and an extended team representing the various branches at the OSC. Drawing on the expertise across the OSC, we have developed specialized working groups to consider novel issues and respond quickly to emerging developments. The work of the OSC LaunchPad team focuses on three main areas:

Engaging with the fintech community	Providing direct support to eligible fintech businesses in navigating regulatory requirements	Taking learnings and applying them to similar businesses going forward

OSC LaunchPad's Direct Support Process

Our direct support process provides an opportunity for firms to discuss their business and proposed approaches as well as raise questions. We are interested in hearing from businesses that meet the following criteria:



- ✔ You are a fintech business that has not yet started operations or is in the process of applying to the OSC for registration or exemptive relief.
- ✔ You have a new innovation or significantly different product, service or application from those currently available.
- ✔ Your innovation will likely provide identifiable benefits to investors.
- ✔ You understand the necessity of investor protections and will invest time and energy in understanding and addressing them.
- ✔ You acknowledge the application of securities laws and have considered how it applies to your business.

For more information on how to apply for direct support, please visit OSC LaunchPad's webpage.

OSC LAUNCHPAD

Key accomplishments of OSC LaunchPad to date

369	Meetings held with fintech businesses and stakeholders
230	Requests for support received and direct support provided to fintech businesses
136	Events that OSC LaunchPad has participated in or hosted
32	Collaborative reviews with the CSA Regulatory Sandbox of novel businesses that want to operate across Canada

Emerging trends

Over the past year, despite the decline in value of crypto assets, the industry focus has continued to be on crypto-asset related businesses, including crypto-asset investment funds, initial coin/token offerings and crypto-asset trading platforms.

Auditors and crypto-asset custodians have critical roles to play in the crypto-asset ecosystem with respect to the safeguarding of crypto assets. We have heard from businesses that are developing crypto-asset custody solutions that they are experiencing challenges with obtaining audit reports, which provide assurance on the operating effectiveness of custody solutions. Other crypto-asset related businesses have also indicated that they are experiencing challenges in obtaining audited financial statements and audited options with respect to crypto assets. We have engaged in discussions with audit firms and custodians to better understand these challenges.

Other emerging industry trends include RegTech services (technology-facilitated regulatory compliance services), SupTech services (technology-facilitated regulatory supervision services), artificial intelligence and machine learning, and open data. We expect additional developments in these areas in the coming year.

For a complete list of novel product offerings and services in respect of which relief has been granted, please visit OSC LaunchPad's webpage.

Publications and resources

In March 2019 we published **Joint CSA/IIROC Consultation Paper 21-402 *Proposed Framework for Crypto-Asset Trading Platforms*,** which sets out a proposed regulatory framework and seeks input from the fintech community, market participants, investors and other stakeholders on a number of areas that will assist in determining appropriate requirements for crypto-asset trading platforms. These include how to address custody and verification of assets, price determination, market surveillance, system and business continuity planning, conflicts of interest, crypto-asset insurance and clearing and settlement.

The comment period ended May 15, 2019. The CSA and IIROC will be reviewing the comments received and determining next steps in the consultation. We intend to take a flexible approach to regulation and use the feedback to establish tailored requirements for crypto-asset trading platforms that considers the benefits of this technology, while addressing risks to investors and creating greater market integrity.

In June 2018 we published **CSA Staff Notice 46-308 *Securities Law Implications for Offerings of Tokens*** to help token issuers determine when an offering of tokens is considered a distribution of securities, including tokens that are commonly referred to as “utility tokens”.

While innovation can offer great investment opportunities, it also comes with risks. OSC LaunchPad continues to support our Investor Office in the publication of fintech-related **guidance and research** that can assist Canadians in making informed decisions. For a complete list of **publications and resources**, please visit OSC LaunchPad’s webpage.

Co-operation with International Regulators

In January 2019, the OSC, along with 28 other financial regulators and organizations, joined forces to establish the **Global Financial Innovation Network** (**GFIN**). GFIN aims to drive more collaboration with regulators and easier cross-border trials for innovative firms and also provides a forum for different financial services regulators to share knowledge, experiences and approaches to emerging issues.

GFIN has also launched the pilot phase of cross-border testing intended to create an environment to allow firms to trial and scale new technologies in multiple jurisdictions, gaining real-time insight into how a product or service might operate in the market. Several Canadian firms and international firms seeking to operate in Canada have submitted applications for participation in the cross-border testing pilot. GFIN is currently reviewing applications and expects the pilot testing phase to begin in Q3 2019.

More information about OSC LaunchPad’s **international regulatory partnerships** can be found on the OSC LaunchPad webpage.

Part 2 INFORMATION FOR DEALERS, ADVISERS AND INVESTMENT FUND MANAGERS

How to navigate Part 2 of the Summary Report

Part 2 of the Summary Report provides an overview of the key findings and outcomes from compliance reviews conducted during the 2018/2019 fiscal year.

The highlights in section 2.1 provide readers with a direct link between the key compliance reviews conducted, the guidance issued as a result of our findings and a list of the registration categories that the guidance applies to. Section 2.2 discusses key or novel issues, suggests best practices and specifies applicable legislation and relevant guidance to assist firms in addressing each of the topic areas. For ease of reference, registration categories are listed beside each deficiency heading to indicate the information that is relevant to firms registered in this capacity.

We encourage registrants to review all the information set out in Part 2 of this report as the guidance presented may be helpful to registration categories other than those listed.

2.1 Annual highlights

a) 2018 Risk Assessment Questionnaire

b) High-risk registrants

c) Referral arrangements

d) Short-term trading and excessive trading

e) High-impact registrants

f) Compensation and incentive practices

g) Expanded exempt market

h) Illiquid holdings

i) Online dealer platforms

j) Sales practices

k) Capital-raising activity

WHAT WE DID	REFERENCE	REGISTRANTS

a) 2018 RISK ASSESSMENT QUESTIONNAIRE

Consistent with prior years, in April 2018 we issued a comprehensive risk assessment questionnaire (the **RAQ**) to 1,058 firms that were registered with the OSC in the categories of PM, restricted PM, IFM, EMD and restricted dealer. The RAQ is issued on a two-year cycle, so registered firms can expect to receive the next version in 2020. The RAQ is our primary tool to gather information about our registrants' business operations, which supports our risk-based approach to select firms for on-site compliance reviews or targeted reviews.

The information collected from the 2018 RAQ was analyzed using a risk assessment model. Every registrant's response was risk-ranked and a risk score was generated. Firms may be risk-ranked as high based on a variety of factors, including the broad nature of a firm's business activities, a large amount of client assets under management (**AUM**), the size of the firm, and the number of clients and/or the type of clients serviced by the firm. Firms that are risk-ranked as high may be selected for a compliance review. In addition, if we conduct a targeted review of a particular area of interest, we may select firms for this review based on their RAQ responses.

- section 2.2.2 (page 30)

- ✔ IFM
- ✔ PM
- ✔ EMD

b) HIGH-RISK REGISTRANTS

In 2018 we commenced compliance reviews of high-risk registrants identified through the RAQ process as discussed above. A sample of registered firms that were risk-ranked as high based on their responses to the 2018 RAQ were selected for review. We are in the process of completing these reviews and will report the findings from these reviews to each firm. As is our normal process, depending on the deficiencies identified during a compliance review, we may consider further regulatory action to remediate the deficiencies.

- section 2.2.1 (page 24-29)
- section 2.2.2 (page 30)
- section 2.2.3 (page 33)
- section 2.2.4 (page 34)

- ✔ IFM
- ✔ PM
- ✔ EMD
- ✔ SPD

WHAT WE DID	REFERENCE	REGISTRANTS

c) REFERRAL ARRANGEMENTS

In 2018, we conducted a sweep (the **referral sweep**) of six registered firms that have a business model based on attracting new clients by way of client referrals from third parties (referral arrangements). The referral sweep focused on determining how PM and EMD firms address the following inherent risks present in referral arrangements:

- client confusion as to the roles and responsibilities of the registrant and referral agent, and
- the risk that an unregistered referral agent may conduct registerable activity.

• section 2.2.5 (page 40)

✔ PM

✔ EMD

✔ SPD

d) SHORT-TERM TRADING AND EXCESSIVE TRADING

In 2018, we conducted a review to assess how IFMs monitor short-term trading and excessive trading (the **STT review**) by unitholders of their investment funds. We selected 25 IFMs to participate in the STT review.

The STT review focused on assessing whether the IFMs had developed and implemented adequate policies and procedures to monitor and deter short-term trading and excessive trading activities in the investment funds they manage. We also reviewed details regarding the circumstances under which a short-term trading fee was being waived to determine whether such action could have an adverse impact to the remaining unitholders of the affected investment fund. Lastly, we investigated whether short-term trading fees were being waived consistently for certain unitholders or unitholders of dealing representatives who had a large level of client assets invested in the IFM's investment funds (i.e., the "top producers").

• section 2.2.5 (page 39)

✔ IFM

✔ MFD

✔ ID

WHAT WE DID	REFERENCE	REGISTRANTS

e) HIGH-IMPACT REGISTRANTS

As part of our risk-based approach to selecting firms for review, we include firms that could have a significant impact on the capital markets if there were a breakdown in their compliance structure or key operations (**high-impact firms**).

In 2018, we completed compliance reviews of six firms which were classified as high-impact. These firms have a combined AUM of $325 billion. The types of deficiencies we identified during these reviews were similar to the deficiencies we identified at other firms in our registrant population.

High-impact firms more frequently use an automated compliance system (**ACS**) to monitor and manage compliance for their trading and portfolio management practices. We continue to note that improvements are required around high-impact firms' controls over their use of an ACS. The use of an ACS by high-impact firms was discussed in detail in section 3.1(c)(iv) of OSC Staff Notice 33-748 *Annual Summary Report for Dealers, Advisers and Investment Fund Managers.*

- section 2.2.2 (page 30)
- section 2.2.5 (page 37-38)

✔ IFM

✔ PM

f) COMPENSATION AND INCENTIVE PRACTICES

We conducted a review of 14 PMs and EMDs focusing on their compensation and incentive practices.

The purpose of this review was to:

- obtain a better understanding of the compensation practices at PMs and EMDs including compensation practices for staff in a compliance or supervisory role,
- assess compliance with the conflicts of interest requirements in Part 13 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**), and
- determine whether firms have adequate controls in place to mitigate against conflicts of interest arising from compensation arrangements.

- section 2.2.5 (page 42)

✔ PM

✔ EMD

✔ SPD

WHAT WE DID	REFERENCE	REGISTRANTS

g) EXPANDED EXEMPT MARKET

We completed a second review to assess the use of prospectus exemptions recently introduced in Ontario (the **expanded exempt market review**). The expanded exempt market review was coordinated in conjunction with the New Brunswick, Quebec and Saskatchewan securities commissions and included 18 EMDs, 10 of which were reviewed by the OSC. The EMDs reviewed facilitated the distribution of securities in reliance on the offering memorandum (**OM**) and/or the family friends, and business associates (**FFBA**) prospectus exemptions. The objective of the review was to assess the use of the OM and FFBA prospectus exemptions, and for the OSC to assess whether there had been improved compliance since the first expanded exempt market review conducted in 2017.

- section 2.2.1 (page 26)

✔ EMD

h) ILLIQUID HOLDINGS

We conducted a review of 11 IFMs who managed investment funds with large holdings in illiquid securities (the **illiquid holdings review**). The illiquid holdings review focused on assessing the adequacy of the IFMs' valuation procedures. In addition, our review assessed whether the IFM was appropriately overseeing the investment fund's compliance with applicable regulatory restrictions or investment restrictions as stated in the investment fund's offering document.

- section 2.2.2 (page 31)

✔ IFM

✔ PM

i) ONLINE DEALER PLATFORMS

In 2017 and 2018, we conducted compliance reviews of 8 EMD and restricted dealer firms that operate online dealer platforms for the distribution of exempt market products. The purpose of these reviews was to determine if the firms had designed and established appropriate compliance systems and supervisory controls to effectively address the unique risks associated with their online business models. Through these reviews we also engaged with firms to understand the challenges they faced in operating an online platform and interacting with investors using this medium. Refer to OSC Staff Notice 33-749 *Annual Summary Report for Dealers, Advisers and Investment Fund Managers* (**OSC Staff Notice 33-749**).

- OSC Staff Notice 33-749 (page 34)

✔ EMD

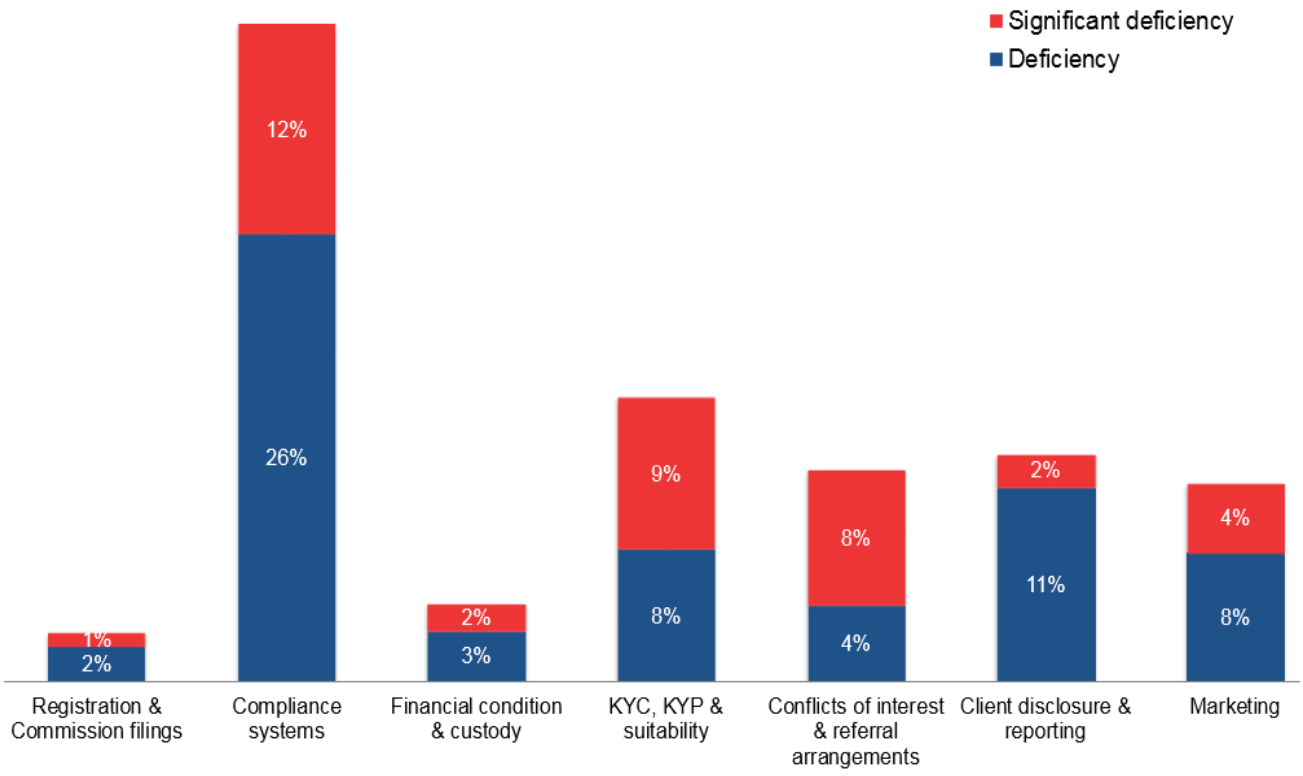
WHAT WE DID	REFERENCE	REGISTRANTS
j) SALES PRACTICES		
We conducted a focused desk review of sales practices (the **sales practices desk review**) involving the provision of non-monetary benefits through items, activities and charitable donations provided under Part 5 and Part 7 of NI 81-105. We selected 25 IFMs to participate in the sales practices desk review. Our work focused on sales practices that could be perceived as inducing dealers and their representatives to sell mutual fund securities on the basis of incentives they were receiving, rather than what was suitable for their clients.	• section 2.2.5 (page 35)	✔ IFM ✔ MFD ✔ ID
k) CAPITAL-RAISING ACTIVITY		
We completed a review of 16 issuers that conducted capital-raising activity without involving a registered dealer and were not registered as a dealer or in any other category of registration. The purpose of the review was to identify issuers who were in the business of trading and required registration as a dealer or relied on an appropriate prospectus exemption.	• section 2.2.1 (page 26)	✔ EMD

2.1.1 Summary of deficiencies identified

The following chart summarizes our findings from reviews set out in the annual highlights section. Deficiencies we identify during the fiscal year are impacted by various factors including the following:

- CRR's planned reviews of specific aspects of a firm's operational activities,
- the nature and complexity of the firms reviewed, and
- firms' compliance with securities law.

Deficiencies by topic area
as a percentage of overall deficiencies



2.2 Registration and compliance deficiencies

2.2.1 Registration & Commission filings

- Form 33-109F4 filing submissions that were returned
- Certification in Form 33-109F4 not being followed
- Registerable activity by non-registered parties
- Novel exemptive relief for dealer business models

2.2.2 Compliance systems

- Inconsistent and inaccurate responses provided in RAQ
- Supervision of dealing representatives using multiple languages
- Valuation of illiquid assets

2.2.3 Financial condition & custody

- Custody requirements for registered firms

2.2.4 Know your client (KYC), know your product (KYP) & suitability

- Concentration and suitability

2.2.5 Conflicts of interest & referral arrangements

- Sales practices
- Prohibited investment in a related entity
- Prohibited inter-fund trades
- Short-term trading and excessive trading
- Referral arrangements
- Compensation and incentive practices

2.2.1 Registration & Commission filings

a) Form 33-109F4 filing submissions that were returned (All)

This year, we returned 3,413 submissions on NRD to AFRs for correction or updating. In addition to delays, and the need for additional staff effort, a returned submission renders the submission ineligible for service standard guarantees.

The most common sections of Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals* (**33-109F4**) requiring correction are:

- Item 6 - Individual categories - 34% of all returns
- Item 10 - Current employment - 26% of all returns
- Item 8.1 - Proficiency experience - 10% of all returns
- Item 1 - Name - 2% of all returns

Examples of common deficiencies in these items include:

- requesting an inappropriate category for the applicant's activities,
- not including the title for officers who are Permitted Individuals,
- not appropriately describing conflicts of interest in the section provided in the current employment entry,
- not providing sufficient or clear proficiency experience details to support claims of relevant experience required for the registration category being sought by the applicant, and
- not providing full legal names, former names, aliases, or trade or business names that the applicant operates under.

Registered firms should:

- understand the activities permitted by each registration category,
- have a discussion with applicants concerning their names and titles,
- finalize the activities contemplated by the firm before adding a registration category,
- speak with applicants to confirm their understanding of the questions set out in the 33-109F4 and review their responses for completeness before submitting their application to the OSC,
- periodically remind applicants of their ongoing reporting obligations and review updates for completeness prior to submission,
- provide sufficient descriptions of outside business activities or other disclosures, and
- have adequate supervision systems to determine if existing procedures are functioning.

Legislative reference and guidance

- National Instrument 33-109 *Registration Information* (NI 33-109)
- Companion Policy 33-109CP *Registration Information* (NI 33-109CP)

b) Certification in Form 33-109F4 not being followed (All)

Some individual applicants complete the 33-109F4 without fully understanding its content and potentially without an adequate level of support and due diligence from their sponsoring firm. The 33-109F4 currently requires a certification of truth and completeness. It also requires the applicant to certify that they have discussed the form with a supervisory officer of their firm and that, to the best of the applicant's knowledge, the officer was satisfied that the applicant understood the questions.

We generally receive a positive certification with 33-109F4 filings. However, in some cases, upon further review, the applicant has not always discussed the form with their firm's supervisory officer, nor do they understand the nature and extent of the information being requested. For example, staff have encountered situations in which applicants, after failing to disclose necessary information, admit that they did not review the application with any other person before certifying that they had discussed the form with a supervisory officer.

Section 5.1 of NI 33-109 requires sponsoring firms to make reasonable efforts to ensure the truth and completeness of information that is submitted. We remind registered firms of their responsibility in overseeing applicants they sponsor. This includes confirming that the applicant fully understands the questions being asked of them in the 33-109F4.

Registered firms should:

- provide individual applicants with an opportunity to have a meaningful discussion with their firm about the 33-109F4 and its content,
- inquire whether individual applicants have any questions or are confused regarding the questions set out in the 33-109F4,
- develop measures that identify areas prone to common errors and proactively discuss these areas with applicants prior to filing the 33-109F4,
- discuss the 33-109F4, its content, and the applicant's completion process prior to submitting the 33-109F4, and
- have policies and procedures that validate the certification contained in the 33-109F4 is being followed.

Legislative reference and guidance

- NI 33-109
- NI 33-109CP

c) Registerable activity by non-registered parties (All)

Registerable activity by non-registered issuers

We are aware of issuers that are directly interacting with investors to raise money under certain exemptions from the prospectus regime including the OM and FFBA prospectus exemptions. In some cases, issuers are directly soliciting and selling investment opportunities to the public via websites and social media. We have conducted reviews of these issuers in response to a concern that certain issuers may be in the business of trading and are not registered as a dealer. Our focus in these reviews were issuers relying on the new prospectus exemptions in Ontario where there may be a misunderstanding on how to utilize these exemptions.

We focused on issuers who:

- filed multiple Form 45-106F1 *Report of Exempt Distribution* (**45-106F1**) filings identifying that no compensation was paid to a registered dealer or registered individual in connection with the distribution(s),
- submitted multiple 45-106F1 filings within a period of time - this raised concerns that the trading activity was being done with repetition, regularity or continuity,
- appeared to be directly soliciting investments through advertising over the internet and social media, and/or
- distributed securities and had large capital raises from Ontario investors.

In some cases we identified regulatory concerns as there appeared to be significant capital-raising activity conducted by these issuers and transactions processed directly by these issuers without the involvement of a registered dealer or reliance on an appropriate registration exemption. Furthermore, many of these transactions relied on the OM prospectus exemption, but in some cases, the transactions were above the investment limits and the amounts invested would have required the involvement of a registered dealer to assess the suitability of the transaction and determine that the transaction was suitable (i.e., positive suitability assessment), in order to be permissible under the exemption. In other cases, the issuer:

- purported to rely on the involvement of an entity or individuals to sell its securities; however, they were not in fact registered, or
- represented that a registered dealer was involved in the transaction but there was no documentation to evidence the involvement of a registered dealer and there was no compensation disclosed on the issuer's filings to the Commission.

In addition, the FFBA prospectus exemption was used for a significant number of all of the transactions processed by certain issuers, which continues to raise concerns for staff that investors may not actually meet the definition of family, friends or business associates.

We remind issuers that offer their own, or an affiliate's securities, to continually reassess whether they are in the business of trading or advising and thus require registration. Some factors to consider when assessing if the issuer has met the business trigger are set out in OSC Staff Notice 33-749 on page 27. This activity does not have to be the entity's sole or even primary endeavour for it to be considered in the business of trading in, or advising on, securities. We remind registrants that when interacting with issuers, to be aware of the requirements under the various prospectus exemptions relied on, and whether it is the issuer or the registered dealer's obligation to conduct certain activities and to maintain evidentiary documentation that the requirements of the exemption have been fulfilled.

Legislative reference and guidance

- Section 8.5 of **NI 31-103**
- Section 1.3 of Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103CP**)
- Sections 1.5 and 1.9 of National Instrument 45-106 *Prospectus Exemptions* (**NI 45-106**)
- Section 3.2 of Companion Policy 45-106CP *Prospectus Exemptions* (**NI 45-106CP**)
- **OSC Staff Notice 33-749**, page 27

c) Registerable activity by non-registered parties (cont'd)

Employees trading without appropriate registration

During the course of our reviews, we also identified registered firms that employed individuals who conducted trading/dealer activities on behalf of the firm without these individuals being registered to do so. Registered firms are responsible for the conduct of individuals acting on behalf of the firm.

In limited instances, we noted that employees who are not registered as dealing representatives (but may be registered in other categories) are soliciting clients. If the employee is soliciting clients for the registered firm, they are required to be registered as a dealing representative. This includes individuals who are registered as UDP, CCO and/or who are registered as an advising representative.

In other instances, employees are recommending securities to clients without registration as a dealing representative. Registered firms and individuals have specific obligations owed to clients under NI 31-103 including know-your-client (**KYC**) and suitability. These obligations must be fulfilled by registered dealing representatives that are appropriately trained and supervised by the firm.

Registering individuals in the wrong category

Similar to the issue of unregistered individuals conducting registerable activity is the problem of registering individuals in the incorrect category. During compliance reviews, staff have seen situations where individuals have registered in a category that does not match the type of activity being conducted. For example, some individuals have obtained registration as dealing representatives when they are conducting registerable activity for managed account clients (for example, collecting KYC information or having discussions about portfolio performance). In these circumstances, the individuals require registration as advising representatives or the activity should be conducted by an appropriately registered advising representative.

Activities of "finders" in the context of private placements and prospectus offerings

We have seen a number of situations where issuers have purported to distribute securities to investors on the basis of a "non-brokered" private placement or prospectus offering while at the same time paying finder's fees/ warrants, broker fees/warrants, referral fees or similar types of compensation to finders, referral agents, investor relations consultants or similar third-parties (collectively referred to here as **finders**). In some cases, the finders have been registered firms or individuals while in other cases the finders are not registered and included former registrants or registrants under suspension.

Staff generally consider a person acting as a finder to be engaging in registerable activity (i.e., an activity that requires registration or an exemption from registration) based on the principles set forth in section 1.3 of NI 31-103CP.

Accordingly, where a prospectus or other offering document or a report of exempt distribution indicates that a person has acted as a finder in an offering – and particularly where it appears that no other dealer or underwriter has been involved in the offering – staff may raise comments requesting further information relating to:

- the identity of the finders,
- the role played by each finder and the manner of compensation for each finder in the offering,
- an explanation of how the finder's role, functions and compensation are different from the role, functions and compensation of a dealer or underwriter in an offering,
- the registration status, if any, of each of the finders, and
- if the finders are registered, confirmation that the finders have complied with their registrant obligations in connection with the transaction, including their KYC, KYP and suitability obligations, their obligation to identify and respond to conflicts of interest, and their client disclosure obligations in relation to referral arrangements.

c) Registerable activity by non-registered parties (cont'd)

The policy reasons for raising these comments include, among others, the concern that:

- a person who is engaging in registerable activity as a dealer and/or underwriter may not be appropriately registered as a dealer or underwriter under subsections 25(1) and (2) of the *Securities Act* (Ontario) (the **Act**),
- a person who is performing a similar function to, and being compensated in a similar manner to, an underwriter in a prospectus offering may be seeking to avoid underwriter liability to investors under the prospectus simply by labelling their role as a "finder" rather than "dealer" or "underwriter",
- an EMD who is performing a similar function to, and is being compensated in a similar manner to, an underwriter in a prospectus offering may be seeking to avoid the restrictions on EMDs participating in prospectus offerings in Part 7 of NI 31-103 simply by labelling their role as a "finder" rather than "dealer" or "underwriter", and
- an ID or PM that is managing a client's managed account and that purchases securities from the issuer for the client's managed account while at the same time taking a finder's fee from the issuer may be in a significant conflict of interest with their clients and may be in breach of other obligations to their clients.

Where staff become aware of a person engaging in dealer activities without appropriate registration or an exemption from registration, or a registrant engaging in registerable activities without compliance with registrant obligations, staff may recommend compliance or enforcement action against the person and/or registrant as appropriate. We also remind market participants that, where a distribution of securities is made in breach of the registration requirements of Ontario securities law, this may provide investors with a civil right of action for rescission or damages against the issuer, its principals and any intermediaries involved in the transaction.

Registered firms should:

- have adequate internal controls to prevent non-registered individuals from conducting trading/advising activity, including promoting, soliciting, or recommending a security,
- review the role and nature of interaction between a registered firm's clients or potential clients and non-registered employees, and
- provide adequate training to employees on the limitations on what activities they can perform based on their registration category.

Legislative reference and guidance

- Section 8.5 of **NI 31-103**
- Section 1.3 of **NI 31-103CP**
- Paragraph **25(1)(b) of the Act**
- Paragraphs **25(3)(b) and (c) of the Act**
- Part 6 - *Activities of "finders" in the context of prospectus offerings* of **OSC Staff Notice 51-706** *Corporate Finance Review Program Report*

d) Novel exemptive relief for dealer business models (EMD)

Staff regularly assess exemptive relief applications from both the dealer registration requirements as well as specific securities law obligations for registered dealers that operate unique business models where the existing obligations may not be applicable or appropriate for their business. The review standard for granting relief varies, but it generally requires a decision maker to determine that granting the requested relief would not be prejudicial to the public interest.

Staff support the development of novel business models and are continuously working to facilitate timely exemptive relief for firms that require this relief in order to operate in compliance with securities regulation.

Examples of firms that have recently received novel exemptive relief include the following:

- a registered dealer that only introduces non-individual permitted clients to issuers and is not involved in the negotiation, documentation, financing or transaction closing of any investment received relief from the trade confirmation and account statement requirements in NI 31-103,
- a not-for-profit angel investor network for accredited investors that relies on and is restricted by government grants to fulfil its mandate and is also not involved in the negotiation, documentation, financing or transaction closing of any investment received relief from the excess working capital, trade confirmation and account statement requirements in NI 31-103, and
- a PM that received relief from the dealer registration requirement, the KYC and suitability requirements, and the requirements to deliver account statements and investment performance reports in respect of investors in a model portfolio service offered by an affiliated MFD.

We encourage firms engaging in similar or other novel business models and their counsel to contact us to discuss their business plans and potential options, including applying for exemptive relief.

Before making a formal application for exemptive relief, firms may wish to first submit a pre-filing. The purpose of a pre-filing is to enable a firm to consult with staff on a specific issue to understand how securities legislation will be interpreted by the OSC. Staff will work with the firm and their counsel to assess whether exemptive relief is required in order to help the firm determine its next steps.

Legislative reference and guidance

- **National Policy 11-203** *Process for Exemptive Relief Applications in Multiple Jurisdictions*
- **OSC Staff Notice 33-747** *2016 Annual Report for Dealers, Advisers and Investment Fund Managers*, page 37
- **OSC Staff Notice 33-746** *2015 Annual Report for Dealers, Advisers and Investment Fund Managers*, pages 45-47

2.2.2 Compliance systems

a) Inconsistent and inaccurate responses provided in RAQ (IFM / PM / EMD)

We assess the accuracy of registered firms' responses to the RAQ during our compliance reviews. In many instances, we have noted that information provided in the RAQ was not consistent with information obtained during the compliance review. It is imperative that the responses provided to us by registrants are both accurate and complete. In addition, complete and accurate responses to the RAQ will assist CRR staff in planning for upcoming compliance reviews and ensuring reviews are conducted as efficiently and effectively as possible. Finally, providing accurate responses avoids the potential for registered firms to be selected as part of a sweep that focuses on a particular topic of interest based on incorrect information provided in the RAQ.

While we acknowledge that the RAQ requires registrants to provide us with a lot of information, registered firms are given six weeks to submit their responses to the RAQ and ten weeks to submit the Prospectus-Exempt Fund Form spreadsheet (for IFMs only). For help completing the RAQ, please attend our outreach session "Completing the Risk Assessment Questionnaire". This session is typically held shortly after the RAQ is issued and discusses frequently asked questions and provides a walk-through of areas of the RAQ which have been challenging for registrants in the past. Any additional questions can be sent to staff at ComplianceSurvey@osc.gov.on.ca.

Individuals involved in the completion of the RAQ for their registered firm are also encouraged to make use of the following resources to assist in the completion of the RAQ:

- FAQ and User Guide, including the section titled "Basics for Completing the Questionnaire",
- Help Page provided in each section of the RAQ, and
- Interactive features in the navigation bar on each page of the RAQ.

b) Supervision of dealing representatives who speak multiple languages (EMD / SPD)

During our reviews of EMDs and SPDs, we noted several instances where firms did not establish and maintain systems of controls and oversight for effectively supervising and monitoring the firm's dealing representatives who communicate with clients using multiple languages. In particular, scenarios were identified where clients were provided disclosure documents and offering materials printed in English and French, while a different language was used by dealing representatives to discuss the key features, risks and fees of the product. This increases the risk of misinformation as clients may be solely relying on the communication provided by the dealing representative to understand the investment opportunity. Dealing representatives may communicate with their clients in whichever language best serves the client; however, registered firms must be able to effectively supervise those communications as part of the overall obligation to supervise each dealing representative's activities.

Registrants are required to establish a system of controls and supervision by establishing, maintaining and applying policies and procedures. Firms should ensure that they are aware of what language is being used to communicate with clients and have a system of controls to supervise the activity conducted in these languages.

b) Supervision of dealing representatives who speak multiple languages (cont'd)

Dealers should:

- identify dealing representatives who use multiple languages,
- have a process in place to supervise the dealing representatives who use multiple languages, and
- document any special supervisory needs relating to monitoring dealing representatives who use multiple languages.

Legislative reference and guidance

- Section 11.1 – *Compliance system* of NI 31-103 and related NI 31-103CP
- Subsection 32(2) of the Act

c) Valuation of illiquid assets (IFM / PM)

Some firms do not have an adequate process to identify and value illiquid assets. During our reviews, we noted that some firms considered an equity investment held by their investment fund to be liquid as long as the investment was listed on an exchange, without further consideration of market activity and conditions. As a result, firms did not always adequately value securities held by their investment funds that were i) thinly traded, ii) subject to trading restrictions or iii) private (collectively, **illiquid holdings**). Some firms used closing market prices with no adjustments to reflect fair value for the following:

- securities subject to trading restrictions, and
- securities for which there was insufficient trading volume to support an active market.

An IFM has a legal obligation to determine fair value of the securities held by its investment fund for net asset value (**NAV**) calculation purposes. An IFM's valuation procedures should assess whether the investment fund would be able to dispose of the securities held at the publicly quoted price by taking market activity and conditions into consideration. A stock listing does not necessarily mean that an equity investment could be disposed of at closing market price. If the IFM believes that it would not be able to dispose of the securities at the publicly quoted trading price, the IFM must determine a value that is fair and reasonable in the circumstances by considering whether any adjustments to the publicly quoted price are required.

Other deficiencies we noted relating to the valuation of illiquid holdings included:

- inadequate documentation of the firm's valuation methodology,
- infrequent updating of market inputs when valuing securities using a valuation model,
- reliance on the PM's pricing of the illiquid security without the IFM performing an independent verification of the stated price.

c) Valuation of illiquid assets (cont'd)

Non-compliance with illiquid asset concentration restrictions

Additionally, we also noted that some mutual funds that are reporting issuers (**public funds**) did not always comply with the concentration restrictions in illiquid assets outlined in section 2.4 of NI 81-102. A public fund must not purchase an illiquid asset if, immediately after the purchase, more than 10% of the public fund's NAV will be made up of illiquid assets. In addition, a public fund must not invest 15% of its NAV in illiquid assets for a period of 90 days or more. An IFM should have an adequate process to monitor compliance with the concentration restrictions for illiquid assets including taking the appropriate corrective action in a timely manner for any breaches identified.

IFMs and PMs should:

- review the publicly-traded securities held by the investment fund to determine whether the publicly quoted trading price of the securities reflects fair value,
- determine an adequate valuation methodology, including establishing the appropriate frequency for valuation relating to all securities that are not traded/quoted on a public exchange,
- periodically review the valuation methodology to confirm that it is still appropriate,
- verify that the market inputs of the valuation model used have been appropriately updated at each valuation date,
- maintain adequate documentation to support the valuation of thinly traded, restricted and private securities, and
- establish a process to monitor the investment fund's compliance with the liquidity requirements stated in its offering documents including any restrictions imposed by NI 81-102 (if applicable).

Legislative reference and guidance

- Part 11 – Division 1 *Compliance* of **NI 31-103** and related **NI 31-103CP**
- Section 2.4 of NI 81-102 *Investment Funds* (**NI 81-102**)
- **OSC Staff Notice 81-727** *Report on Staff's Continuous Disclosure Review of Mutual Fund Practices Relating to Portfolio Liquidity*

2.2.3 Financial condition & custody

Custody requirements for registered firms (IFM / PM)

On June 4, 2018, the amendments to NI 31-103 that enhanced the custody requirements of registered firms (the **Custody Rules**) came into force.

During our normal course reviews, we noted that IFMs had not updated their prime brokerage agreements to meet the requirements of the Custody Rules. Section 14.5.2 of NI 31-103 requires IFMs to exercise due skill, care and diligence in the selection and appointment of the custodian for the investment funds they manage. This includes confirming that the investment fund's custodial agreements or prime brokerage agreements address key matters such as the location of portfolio assets, any appointment of a sub-custodian, the method of holding portfolio assets, the standard of care of the custodian and the responsibility for loss.

Additionally, we noted that disclosure documents provided by IFMs to clients (where the IFM was distributing its own products or also acting as the PM for an investment fund) did not always include adequate disclosure. We noted that the following risks were not disclosed:

- the differing standard of care between a prime broker and a custodian, and
- the potential risk of using a prime broker instead of a traditional custodian.

We also noted that IFMs do not always hold cash-in-transit in accordance with the new requirements under the Custody Rules. Under section 14.5.3 of NI 31-103, cash-in-transit for an investment fund or client should be held as follows:

- in an account in the name of the fund or client with a qualified custodian, or
- in a designated trust account in the name of the IFM in trust for the fund or the client, and separate and apart from the IFM's own property.

IFMs and PMs should:

- review their relationship disclosure documents to confirm that this disclosure has been updated to include:
  - the location where, and a general description of the manner in which, the client's (including an investment fund's) assets are held, and
  - a description of the risks and benefits arising from the assets being held at that location and in that manner.

IFMs should:

- review their custodial and prime brokerage agreements to verify that these agreements include key matters such as the location of portfolio assets, any appointment of a sub-custodian, the method of holding portfolio assets, the standard of care of the custodian and the responsibility of loss. If these key matters are not included, we expect IFMs to work with the prime broker or custodian to update the agreement, create an addendum to the agreement, or enter a stand-alone agreement to incorporate these details, and
- hold cash, specifically cash-in-transit, in accordance with the Custody Rules.

Legislative reference and guidance

- Sections 14.5.2 and 14.5.3 of NI 31-103 and related NI 31-103CP

2.2.4 Know your client (KYC), know your product (KYP) & suitability

Concentration and suitability (EMD / SPD)

We noted instances where dealers did not adequately assess clients' concentration risk as part of their suitability assessment. In certain cases, dealers did not collect enough KYC information to reasonably assess concentration risk and, as a result, concentration risk was not considered as part of the suitability assessment.

We also observed that certain EMDs used client-directed-trade instructions as a tool to circumvent their suitability obligations. During compliance reviews, we noted some firms used client-directed trade instructions in a large portion (in some cases over 40%) of client files reviewed by staff. In these cases, EMDs would assess a transaction to be unsuitable (for excessive concentration risk or other reasons) and include a client-directed trade instruction in the client's file and proceed with the transaction. This raises concerns that firms are not appropriately discharging their obligation to assess the suitability of the transaction, and are routinely documenting trades as being unsuitable and using client-directed trade instructions as an alternative to engaging in a meaningful suitability conversation with the client.

Dealers should:

- establish policies and procedures for assessing concentration risk, including what information should be collected from clients to assess concentration risk, how concentration risk is calculated and what thresholds would cause a client to be over-concentrated,
- if a dealer has concerns that a client has a high concentration in a single issuer, group of related issuers, or a single industry, they should:
  - engage in a meaningful dialogue with the client to explain the importance of diversification and the risk of over-concentration,
  - consider a lower investment amount that would reduce the client's concentration risk, and
  - document why the transaction was deemed suitable despite the client's concentration risk.
- if a transaction is deemed to be unsuitable due to over-concentration concerns, but the client nevertheless wishes to proceed with the transaction, the dealer should:
  - document the discussion with the client regarding the client's concentration risk and the unsuitability of the transaction, and
  - obtain a signed client-directed trade instruction, which includes a specific explanation of the unsuitability of the transaction.

Legislative reference and guidance

- 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*
- OSC Staff Notice 33-740 *Report on the results of the 2012 targeted review of portfolio managers and exempt market dealers to assess compliance with the know-your-client, know-your-product and suitability obligations*

2.2.5 Conflicts of interest & referral arrangements

a) Sales practices (IFM / MFD / ID)

We executed a focused desk review relating to the provision of non-monetary benefits by IFMs to participating dealers and dealing representatives under Part 5 and Part 7 of NI 81-105. The sales practices desk review included a sample of 25 IFMs and focused on the provision of non-monetary benefits through items and activities (both promotional and non-promotional) over a period of approximately 18 months covering the IFM's fiscal 2017 and fiscal 2018 (up to August 31, 2018). The following chart summarizes the total number of promotional items and activities reviewed through this desk review across the 25 IFMs.

	Review period (Fiscal 2017 – August 31, 2018)
Total promotional items	15,750 items given
Total promotional activities	57,800 events attended by 105,200 dealing representatives

The purpose of the sales practices desk review was to:

- determine if there had been improvement in sales practice compliance resulting from the recent sales practices settlement agreements in 2017 and 2018, and the previously issued guidance in OSC Staff Notice 33-743, and
- review and assess an IFM's internal controls and policies, procedures, and practices relating to the provision of non-monetary benefits.

The majority of IFMs included in the sales practices desk review used the most recently published sales practices settlement agreements and OSC Staff Notice 33-749 to improve their policies and procedures with respect to the provision of non-monetary benefits through items and activities provided as promotional. Some IFMs also decreased the limits set per item, per activity and the total overall non-monetary benefits provided on an annual basis.

Part 5 of NI 81-105

Part 5 of NI 81-105 regulates the sales practices of industry participants in connection with the distribution of publicly offered securities of mutual funds to safeguard the interests of investors. As a result, NI 81-105 establishes a minimum standard of conduct to ensure that any compensation or non-monetary benefits provided to participating dealers and their respective representatives are not so extensive or so frequent so as to provide a perception of influence over the selection of mutual funds for distribution by a representative to their clients.

Non-compliant sales practices

Although we noted improvements in the sales practices provided by IFMs, we continued to raise deficiencies in the following areas:

- provision of promotional items of non-minimal value,
- provision of excessive business promotion activities,
- provision of non-promotional items and activities,
- provision of non-monetary benefits on a frequent basis,
- provision of monetary support to non-educational participating dealer and/or dealing representative events,
- inadequate internal controls to monitor the provision of non-monetary benefits, and
- inadequate written policies and procedures governing the provision of non-monetary benefits and the solicitation of non-compliant monetary and non-monetary benefits.

a) Sales practices (cont'd)

We have reported the findings from this current initiative to each IFM included in the sales practices desk review.

We would like to remind IFMs of their obligations to comply with Part 5 of NI 81-105 when engaging in sales practices with participating dealers and dealing representatives. We strongly encourage registrants to use the guidance included in the most recent OSC Staff Notice 33-749, particularly the example qualitative framework provided, to improve their understanding of, and compliance with, applicable regulatory requirements. All previously issued guidance related to sales practices is meant to assist IFMs in meeting their duty to act honestly, in good faith, and in the best interests of their investment funds as required by section 116 of the Act. Many of the concepts related to sales practices require judgment. Through previously issued guidance, we have tried to establish parameters around these concepts which best correlate with an IFM's standard of care. We would like to remind IFMs that in establishing internal sales practice parameters the overarching objective and spirit of the rule must always be at the forefront and adhered to.

Prohibited categories of spending

We noted instances where IFMs were providing monetary support solicited by participating dealers and dealing representatives for dealer events that did not comply with the available exemptions under Part 5 of NI 81-105. IFMs can provide monetary support solicited by participating dealers and dealing representatives under sections 5.1 and 5.5 of NI 81-105 if there is an educational component to the event. We noted IFMs provided monetary support for dealer events such as:

- holiday parties,
- activity days,
- dinner for prospective and existing clients, and
- appreciation dinners for dealing representatives.

IFMs, MFDs and IDs should:

- establish clear written policies and procedures, including illustrative examples, of when monetary support can be provided to a participating dealer and/or dealing representative for events,
- establish clear written policies and procedures to address when IFM support can be provided in response to solicitation by participating dealers and/or dealing representatives, and
- provide monetary support only for events solicited by participating dealers and/or dealing representatives that comply with the available exemptions in Part 5 of NI 81-105 and an IFM's written policies and procedures.

Legislative reference and guidance

- Section 2.1 of National Instrument 81-105 *Mutual Fund Sales Practices* (NI 81-105)
- Section 2.2 of NI 81-105
- Part 5 of NI 81-105
- Section 11.1 – *Compliance system* of NI 31-103 and related NI 31-103CP
- Section 2.2.5(c) of OSC Staff Notice 33-749
- OSC Staff Notice 33-743 *Guidance on sales practices, expense allocation and other relevant areas developed from the results of the targeted review of large investment fund managers*

b) Prohibited investment in a related entity (IFM / PM)

During the course of our reviews, we identified instances where a registered adviser's managed account clients, including clients that are investment funds, were invested in securities of a related issuer (i.e., where an officer, director or adviser of the firm was also an officer, director or partner of the issuer). Registered advisers did not always take appropriate steps, prior to purchasing securities of a related issuer for their managed account clients, to comply with securities law. Specifically, for managed account clients, including where the client was a private investment fund, the registered adviser did not disclose and obtain consent for the purchase of securities in the related issuer from the managed account clients prior to the purchase.

Under section 13.5(2)(a) of NI 31-103, a registered adviser is allowed to purchase securities of an issuer related to the registered adviser for a portfolio it manages, including a private investment fund it manages, if this conflict is:

(i) disclosed to the client, and
(ii) written consent is obtained from the client prior to the purchase of the security.

If the client is a private investment fund, the disclosure should be provided to, and the consent obtained from, each security holder of the investment fund in order to be meaningful. Disclosure to the client should be prominent, specific and clear.

This approach may not be practical for public funds, as such, firms should consider the specific exemption codified under section 6.2 of NI 81-107 which allows public funds to make or hold an investment in the security of an issuer related to it, its manager or an entity related to the manager if, at the time the investment is made, the Independent Review Committee (**IRC**) approves the trade and the purchase is made on an exchange on which the securities of the issuer are listed and traded.

IFMs and PMs must:

- maintain adequate policies and procedures to identify all conflicts of interest, including a purchase of securities of a related issuer for an investment portfolio managed by it, including an investment fund it manages,
- when purchasing securities of a related issuer for managed account clients, including private investment funds:
  - provide adequate disclosure, and
  - obtain written consent from clients prior to the purchase.
- when purchasing securities of a related issuer for public funds, at the time that the investment is made, ensure that:
  - the IRC has approved the investment, and
  - the securities are purchased through an exchange where the securities of the issuer are listed and

Legislative reference and guidance

- Paragraph 13.5(2)(a) of NI 31-103 and related NI 31-103CP
- Paragraph 111(2)(c) of the Act
- Section 6.2 of National Instrument 81-107 *Independent Review Committee for Investment Funds* (NI 81-107)

c) Prohibited inter-fund trades (IFM / PM)

We continue to see registered firms allowing prohibited inter-fund trades to occur between investment funds (that are not reporting issuers) that are both managed and advised by the registered firm.

During the course of our reviews we noted instances where the registered firm traded securities between two private investment funds both managed and advised by the registrant. The inter-fund trading was the result of a rebalancing of the portfolio securities held by both private investment funds. The securities were in line with the investment objectives and investment restrictions of the funds and were held by the fund prior to the occurrence of the inter-fund trades. The inter-fund trade occurred at the closing price through a registered dealer. The investment funds and ultimately the underlying unitholders were not negatively affected. However, due to the potential for conflicts of interest in these types of transactions, the inter-fund trades were offside securities law.

Section 13.5(2)(b) of NI 31-103 strictly prohibits inter-fund trading between two investment funds that have the same adviser. This transaction gives rise to an actual or perceived conflict of interest as the registered adviser is responsible for determining the terms of the trade for both funds. Registered advisers wishing to engage in inter-fund trading between two private investment funds managed and advised by them can apply for exemptive relief. The exemptive relief contains safeguards that we feel are necessary to allow for this inter-fund trading to occur in a manner that adequately addresses any actual or perceived conflict of interest. These safeguards include:

- ensuring the inter-fund trade is consistent with the investment objectives of the participating private investment funds,
- requiring that the matter is approved by an IRC, and
- requiring that the inter-fund trade is transacted at the current market price, and in respect of exchange-traded securities, the inter-fund trade is executed at the last sale price.

There is an exemption from this prohibition that exists for inter-fund trades between two public funds in section 6.1 of NI 81-107.

IFMs and PMs must:

- maintain policies and procedures that prohibit inter-fund trades between two private investment funds, or between a public fund and a private investment fund, and
- put in place adequate pre-trade controls to identify and prevent prohibited inter-fund trades from occurring.

Legislative reference and guidance

- Paragraph **13.5(2)(b) of NI 31-103** and related **NI 31-103CP**
- Section 6.1 of **NI 81-107**

d) Short-term trading and excessive trading (IFM)

We conducted a desk review to assess how IFMs monitor short-term trading and excessive trading by unitholders of their investment funds.

Short-term trading activity can be harmful to unitholders and funds by increasing costs to the fund, by disrupting a PM's strategies and by requiring PMs to maintain higher levels of cash. There is also the conflict of interest if an IFM were to consistently waive short-term trading fees for certain unitholders or unitholders of certain dealing representatives with a large level of client assets invested in the IFM's funds.

Overall, we found that all firms reviewed were monitoring for short-term trading activity with most firms having adequately documented policies and procedures. We did identify some instances where IFMs waived the short-term trading fee for the benefit of the redeeming unitholder or the redeeming unitholder's dealing representative, without considering the impact to the remaining unitholders in the affected investment fund. Our review found that, although short-term trading fees were waived in some instances, the impacts to the affected investment funds were negligible and that short-term trading fees were not being consistently waived for certain unitholders or unitholders of certain dealing representatives.

IFMs should:

- have a system of controls in place to monitor for short-term trading and excessive trading by unitholders of their investment funds,
- maintain clearly documented policies and procedures which contain (but are not limited to):
  - the criteria used by the firm to identify a short-term trade,
  - the criteria used by the firm to identify excessive trading,
  - the process used by the firm to monitor for short-term trading and excessive trading activity,
  - whether the firm utilizes a first-in first-out or last-in first-out methodology for monitoring short-term trading and excessive trading activity,
  - the consequences for a redeeming unitholder who is identified to be in breach of the firm's short-term trading and excessive trading policy,
  - the circumstances under which a short-term trading fee could be waived,
  - the person(s) at the firm who have the authority to waive a short-term trading fee and the process by which a fee can be waived,
- periodically evaluate whether the established policies and procedures are adequate and effective in monitoring and deterring short-term trading and excessive trading activity in their investment funds, and
- maintain adequate documentation, including the firm's rationale for waiving a short-term trading fee.

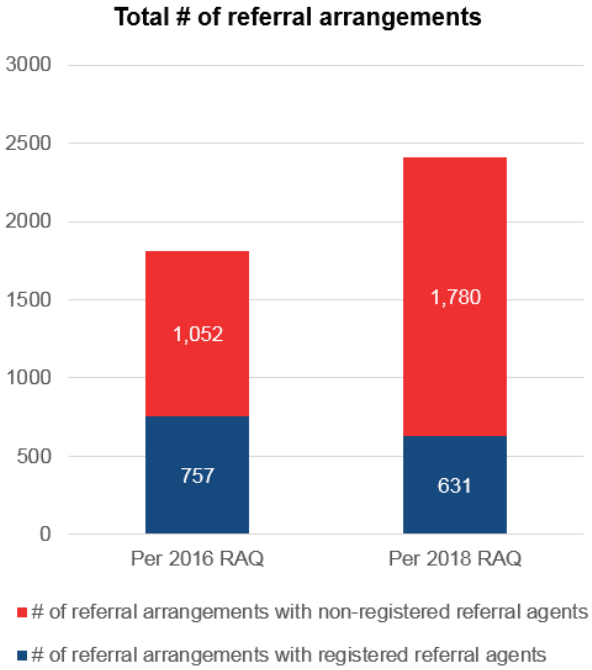
Legislative reference and guidance

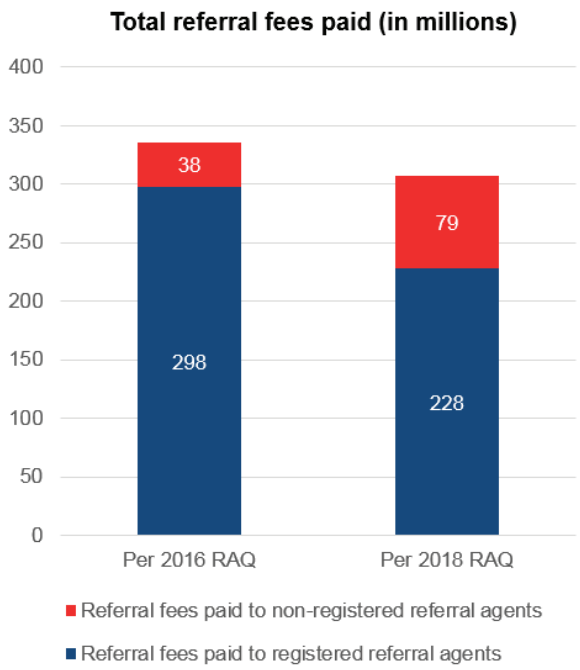
- Part 11 – Division 1 *Compliance* of **NI 31-103** and related **NI 31-103CP**
- Section **116 of the Act**

e) Referral arrangements (PM / EMD / SPD)

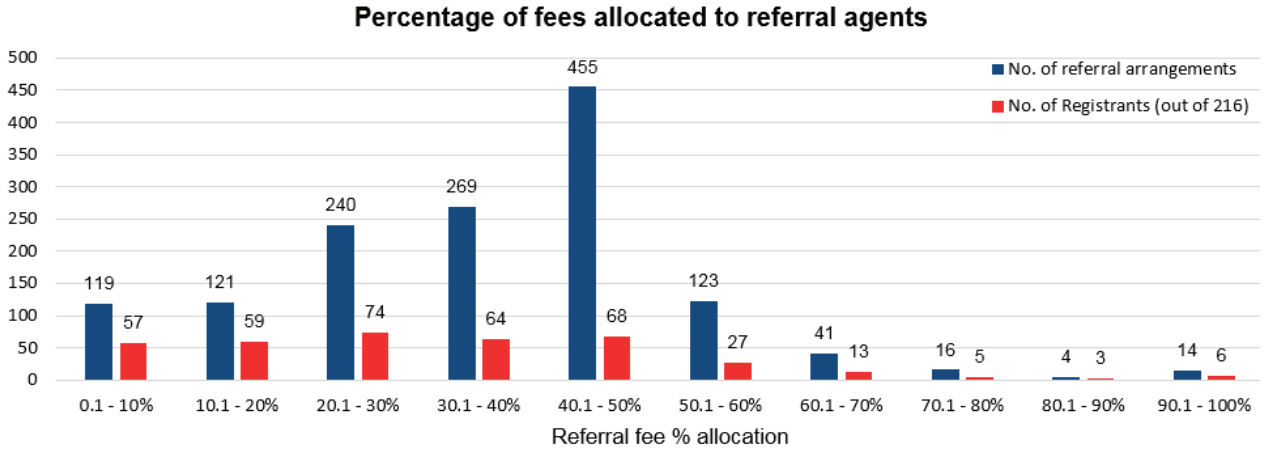
During the year we continued to assess the nature and extent of the use of referral arrangements by registrants and the structure of referral fee payments. The following graphs are derived from data gathered from our 2016 and 2018 RAQ processes and illustrate trends in the space. Specifically:

- there has been a 69% increase in the number of referral arrangements entered into with non-registered referral agents in 2017 when compared to 2015,
- 74% of the referral arrangements in 2017 were entered into with non-registered parties in comparison to 58% in 2015,
- the amount of referral fees made to non-registered referral agents has increased 108% to $79m in 2017 from $38m in 2015, and
- the percentage of referral fees made to non-registered referral agents over the total of referrals paid increased to 26% in 2017 from 11% in 2015.





In addition, based on responses to the 2018 RAQ, 216 of the 280 firms (or 77%) who entered into a referral arrangement reported that referral agents were compensated on an ongoing basis and, in some cases (approximately 14%), referral agents received over 50% of the fees earned by the registrants as illustrated in the following chart:



e) Referral arrangements (cont'd)

i) Oversight of referral agents

During the referral sweep, we found some referral agents continue to be involved in servicing clients that have been referred to a registered firm. We continue to be concerned that referral agents are conducting activities that require registration under securities law or are representing themselves as being able to perform registerable activities. To mitigate against these inherent risks, registrants should develop and execute policies and procedures to proactively monitor and assess if referral agents are conducting themselves as agreed upon in the referral arrangement agreement.

PMs, EMDs and SPDs should:

- develop policies and procedures specific to the oversight of referral agents that:
  - define the responsibilities of the referral agent,
  - define the activities a referral agent is prohibited from conducting,
  - provide training on a periodic basis to referral agents on their roles and responsibilities within the arrangement,
  - monitor the referral agent's relationship with referred clients to determine whether the referral agent is performing an activity that requires registration,
  - evaluate how referral agents are marketing their services (for example, through a website or social media) to assess the adequacy of disclosure explaining the services offered under the referral arrangement, and
  - address cases in which it is determined that a referral party is performing an activity that requires registration.

(ii) Reducing client confusion about the roles and responsibilities of referral parties

A common theme we noted as a result of speaking to clients was that many continued to interact primarily with the referral agent and were unsure about the role of the registrant. In these situations, communications between the registered individual and the referred client were typically infrequent. Further, we found that the majority of referred clients had a long-term relationship with their referral agent before they were introduced to the registrant. As a result of the continuing relationship between the referral agent and the client, we found that:

- communications between registered individuals and clients were typically not in person, but rather through telephone calls or email. These communications were infrequent throughout the year, which created a challenge for registered individuals to truly establish a relationship with the referred client.,
- clients primarily communicated with referral agents even on topics that should have been discussed with the registered individual (e.g., questions about portfolio holdings, questions about the client's account and changes in a client's KYC information), and
- in some cases, the nature of the relationship resulted in undue reliance by the registered individual on the referral agent to transfer client information on matters that required a registered individual's involvement.

In combination, these practices can lead to client confusion and make it difficult for referred clients to "know" their advising representative or dealing representative, and more importantly, understand the roles and responsibilities of both the registered individual servicing their investment accounts and the referral agent.

e) Referral arrangements (cont'd)

PMs, EMDs and SPDs should:

- monitor the effectiveness of the firm's policies and procedures regarding oversight of referral agents,
- take steps to develop a relationship with referred clients so these clients understand the registrant's role,
- develop specific policies and procedures to mitigate against and address client confusion, including procedures to:
    - identify and monitor confusion amongst the firms' clients on an ongoing basis,
    - resolve instances where clients continue to remain confused about the role of the registrant and/or referral agent,
    - address situations in which a referral party's actions have led to the client confusion, and
    - address situations in which a registered individual's actions have led to the client confusion.

Legislative reference and guidance

- Section 11.1 – *Compliance system* of NI 31-103 and related NI 31-103CP
- Sections 13.2 *Know your client* and 13.3 *Suitability* of NI 31-103 and related NI 31-103CP
- Part 13 - Division 3 *Referral arrangements* of NI 31-103 and related NI 31-103CP
- Section 4.2(a)(iii) - *Referral arrangements and finders* of OSC Staff Notice 33-745 *Annual Summary Report for Dealers, Advisers and Investment Fund Managers*
- Section 4.3.1 - *Delegating KYC and suitability obligations to referral agents* of OSC Staff Notice 33-742 *2013 Annual Summary Report for Dealers, Advisers and Investment Fund Managers*

f) Compensation and incentive practices

During our compensation and incentive practices review, we did not identify any serious non-compliance issues as registrants appeared to have adequate controls to address compensation-related conflicts such as:

- use of both quantitative (e.g., AUM level, client billings) and qualitative factors (e.g., leadership skills, client feedback) to determine bonuses for employees,
- use of a rolling period (e.g., one year) to determine the AUM for calculating bonuses,
- use of a product-neutral grid (e.g., commission rates remain the same regardless of product(s) distributed),
- use of claw-back provisions to address issues such as non-compliance or client complaints,
- reviewing accounts having similar mandates to identify performance outliers that may indicate the potential risk of advising representatives chasing investment performance to increase their compensation,
- reviewing and monitoring accounts on an ongoing basis to ensure investment portfolios remain aligned with clients' investment objectives and risk parameters, and
- requiring that the Board of Directors or risk committee review the compensation practices at least annually to ensure that controls remain effective to address compensation-related conflicts.

We would like to remind firms of their obligation to review their compensation arrangements and incentive practices to ensure compliance with the requirements set out in Part 13 of NI 31-103. These include:

- identifying conflicts of interest that should be avoided,
- determining the level of risk that a conflict of interest raises, and
- responding appropriately to conflicts of interest.

Legislative reference and guidance

- Part 13 - Division 2 *Conflicts of interest* of NI 31-103 and related NI 31-103CP
- CSA Staff Notice 33-318 *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*

Part 3

INITIATIVES IMPACTING REGISTRANTS

3.1 Derivatives regulation

CRR staff have been working with the Derivatives Branch to develop a number of rules relating to the regulation of derivatives, including proposed rules that will set out the principal business conduct and registration requirements and exemptions for derivatives dealers and derivatives advisers (collectively, **derivatives firms**). We are developing these rules to help protect investors, reduce risk, improve transparency and accountability, and to implement a comprehensive regime for the regulation of persons or companies that are in the business of trading derivatives and in the business of advising on derivatives.

On April 19, 2018, the CSA published for comment **Proposed National Instrument 93-102 Derivatives: Registration** and a related companion policy. Similarly, on June 14, 2018 the CSA published for a second comment period **Proposed National Instrument 93-101 Derivatives: Business Conduct** and a related companion policy for a second comment period. We are continuing to review the comments received on these proposed rules in consultation with our CSA colleagues.

In addition, CRR staff continue to work with the Derivatives Branch on the implementation of other rules relating to derivatives, including conducting compliance reviews of derivatives firms in connection with their compliance with OSC Rule 91-507 *Trade Repositories and Derivatives Data Reporting* and National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions.*

3.2 Modernization of investment fund product regulation

On October 4, 2018, the CSA published a notice of amendments to NI 81-102 and other instruments relating to the establishment of a regulatory framework for alternative mutual funds (collectively, the **Alternative Fund Amendments**). The Alternative Fund Amendments came into force on January 3, 2019.

The Alternative Fund Amendments reflect the CSA's efforts to modernize the investment fund regulatory regime in Canada and more specifically to help facilitate the introduction of more alternative and innovative strategies typically associated with "liquid alternative" funds, in the retail investment space, while maintaining appropriate restrictions on the use of those strategies. The key aspect of the Alternative Fund Amendments is the establishment of a new category of mutual fund called "alternative mutual funds". This replaces the old category of commodity pool resulting in existing commodity pools becoming alternative mutual funds. Alternative mutual funds differ from more conventional mutual funds primarily in the ability to make greater use of leverage, including through direct borrowing and margin, increased short selling and the use of derivatives.

The Alternative Fund Amendments include alternative mutual fund-specific prospectus and financial reporting disclosure requirements. The Alternative Fund Amendments also include changes for conventional mutual funds to permit limited exposure to alternative mutual fund strategies through fund of fund investing and to codify certain exemptive relief routinely granted to those funds.

For more information, see the **CSA Notice of Amendments Modernization of Investment Fund Product Regulation - Alternative Mutual Funds,** published on October 4, 2018.

In addition, an overview of the Alternative Fund Amendments may be found in the Registrant Outreach Session, available at the following link: **www.osc.gov.on.ca/documents/en/Dealers/ro_20190514_alternative-funds.pdf**

3.3 Syndicated mortgages

On March 8, 2018, the CSA published for comment **proposed amendments** to both NI 31-103, NI 45-106 and NI 45-106CP relating to the transfer of regulatory oversight of syndicated mortgage investments from the Financial Services Commission of Ontario to the OSC (the **2018 Proposal**).

We received a number of comment letters in response to the 2018 Proposal. Considering the comments received, on March 15, 2019, the CSA published for comment **revised proposed amendments** to NI 31-103, NI 31-103CP, NI 45-106 and NI 45-106CP (the **2019 Proposal**). The proposed changes include the following:

- removing the registration and prospectus exemptions for "non-qualified" syndicated mortgages in Ontario and certain other jurisdictions,
- providing additional guidance in NI 31-103CP with respect to the "relevant securities industry experience" requirement for firms and individuals that previously relied on a registration exemption,
- introducing additional requirements to the OM prospectus exemption under section 2.9 of NI 45-106 that apply when the exemption is used to distribute syndicated mortgages, and
- amending the private issuer prospectus exemption under section 2.4 of NI 45-106 so that it is not available for the distribution of syndicated mortgages.

The proposed amendments are expected to come into effect on December 31, 2019. The comment period for the 2019 Proposal ended May 14, 2019. The CSA is reviewing the comments received and plans to publish a final notice of amendments after the review is complete.

3.4 Consequential custody amendments

On March 14, 2019, the CSA published (in final form) **custody-related amendments** to NI 31-103 which came into force on June 12, 2019 (the **2019 Custody Amendments**). The 2019 Custody Amendments were published for comment by the CSA on October 25, 2018; the comment period ended on December 24, 2018 and no comments were received.

The purpose of the 2019 Custody Amendments is to continue to align the permissible custodial practices in section 14.6.1 of NI 31-103 with the similar permitted custodial practices for investment funds in subsection 6.8(2) of NI 81-102. Subsection 6.8(2) of NI 81-102 was amended on January 3, 2019 and it addresses which entities may hold portfolio assets as margin for certain derivatives transactions outside Canada.

The custody provisions in NI 31-103 have generally permitted the same types of custodians to hold assets for prospectus-exempt funds as are permitted for prospectus-qualified funds (**Retail Funds**), except where there is a policy justification to allow additional custodians for prospectus-exempt funds.

In part, the amendments to subsection 6.8(2) of NI 81-102 broadened the pool of entities that may hold portfolio assets of Retail Funds as margin by allowing Retail Funds to deposit portfolio assets with members of regulated clearing agencies in respect of certain prescribed margin transactions. These additional entities, and the dealers that are currently permitted to act as custodians in NI 81-102, will also be able to hold assets deposited with them in respect of an additional type of margin transaction, namely, transactions involving cleared specified derivatives. The 2019 Custody Amendments will provide continued alignment with the custody provisions in NI 81-102.

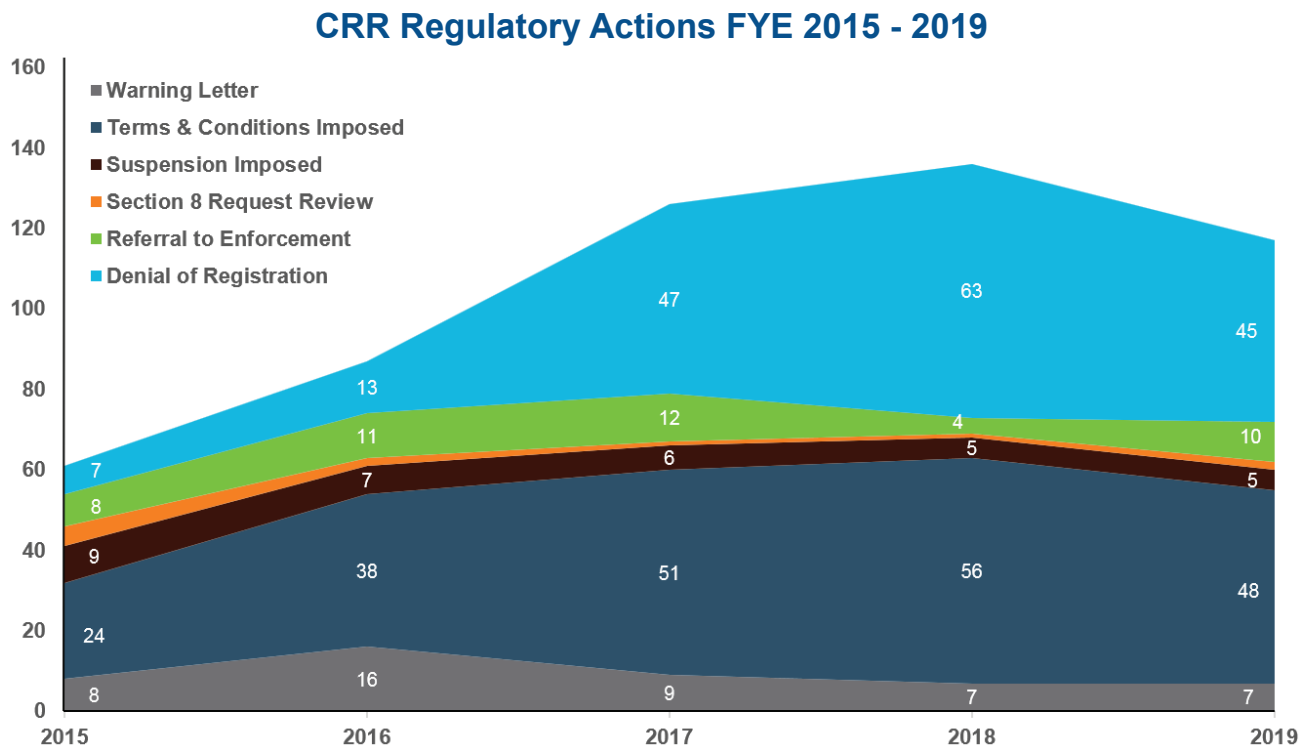
Part 4 ACTING ON REGISTRANT MISCONDUCT

4.1 Annual highlights and trends

The Registrant Conduct Team within the CRR Branch is responsible for investigating conduct issues involving individual and firm registrants, recommending regulatory action where appropriate, and conducting Opportunity to be Heard (**OTBH**) proceedings before the Director. Potential registrant misconduct is identified through compliance reviews, applications for registration, disclosures on NRD, and by other means such as complaints, inquiries or tips.

Acting on registrant misconduct matters is central to effective compliance oversight. It also promotes confidence in Ontario's capital markets, both among the investing public and among the registered firms and individuals who make best efforts to comply with Ontario securities law. Registrants must remain alert and monitor for potential misconduct by enacting and implementing appropriate policies and procedures, and ensuring that controls are in place to detect and address instances of misconduct.

The following chart summarizes the regulatory actions taken by CRR staff against firms or individuals engaged in registrant misconduct or serious non-compliance with Ontario securities law.



CRR is continually improving our information tools, which are used to identify high-risk registrants and applicants for registration. This has resulted in a trend to increased regulatory actions over the past five years. Sources of information include our risk-based compliance reviews, background and solvency checks on individual registrants or individual applicants, responses to the RAQ, external contacts received by OSC staff, and referrals from SROs and other organizations.

The chart illustrates that CRR makes use of regulatory actions along the compliance-enforcement continuum, the action being commensurate with the magnitude of misconduct or non-compliance in a given situation. Terms and conditions, denials of registration, and suspensions of registration are all tools available to CRR staff to address serious non-compliance. Referrals are made to the Enforcement Branch in cases where the appropriate tool is a power that can only be exercised by the Commission.

The statistical reduction in denials of registration from 63 in fiscal 2017/2018 to 45 in fiscal 2018/2019 reflects a recordkeeping change. This category of regulatory action no longer includes situations where a firm withdraws an individual's application for registration before the matter has been assigned to staff of the Registrant Conduct Team.

In more serious cases, registered firms may decide not to continue sponsoring registration for individuals who are subject to a conduct review by staff. Typically, this involves conduct that might result in staff recommending suspension. In these situations, we characterize the outcome as an "avoided suspension". During the past fiscal year, there were six avoided suspension matters in which the firms terminated their sponsorship of the particular registered individuals, in addition to the five registration suspensions noted in the chart.

Referrals to the Enforcement Branch increased to ten in fiscal 2018/2019 from four in fiscal 2017/2018 as a result of our registration and compliance review activity.

One example of a referral made by CRR to the Enforcement Branch was in the matter of **Clifton Blake Asset Management Ltd., et al.** in which the Commission issued an order on March 28, 2019 approving a settlement agreement between Enforcement Staff and the individual and corporate respondents. The respondents were in the business of trading in the securities of a mortgage investment entity (**MIE**), Clifton Blake Mortgage Fund Trust, and sold approximately $25 million worth of these securities to approximately 144 investors. Those activities required registration pursuant to the registration requirements in the Act and in NI 31-103. The respondents were not registered with the OSC and, among other violations of Ontario securities law, failed to ensure that the investments were suitable for their investors. The settlement agreement required the respondents to pay an administrative penalty of $100,000 and to honour requests from certain investors to redeem their securities.

In the past, Enforcement staff have entered into settlement agreements with other MIEs, mortgage brokers, administrators and their principals involved in trading in securities without registration. Those settlements involved substantial penalties and costs being levied against businesses and individuals, as well as the requirement to reimburse investors. For example, in February 2016, the Commission approved a settlement in the matter of **Liahona Mortgage Investment Corp., et al.** pursuant to which the respondents were required to pay an administrative penalty of $50,000 and costs of $45,000. The various settlement agreements demonstrate that the OSC continues to enforce compliance with the registration requirements as they apply to the MIEs, and that the associated monetary penalties have increased over time.

As the Commission recently stated in another decision:

Registration is another cornerstone of Ontario securities law. It protects investors and promotes confidence in the capital markets by seeking to ensure that those who sell or promote securities are proficient and solvent and that they act with integrity. When an unregistered individual or firm engages in activity that requires registration, the individual or firm defeats some of the necessary legal protections, shields the activity somewhat from regulatory monitoring, puts investors at risk, and undermines the integrity of the capital markets.[1]

[1] *Meharchand (Re)*, 2019 ONSEC 7, para. 47.

4.2 Opportunity to be Heard (OTBH) process

Before a Director of the OSC imposes terms and conditions on registration, refuses an application for registration, or suspends a registration, an applicant or registrant has the right under section 31 of the Act to request an OTBH before the Director. A registrant or applicant may also request a hearing and review by the Commission of a Director's decision under section 8 of the Act.

DIRECTOR'S DECISIONS

Director's decisions on OTBH proceedings are published in the OSC Bulletin and on the OSC website at **Director's Decisions**, where they are presented by topic and by year. Director's decisions can be used as an important resource for registrants, as they highlight matters of concern to the OSC, as well as the regulatory action that may be taken as a result of misconduct and non-compliance. The publication of Director's decisions also ensures that CRR's response to serious misconduct is visible to market participants and investors.

Eight Director's decisions were published in the fiscal year 2018/2019 on registrant conduct issues. Two decisions followed contested OTBHs, and one decision approved staff's recommendation in respect of a registrant who did not request an OTBH. The remainder of the Director's decisions were made on a basis of joint recommendations made to the Director by staff and registrants pursuant to settlement agreements. A settlement agreement typically contains an agreed statement of facts in addition to a joint recommendation to the Director. Therefore, proceeding by way of a joint recommendation with staff allows the registrant to participate in setting out the factual narrative that becomes the basis for the Director's decision.

In three of the decisions, registrants were suspended as a result of their failure to comply with the terms and conditions of their registration. Specifically, these registrants were required to complete a course by a specified deadline. Staff reminds registrants that failure to comply with terms and conditions of registration can lead to a suspension. Further, if a registrant is required to complete a course or satisfy terms and conditions by a certain deadline, the sponsoring firm should have appropriate controls and supervision in place to ensure that the required activity occurs within the specified time period.

The Registrant Conduct Team continues to investigate instances where registrants failed to make the required criminal disclosure, the consequences of which may include regulatory action such as suspension of registration. See, for example, the summary of the Director's decisions regarding Todd Milligan and Glenn Coulson in the *Cases of Interest* section below. In the latter decision, the registrant did not make a required disclosure to staff regarding a criminal charge, relying on the advice of his criminal lawyer who had no experience in securities law and with whom the registrant did not discuss the specific disclosure obligation. As part of the settlement agreement with staff, the registrant admitted that his reliance on the advice of his criminal lawyer was not reasonable. While the Director accepted the joint recommendation on the basis of the agreed facts and admissions, rather than make findings on this issue, the decision nevertheless highlights that reliance on legal advice in not making a required disclosure, and whether such reliance is reasonable, should be considered in light of the expertise of the lawyer and the nature of the advice requested and given.

4.3 Cases of interest

DIRECTOR'S DECISIONS AND SETTLEMENTS BY TOPIC

Todd Milligan (May 30, 2018)

Topic: Misleading Staff or sponsor firm

Mr. Milligan was a registered mutual fund dealing representative. On February 26, 2016, Mr. Milligan was informed by the police that he was going to be charged with disobeying a court order. After an administrative delay, Mr. Milligan was charged on May 4, 2016. On July 20, 2016, Mr. Milligan pled guilty to the charge and received a conditional sentence. Mr. Milligan did not report either the charge or the disposition on NRD as required by Ontario securities law. Staff subsequently became aware of the charges and recommended to the Director that Mr. Milligan's registration be suspended for failing to comply with his disclosure obligation. Following an OTBH, the Director suspended Mr. Milligan for a period of three months.

Anna Joanna Knight (July 13, 2018)

Topics: Reliance on prospectus exemptions; Trading or advising without appropriate registration; Conflicts of interest; and KYC, KYP, and suitability

Ms. Knight, a dealing representative in the category of MFD and EMD, applied to reactivate her registration on September 21, 2017 with a new sponsoring firm. At that time, she was under investigation by the MFDA for using two pre-signed forms and selling a small amount of an off-book product at her former firm. Her former firm and its principals were also under investigation by the MFDA for serious breaches of Ontario securities law including the off-book sale of the same exempt product sold by Ms. Knight. Ms. Knight knew that the principals of her firm controlled the issuer but did not disclose the conflict of interest to her clients. Ms. Knight also sold the product to two clients who were not qualified to purchase a prospectus-exempt product and to clients for whom it was not suitable.

In February 2016, Ms. Knight was issued a warning letter by the MFDA for using copied and altered forms in 2014 and signed an undertaking to her firm promising not to use pre-signed forms, photocopied forms or altered forms. Despite this, two pre-signed forms were found during the MFDA field review of Ms. Knight's former firm in November 2016. The field review also revealed that Ms. Knight had advised clients to sell exchange-traded securities when she was not registered as an adviser, and where no exemptions from the adviser registration requirement were available to her.

Following settlement discussions, Ms. Knight agreed to withdraw her application and only submit a further application for registration as a mutual fund dealing representative following a full audit report of Ms. Knight's Certified Financial Planner business and licensed insurance business covering a specified period. Ms. Knight was also required to complete two courses prior to reapplying for registration and agreed that she would be under strict supervision for at least one year and ineligible to apply for registration as an exempt market dealing representative while under strict supervision.

Ms. Knight has since reapplied for registration as a mutual fund dealing representative, having complied with the terms of the settlement agreement, and her application was approved subject to the terms and conditions set out above.

Antonetta Adebayo (July 16, 2018)

Topics: Compliance with terms and conditions of registration; Courses for proficiency requirement

Ms. Adebayo was registered as a mutual fund dealing representative. On August 2, 2017, terms and conditions were imposed on Ms. Adebayo's registration, to which she consented, due to Staff's concerns with her solvency and a failure to disclose a personal business, a direction to pay the Canada Revenue Agency, and a consumer proposal. The terms and conditions required Ms. Adebayo to complete the Conduct and Practices Handbook Course (the **CPH**) no later than April 30, 2018 as well as close supervision on her registration for a minimum of one year.

As of June 11, 2018, Ms. Adebayo had not complied with the terms and conditions, having not received a passing grade on the CPH. As a result, and given Ms. Adebayo's failure to disclose the required financial information, it was staff's view that Ms. Adebayo lacked the proficiency required of a registered individual. Staff was also of the view that by failing to satisfy the terms and conditions, Ms. Adebayo failed to comply with Ontario securities law and rendered her registration objectionable. Ms. Adebayo did not request an OTBH, and the Director suspended Ms. Adebayo's registration, as recommended by staff.

Karine Brizard (July 18, 2018)

Topics: Compliance with terms and conditions of registration; Courses for proficiency requirement

Ms. Brizard was registered as a mutual fund dealing representative. In September 2017, terms and conditions were imposed on Ms. Brizard's registration, to which she consented, due to staff's concerns related to Ms. Brizard's insolvency and ongoing consumer proposal as well as her failure to disclose an earlier bankruptcy. The terms and conditions required Ms. Brizard to complete the CPH within six months as well as close supervision on Ms. Brizard's registration. Ms. Brizard failed to complete the CPH before the deadline, and after requesting and being granted two extensions by staff to write the CPH exam, she failed two additional attempts after the deadline. As a result, staff recommended that Ms. Brizard's registration be suspended.

Following an OTBH, the Director determined that Ms. Brizard's registration should be suspended on the basis that she did not comply with the terms and conditions of her registration by failing to successfully complete the CPH within the required timeframe. The Director also took into account Ms. Brizard's failure to meet her ongoing registration obligations by not disclosing her bankruptcy which was material to her solvency and suitability for registration. The decision also provided that Ms. Brizard could reapply to be registered if she completed the CPH.

Chris Triantos (August 31, 2018)

Topic: Compliance with terms and conditions of registration

Mr. Triantos was a registered mutual fund dealing representative. In October 2017, the Director imposed terms and conditions on Mr. Triantos's registration that, among other things, required him to successfully complete the CPH by April 26, 2018. Mr. Triantos wrote the CPH exam on April 26, 2018, but did not achieve a passing mark. Prior to informing staff of his unsuccessful attempt at the exam, Mr. Triantos registered to re-write it on May 25, 2018, and at staff's request, his sponsor firm prohibited him from trading in securities pending the outcome of his second attempt at the exam. Mr. Triantos did not pass the exam on his second attempt, or on a third attempt on July 28, 2018. The Director approved a settlement agreement pursuant to which Mr. Triantos's registration was suspended. The settlement agreement provided that Mr. Triantos could apply to reactivate his registration if he successfully completed the CPH or the Ethics and Professional Conduct Course.

Glenn Coulson (October 16, 2018)

Topic: Misleading Staff or sponsor firm

Mr. Coulson was a registered mutual fund dealing representative. Shortly after becoming registered in August 2015, Mr. Coulson was charged criminally in relation to conduct that had occurred several years before he became a registrant. The charges were laid in September 2015. Ontario securities law required that Mr. Coulson disclose the charges on NRD within 10 days of their occurrence, however he did not comply with this requirement. Mr. Coulson received an absolute discharge in August 2017, and informed his sponsor firm about the charges in December 2017 (the firm subsequently disclosed the charges on NRD on Mr. Coulson's behalf). Between the date he was charged and the date of his absolute discharge, Mr. Coulson completed two annual certifications for his sponsor firm in which he indicated that his regulatory disclosure was up-to-date. Mr. Coulson did not make the required disclosure to staff, or to his sponsor firm, because his criminal lawyer had instructed him not to discuss the matter with anyone. However, the lawyer had no experience in securities law, and Mr. Coulson did not discuss the specific disclosure obligation with him. The Director approved of a settlement agreement pursuant to which Mr. Coulson's registration was suspended for a period of two months as a result of his failure to comply with his disclosure obligation.

Donald Mason (October 29, 2018)

Topic: Duty to supervise

Mr. Mason, a registered mutual fund dealing representative, was the subject of a November 30, 2017 Director's Decision imposing terms and conditions by which Mason was restricted from acting as a dealing representative with members of the church (or their families) where he acted as lay minister. The Commission dismissed Mr. Mason's request for a stay of the Director's Decision pending a hearing and review which he had requested.

The parties agreed to settle the matter prior to the hearing and review commencing. Mr. Mason agreed to narrower terms and conditions restricting him from dealing with individuals (and their families) whom he visited in a caregiving role pursuant to his Christian Worker's licence. Mr. Mason was not restricted from dealing with church members generally, given his non-leadership role at the church and that he would only deliver messages to the church infrequently and at the direction of the pastor. The Director approved this joint recommendation and the revised terms and conditions took effect.

Maria Psihopedas (November 21, 2018)

Topic: Duty to supervise

This case was the settlement of an application for a hearing and review of a decision of the Director to refuse Ms. Psihopedas's registration as a mutual fund dealing representative. In March 2018, following an OTBH, the Director refused Ms. Psihopedas's application for registration on the basis that she had misrepresented the sentence imposed on her by a court following a criminal case against her. Ms. Psihopedas applied for a hearing and review of the Director's decision, and before that hearing was held, Ms. Psihopedas obtained new evidence that provided a reasonable explanation for why she had misrepresented her sentence. The matter was therefore remitted back to the Director for her consideration, together with a joint recommendation from Staff and Ms. Psihopedas that she be granted registration, subject to terms and conditions that she complete the Ethics and Professional Conduct Course. The Director accepted the joint recommendation.

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