ONTARIO SECURITIES COMMISSION

OSC Staff Notice 33-756

Registration, Inspections and Examinations Division

Summary Report for Dealers, Advisers and Investment Fund Managers

July 26, 2024

Ontario

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Message from Sonny Randhawa
Executive Vice President, Regulatory Operations

We are pleased to share this year's Summary Report for Dealers, Advisers and Investment Fund Managers (**Summary Report**) under our new name, Registration, Inspections and Examinations Division (**RIE**). While our name and division structure are new, this Summary Report follows the purpose and format of previous years' and provides an overview of our compliance and registration work for the 2023-2024 fiscal year.

In May 2024, the OSC released its strategic plan detailing how it will approach its work over the next six years. With six strategic goals at its core, the plan sets out how a modernized OSC aims to work together with our regulatory partners and stakeholders to make Ontario's capital markets inviting, thriving and secure. The strategic plan includes how the OSC will mobilize its resources and expertise in a way that is responsive to the changes, opportunities and risks of today's rapidly evolving capital markets.

To better deliver on our strategic goals, the OSC re-organized its structure, including the Compliance and Registrant Regulation Branch becoming RIE. RIE's focus remains on operating a robust, yet balanced, gateway for Ontario's capital markets, and providing efficient and effective compliance oversight of our market participants. In our new operating structure, RIE will work closely with our Investment Management and Trading and Markets Divisions to advance the OSC's mandate by using a risk-based approach to conduct inspections, targeted sweeps, and examinations to support a timely response to emerging issues. Employing an approach that involves analysis of data, market trends and input from other regulatory divisions to identify areas of heightened risk, RIE's renewed focus will proactively promote compliance through more frequent external communications to prevent and course correct bad practice and by working closely with our Enforcement Division.

In addition to our "Registration as the First Compliance Review" program, compliance priorities for 2024-2025 include:

- compliance reviews of high-risk firms, following the analysis of the data collected in response to the Risk Assessment Questionnaire (**RAQ**)
- compliance reviews of high-impact firms (the largest firms by assets under management)
- reviews of specialized dealers and derivatives dealers

As the OSC continues to embed its six-year strategic plan, we will keep under review the work we are doing to ensure it aligns with our six strategic goals.

The 2023-2024 year saw us reintroducing an in-person component to our compliance reviews while continuing to make the best use of updated electronic

tools to collect information from registrants. To this end, the 2024 RAQ was launched using a new Microsoft-based platform that is dynamic, includes greater functionality to allow for more users to contribute to a firm's response, and incorporates a new single sign-on solution with two-factor authentication. As in previous years, the new platform pre-populated certain non-financial information in the RAQ with the firm's previous responses, in our ongoing effort to reduce regulatory burden and right-size regulation, while still collecting this essential data.

Highlights of our work over the past year include compliance reviews of new firms ranked as high-risk following registration and a sweep of registered restricted dealers operating crypto asset trading platforms. Additionally, together with the Canadian Securities Administrators (**CSA**) and Canadian Investment Regulatory Organization (**CIRO**), we conducted reviews focused on the implementation of the Client Focused Reforms (**CFRs**) know your client, know your product and suitability determination requirements. We anticipate publishing the findings from these reviews, along with guidance, as we did following the reviews of the implementation of the CFR conflicts of interest requirements.

Outreach remains a priority, and we continue to provide tools and programs to support registrants with their compliance obligations. Visit the Registrant Outreach webpage to access the Topical Guide for Registrants, Director's decisions, and calendar of events for past and upcoming educational webinars.

We are excited with the possibilities our new strategic plan and structure brings. By modernizing the OSC, we are creating a bold and agile regulator for Ontario that supports our market participants to thrive while also enhancing the investor experience.

At the time of issuance of this Summary Report, we are actively recruiting for the Senior Vice President, RIE. I look forward to working with the SVP, RIE to deliver on the division's 2024-2025 business plan.

If you have a question, comment, or would like to discuss regulatory matters, please feel free to reach out to us. As always, we look forward to engaging with you.

Sonny Randhawa, EVP, Regulatory Operations
Ontario Securities Commission

Glossary of legislative reference

Act: *Securities Act*, RSO 1990, c. S. 5

Form 13-502F4: Form 13-502F4 *Capital Markets Participation Fee Calculation*

Form 31-103F1: Form 31-103F1 *Calculation of Excess Working Capital*

Form 33-109F4: Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals*

Form 33-109F5: Form 33-109F5 *Change of Registration Information*

Form 33-109F6: Form 33-109F6 *Firm Registration*

MI 32-102CP: Companion Policy 32-102CP *Registration Exemptions for Non-Resident Investment Fund Managers*

NI 23-103: National Instrument 23-103 *Electronic Trading and Direct Electronic Access to Marketplaces – Part 1 – Definitions and Interpretation*

NI 23-103CP: Companion Policy to NI 23-103

NI 31-103: National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

NI 31-103CP: Companion Policy to NI 31-103

NI 33-109: National Instrument 33-109 *Registration Information*

NI 45-106: National Instrument 45-106 *Prospectus Exemptions*

NI 45-106CP: Companion Policy to NI 45-106

OSC Rule 13-502: OSC Rule 13-502 *Fees*

OSC Rule 13-502CP: OSC Companion Policy 13-502CP *Fees*

OSC Rule 13-503: OSC Rule 13-503 *Commodity Futures Act Fees*

OSC Rule 31-505: OSC Rule 31-505 *Conditions of Registration*

Introduction

The Registration, Inspections and Examinations Division (**RIE**) (previously the Compliance and Registrant Regulation Branch) of the Ontario Securities Commission (**OSC**, **Commission**) is responsible for the registration and ongoing supervision 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, efficient and competitive capital markets and confidence in capital markets,
- foster capital formation, and
- contribute to the stability of the financial system and the reduction of systemic risk.

Registration and examination 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 for Dealers, Advisers and Investment Fund Managers (**Summary Report**) is designed to assist registrants by providing information about:

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 for conduct of registrants and applicants for registration. This section also provides insight into the types of regulatory actions we may take to address non-compliance.

Who this report is relevant to

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

Firms	Individuals
1,145[1]	70,272

IFMs	PMs	EMDs	SPDs
537[2]	329[3]	275[4]	4[5]

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

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

[1] Excludes firms registered solely in the category of MFD, ID, commodity trading adviser, commodity trading counsel, commodity trading manager and futures commission merchant.
[2] Includes firms registered only as IFMs and IFMs also registered in other registration categories (other than SPD).
[3] Includes firms registered only as PMs, RPMs, and PMs/RPMs also registered in other registration categories (other than IFM).
[4] Includes firms registered only as EMDs, RDs, and EMDs/RDs also registered in other registration categories (other than IFM or PM).
[5] Includes firms registered only as SPDs and SPDs also registered in other registration categories.

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:

- exempt market dealer (**EMD**)
- scholarship plan dealer (**SPD**)
- restricted dealer (**RD**)
- portfolio manager (**PM**)
- restricted portfolio manager (**RPM**)
- investment dealer (**ID**) – firms in this category must be a member of the Canadian Investment Regulatory Organization (**CIRO**)
- mutual fund dealer (**MFD**) – firms in this category must be a member of CIRO

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
- futures commission merchant

Investment fund manager (**IFM**) is a separate category for firms that direct the business, operations or affairs of investment funds.

Although firms registered in the category of MFD, ID or futures commission merchant, and their registered individuals, are directly overseen by the self-regulatory organization CIRO, the OSC approves the registration of firms in these categories and approves the registration of individuals sponsored by a MFD. Applications for firm registration are reviewed by OSC staff, but we remind firms seeking registration in the category of MFD, ID or futures commission merchant to also apply separately for membership with CIRO.

While this report focuses primarily on registered firms and individuals directly overseen by the OSC, firms directly overseen by CIRO are encouraged to review the Summary Report as certain information is applicable to them as well.

Service standards

We are committed to accountability and transparency, and to ensuring services are delivered in the most efficient and effective ways possible. The compliance review and registration service standards and timelines are incorporated into the OSC Service Commitment and can also be accessed at:

- Registration Materials
- Notices of End of Individual Registration or Permitted Individual Status
- Compliance Reviews: Registrants

Organizational structure

The RIE Division is led by the SVP, Registration, Inspections and Examinations, supported by the Deputy Director, Registrant Conduct and the Deputy Director, Operations.

The Division is organized into: Compliance Teams, the Registrant Conduct Team, the Data Strategy and Risk Team and the Registration Team.

The Compliance Teams are responsible for conducting compliance reviews of market participants, and examining emerging compliance risks. Operations staff are accountants and lawyers who are subject matter experts in the compliance requirements applicable to different types of registered firms. They also provide support to the Registration Team in assessing new applicants for registration.

The Registrant Conduct Team handles matters that require further regulatory action to remediate registrant misconduct or to review higher-risk registration applications. Registrant misconduct may be addressed by applying terms and conditions to registration, suspension of registration or referral to Enforcement.

The Data Strategy and Risk Team performs financial analysis of registrants' interim and annual financial statements and capital calculations, leads the Capital Markets participation fee process and oversees all fee matters. This team also supports data requirements and conducts data analytics.

The Registration Team focuses on the initial registration of firms and individuals, subsequent changes to registration, including the surrender of registration, and ongoing maintenance of registration information.

Staff contact information

Name	Title	Phone
To be filled	Senior Vice President, Registration, Inspections & Examinations	N/A
Elizabeth King	Deputy Director, Registrant Conduct	416-204-8951
Felicia Tedesco	Deputy Director, Operations	647-404-7582
Michael Denyszyn	Manager, Registrant Conduct Team	647-295-5317
Alizeh Khorasanee	Manager, Dealer Team	416-716-3307
Vera Nunes	Manager, Investment Fund Manager Team	416-593-2311
Jeff Sockett	Manager, Data Strategy and Risk Team	416-593-2160
Dena Staikos	Manager, Specialized Dealer Team Portfolio Manager Team (interim)	416-558-9218
Jason Tan	Manager, Registration Team	647-642-2650

The format for our email addresses is first initial and last name: First Last, flast@osc.gov.on.ca.

For registration or fee inquires, please use the following contact information:

- Registration inquiries: registrations@osc.gov.on.ca
- Fees inquiries: annualfees@osc.gov.on.ca

Part 1: Outreach

1.1 Outreach program and resources

1.2 Registration Outreach Roadshow

1.3 Registrant Advisory Committee

1.1 Outreach program and resources

Launched in 2013, the objectives of our Registrant Outreach program are to strengthen communication with Ontario registrants and other industry participants (such as lawyers and compliance consultants), to promote strong compliance practices and to enhance investor protection.

Registrant Outreach statistics since inception

Sessions (in-person and webinars)	Replays viewed	Individual attendance	Topical Guide for Registrants – annual page views
73	13,040	15,766	> 11,000

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 program 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 alerts here.

Looking for a listing of recent e-mail alerts and links to each?

Refer to the Compliance-related reports, staff notices and email notifications webpage.

Interested in reading previously published Director's decisions?

Refer to the Opportunity to be heard and 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 Outreach Roadshow

The Registration Team held its annual Registration Outreach Roadshow in early 2024.

The Roadshows are part of our continued efforts to strengthen working relationships with compliance and registration teams of registered firms we frequently interact with, as well as legal counsel and other authorized filing representatives who assist firms and individuals on registration matters. At these informal sessions, we share our observations on common deficiencies, tips for registration filings and OSC expectations for registration matters, as well as highlight upcoming OSC and Canadian Securities Administrators (**CSA**) initiatives. We encourage a dialogue with industry stakeholders on their experiences with the registration process.

We were pleased to return to in-person sessions this year, visiting several high-volume mutual fund dealer firms and a scholarship plan dealer, and hosting a group of law firms. We presented data 'scorecards' for attendee firms showing trends in the number of registrants, types of registration applications and conduct files. We identified areas of success from a regulatory perspective as well as areas for improvement, and offered insights on how firms could achieve greater efficiencies.

Other topics included tips on the main registration forms, as well as practices for firms and individuals to drive down instances of non-disclosure of required information for individual registrants (e.g. criminal charges or bankruptcies under items 14 and 16 respectively of Form 33-109F4). We discussed the need for clear content in, and timely filings of, Form 33-109F1 *Notice of End of Individual Registration or Permitted Individual Status*, where the circumstances of an individual registrant leaving a sponsoring firm can be a point of regulatory interest.

Lastly, we discussed the registration conduct continuum, including what to expect if a registration submission is transitioned to the Registrant Conduct Team for investigation. We provided guidance that these filings are no longer treated as standard and are not subject to the OSC Service Commitment. We also offered guidance to CCOs on how to prepare for an initial call with the Registrant Conduct Team.

We continue to see the importance of these Roadshows. Numerous firms noted in post-session surveys that they benefit from these sessions, and provided feedback that we look forward to incorporating in future sessions.

1.3 Registrant Advisory Committee

Established in January 2013, the Registrant Advisory Committee (**RAC**) meets quarterly, with members serving a minimum two-year term. It is currently comprised of 14 external members whose terms run from January 2023 to December 2024.

The RAC's objectives are to:

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

Discussion topics during the fiscal year (April 1, 2023 – March 31, 2024) included:

- the first OSC TestLab report highlighting perspectives on regulatory technology (RegTech) in Ontario's capital markets
- the use of ChatGPT and artificial intelligence within the investment industry
- a demonstration of new enhancements and features to the 2024 RAQ intended to promote user interaction
- the evolution of Canada's retail exempt market

Part 2: Information for dealers, advisers and investment fund managers

2.1 Annual highlights

2.2 Registration and compliance deficiencies

2.3 Crypto asset trading platforms registration matters and compliance deficiencies

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 2023-2024 fiscal year:

- Section 2.1 discusses the annual highlights of the work we completed during the 2023-2024 fiscal year.
- 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 that the information is relevant to firms registered in those categories.
- Section 2.3 focuses on crypto asset trading platforms and discusses key or novel issues, suggests best practices, and specifies applicable legislation and relevant guidance to assist crypto asset trading platforms, restricted dealer firms and applicants in addressing each of the topic areas.

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

2.1.1 Presence review

2.1.2 High-risk firms identified through the "Registration as the First Compliance Review" program

2.1.3 Assess compliance with Client Focused Reforms - know your client, know your product and suitability determinations review

2.1.4 Business arrangements sweep

2.1.5 Focused reviews – emerging issues

2.1.1 Presence review

In 2023, we carried out reviews of registered firms that were registered and had not been reviewed since their initial compliance review which took place as part of the "Registration as the First Compliance Review" program[6]. The scope of these reviews was primarily determined based on the level of the firm's business activity in Canada.

We reviewed 24 firms, of which 20 had limited activity in Canada and many are also regulated by foreign regulators. These reviews focused on confirming and updating our understanding of the firm's:

- corporate structure and lines of business
- registerable activities in Ontario, including products and services offered, as well as the firm's interaction with its Ontario clients
- marketing activities in Ontario
- compliance function, including the appropriate registration of individuals

The remaining four firms were subject to normal course, on-site compliance reviews using a risk-based approach to focus on specific areas of the firm's business activities.

2.1.2 High-risk firms identified through the "Registration as the First Compliance Review" program

Our "Registration as the First Compliance Review" program includes a risk assessment of newly registered firms. The firm may be categorized as high-risk based on the firm's proposed business operations, compliance systems and proficiency of the firm's individuals. As a result, targeted reviews of these firms may be scheduled within a certain period of time following the commencement of the firm's operations.

During the year, we conducted compliance reviews of firms categorized as high-risk to assess their compliance with Ontario securities law. We identified non-compliance with securities law across key operational areas. Significant deficiencies that were common to over half the sampled firms included:

- inadequate compliance system and CCO and UDP not performing their responsibilities
- inadequate disclosure to clients regarding conflicts of interest

[6] For more information on the "Registration as the First Compliance Review" program, please refer to section 3.1a) *Pre-registration reviews* of OSC Staff Notice 33-745 *2014 Annual Summary Report for Dealers, Advisers and Investment Fund Managers*.

- not being aware of financial condition at all times and incorrect calculation of excess working capital

2.1.3 Assess compliance with Client Focused Reforms - know your client, know your product and suitability determinations review

In effect since 2021, the CFRs were a set of amendments to NI 31-103 designed to better align the interests of registrants with the interests of their clients, improve outcomes for clients, and make clearer to clients the nature and the terms of their relationship with registrants. The CFRs introduced enhanced requirements in the areas of conflicts of interest (**COI**), know your client (**KYC**), know your product (**KYP**), suitability determinations and relationship disclosure.

In 2023, together with the CSA and CIRO, we commenced a review of registered firms to assess their compliance with the KYC, KYP and suitability determination requirements. Once these reviews are complete, we plan to publish a staff notice to summarize our findings and to provide additional guidance to advisers and dealers and their representatives, including suggested practices.

In 2022, the CSA and CIRO conducted a review of registered firms to assess their compliance with the COI requirements under the CFRs, including reviewing the conflicts disclosure that the firms provide to their clients. A report outlining the results and providing additional guidance on how registrants are expected to comply with the COI requirements was published in August 2023 (Joint CSA/CIRO Staff Notice 31-363 *Client Focused Reforms: Review of Registrants' Conflicts of Interest Practices and Additional Guidance*).

2.1.4 Business arrangements sweep

In 2023, we began a focused compliance review of 10 Ontario-based firms that entered into a business arrangement with an unrelated registered firm for its IFM and/or PM services.

The purpose of this focused compliance review was to ensure that the roles and responsibilities of each party aligned with their registration category, and that the offering documents and marketing materials used by the parties did not contain misleading information regarding the roles and responsibilities of each party.

The findings of this sweep are summarized in section 2.2.3 of the Summary Report.

2.1.5 Focused reviews – emerging issues

As part of our commitment to proactively respond to emerging issues, we monitor industry developments and media reports, and follow up directly with firms if required. Specifically, during the past year, the current environment of higher interest rates led to some real estate/mortgage issuers halting or suspending redemptions. We contacted these market participants on a timely basis following their announcements to understand:

- the terms on which the redemptions were halted, and whether these were in accordance with the provisions set out in the offering or constating documents of the issuer
- whether investors and dealers were provided with full disclosure of the suspension of redemptions, the anticipated length of the suspension, and any conditions that could either shorten or lengthen the suspension
- whether regularly scheduled distributions to investors were impacted
- whether any marketing materials made clear the halted status of redemptions
- the plan to manage the liquidity of the real estate/mortgage portfolio, and to resume redemptions in accordance with the provisions of the constating documents

In the coming year, we anticipate looking further into the role and responsibilities of EMDs in the distribution of real estate and mortgage products. We will continue to follow up directly with firms in the real estate sector experiencing liquidity issues that cause the suspension of redemptions to understand their plans for managing portfolio liquidity and resuming redemptions. We will also continue with our practice of following up with market participants on emerging matters as required.

2.2 Registration and compliance deficiencies

2.2.1 Portfolio manager considerations in a fund of fund structure

2.2.2 Books and records to demonstrate investment fund manager appointment

2.2.3 Registerable activities conducted by unregistered firms

2.2.4 Outsourced compliance and Chief Compliance Officer functions

2.2.5 Inadequate collection of trusted contact person information

2.2.6 Awards / ranking contests for advisers

2.2.7 Conflicts in relation to section 11.9 / 11.10 notices

2.2.8 Referral arrangements between portfolio managers and unregistered firms

2.2.9 Foreign firms that do not rely on the international adviser exemption

2.2.10 Business continuity planning

2.2.11 Issuer-sponsored dealing representatives

2.2.12 Dealer obligation when relying on the offering memorandum exemption

2.2.13 Related party receivables in excess working capital

2.2.14 Capital markets participation fees

2.2.15 Incomplete applications

2.2.16 Investment Fund Manager proficiency

2.2.1 Portfolio manager considerations in a fund of fund structure (IFM / PM)

In reviewing fund of fund (**FOF**) structures, staff has raised questions about whether a PM should be appointed to the top fund, even if the top fund invests in only one underlying fund.

In instances where an investment fund holds only one portfolio security (including a FOF structure where a top fund has been created as a separate issuer and invests only in the securities of the bottom fund), there still needs to be an analysis of whether there is 'advising' taking place at the top fund level, requiring a portfolio manager to be appointed for the top fund. While the top fund's investment objective may be to invest in only one portfolio security (the securities of the underlying fund), staff is of the view that there are investment decisions being made at the top fund level requiring a PM. Examples of these decisions include: the timing of new investments into the bottom fund, managing redemption requests, determining distributions from the top fund, determining how much cash the top fund should hold, other aspects of cash management, and if the strategy of only holding securities of the bottom fund needs to be altered in certain situations.

As IFM registration does not include advising in securities, there should be a PM in place to advise the top fund. The PM should be appointed by the IFM.

IFMs should:

- ✓ assess whether a PM should be appointed to an investment fund even if the portfolio of the investment fund is limited to only one underlying investment

Legislative reference and guidance

- Act, s. 25(3) *Registration*
- NI 31-103CP, s. 1.3 *Fundamental concepts*

2.2.2 Books and records to demonstrate investment fund manager appointment (IFM)

In some of our compliance reviews, we noted that the investment fund's constating documents did not properly appoint the person or company that directed the business, operations or affairs of the fund - that is, the IFM.

We expect to see documentation that shows an entity, such as the general partner (**GP**) or trustee, delegating the IFM function to the registered IFM firm. This delegation can be stipulated in agreements such as the declaration of trust or the GP agreement.

We have seen instances of IFMs being named in fund offering documents; however, they had not been formally appointed as the IFM of the investment fund in the fund's constating documents.

IFMs should:

- ✓ ensure the investment fund's constating documents appropriately appoint the person or company that directs the business, operations or affairs of the investment fund (i.e. the IFM)

Legislative reference and guidance

- NI 31-103 and related NI 31-103CP, s. 11.1 *Compliance system and training*
- NI 31-103 and related NI 31-103CP, s. 11.5 *General requirements for records*

2.2.3 Registerable activities conducted by unregistered firms (All)

We identified regulatory concerns in an arrangement where a PM firm entered into an agreement with an unrelated third-party for its IFM services. Under this arrangement, the IFM was not performing its required duties either because it was restricted by the written business agreement, or it had inappropriately delegated its responsibilities to the PM. As a result of the regulatory concerns noted in this type of arrangement, we conducted a focused compliance review of Ontario-based firms (both registered and unregistered firms) that entered into a business arrangement with an unrelated registered firm for its IFM and/or PM services.

The most common business arrangement identified as part of this focused compliance review involved firms that had proprietary investment funds for which the firm acted as the PM, but an unrelated third-party firm was appointed as the IFM for those proprietary funds. The business arrangements we reviewed as part of this focused compliance review pose a regulatory concern due to the activities being conducted by each party. During our review, we identified instances where it was the PM, and not the appointed third-party IFM, that directed the affairs of the investment funds. For example, we noted instances where the PM directed the IFM to terminate an investment fund.

These regulatory concerns were also noted in our review of the written business agreements between the PM and the IFM which contained problematic clauses that suggested the PM had certain rights and obligations that are central to the role of an IFM in directing or managing the business, operations or affairs of an investment fund despite the PM firm not being registered as an IFM. Some examples of problematic clauses noted in the business agreements included:

- the PM was permitted to terminate or change the IFM for the investment fund
- the PM was permitted to change the investment fund's service providers, including the administrator
- the IFM was required to obtain the consent of the PM before it could change certain of the investment fund's service providers

- the PM was responsible for certain key decisions with respect to the operation of the investment fund, such as when to merge or terminate the fund
- the PM was compensated for acting as an IFM

As stated in last year's Summary Report, we consider agreements that attempt to restrict an IFM from exercising the standard of care in s. 116 of the Act which includes the duty to "exercise the powers and discharge the duties of their office honestly, in good faith and in the best interests of the investment fund", to not be in compliance with securities law.

We remind firms that it is only the IFM that can direct the business, operations or affairs of an investment fund and it cannot delegate its duties to another party involved in providing services to the investment fund, such as the PM. As a reminder the key functions and activities that an IFM is responsible for were discussed in last year's Summary Report.

Subsection 25(4) of the Act prohibits a person or company from acting as an IFM unless the person or company is registered as an IFM or is exempt from the registration requirement.

During this focused compliance review, we also noted instances where unregistered firms were inappropriately relying on the PM registration of another firm. In these cases, the party that was appointed as the PM for the investment fund, according to the business agreement between the parties, did not appear to be the party that, in substance, was making the investment decisions for the investment fund. The written business agreement specified that the unregistered firm would participate in the investment fund's investment committee and assist the PM with making investment decisions for the investment fund. Although the business agreement specified that the final investment decision would be that of the PM, staff identified evidence to the contrary suggesting the unregistered firm was the party making the investment decisions for the investment fund.

IFMs and PMs should:

- ✓ perform a thorough review of all business agreements to verify that the roles and responsibilities of each party align with their registration category
- ✓ ensure that any registerable activity performed by each party is executed as permitted under its registration category

Legislative reference and guidance

- Act, s. 1(1) *Definitions – investment fund manager*
- Act, s. 25(3) *Registration, advisers*
- Act, s. 25(4) *Registration, investment fund managers*
- Act, s. 116 *Standard of care, investment fund managers*

- NI 31-103 and related NI 31-103CP, s. 7.3 *Investment fund manager category*
- NI 31-103 and related NI 31-103CP, s. 7.2 *Adviser categories*
- MI 32-102CP, *under Requirement to register as an investment fund manager* of Part 1 *Fundamental Concepts*
- OSC Staff Notice 33-755 *2023 Summary Report for Dealers Advisers and Investment Fund Managers*, page 27

2.2.4 Outsourced compliance and Chief Compliance Officer functions (All)

We have seen registered firm business models where all compliance functions, including the establishment of a firm's compliance system and provision of the services of chief compliance officer, were provided by a third-party entity. Significant compliance deficiencies were noted, which were addressed through terms and conditions on the firms' registration and the firms' altering their business models.

We have also seen instances where firms have proposed to register third-party CCOs sponsored by, and in some cases affiliated with, a compliance consulting firm. A number of regulatory concerns were identified by staff, and these models were ultimately not pursued by the firm.

We remind firm applicants and registrants that, as set out in CSA Staff Notice 31-358, registered firms must not outsource all compliance functions and CCO's responsibilities to a third-party service provider.

Registered firms must remain responsible and accountable under securities law for all compliance functions that they propose to be handled by service providers. Part 11 of NI 31-103 requires that registered firms establish, maintain, and apply policies and procedures that establish a system of controls and supervision sufficient to provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation, and manage the risks associated with its business in accordance with prudent business practices.

Controls must be in place to oversee service providers to verify that all functions are being adequately performed so that the firm is able to meet its regulatory obligations.

CSA Staff Notice 31-358 is also relevant to these compliance and CCO models, notwithstanding that it focused on shared CCO models. We expect that firms consider and address the principles and sample questions set out in the Appendices of CSA Staff Notice 31-358 when considering such models, including:

- how an effective compliance system will be maintained

- the CCO of a registered firm must be an officer, partner or sole proprietor of the registered firm
- the CCO has the proficiency as well as capacity to act as CCO
- whether any conflicts of interest result from the CCO model, such as if the interests of the CCO and the firm are misaligned, and how these conflicts are identified and mitigated
- whether the CCO and sponsoring firms have adequately protected confidential client information

Firms should identify and communicate issues and risks with proposed CCO models to the Registration Team at the time registration applications are filed and provide analysis addressing those issues.

Legislative reference and guidance

- Act, s. 32(2) *Duty to establish controls, etc.*
- NI 31-103 and related NI 31-103CP, s. 11.1 *Compliance system and training*
- NI 31-103CP, *General business practices – outsourcing, Compliance system and training*
- Registrant Outreach Seminar June 2017 – *Effective Oversight of Service Providers and Modernization of Investment Fund Product Regulation – Alternative Funds*, slides 5-33
- CSA Staff Notice 31-358 *Guidance on Registration Requirements for Chief Compliance Officers and Request for Comments*

2.2.5 Inadequate collection of trusted contact person information (PM / EMD)

Although amendments to NI 31-103 to enhance protection of investors by providing registrants with tools and guidance to address issues of financial exploitation and diminished mental capacity came into effect at the end of 2021, we continue to see instances where PMs and EMDs have not adjusted their business processes to comply with the amendments.

In a number of reviews, we found that the registrant did not take reasonable steps to obtain the trusted contact person (**TCP**) information from the client. These firms incorrectly believed that the requirements apply only to vulnerable or senior clients and, as a result, only attempted to collect TCP information from these clients, rather than all clients.

In other cases, firms were not able to provide evidence to support that they had taken reasonable steps to collect TCP information, or that written consent was obtained from clients. In one case, the firm did not adjust their onboarding processes to attempt to collect TCP information concurrently with the collection of the clients' other KYC information. Instead, the onus was placed on the client to

locate the TCP designation form on the firm's website if they were interested in providing TCP information.

PMs and EMDs should:

- ✓ establish processes that require the firm to take reasonable steps to obtain TCP information from the client while collecting, documenting and updating the client's other KYC information
- ✓ explain to the client the purpose of a TCP and the circumstances under which information about the client's account might be disclosed to their TCP
- ✓ maintain written policies and procedures in respect of the collection and documentation of TCP information

Legislative reference and guidance

- NI 31-103 and related NI 31-103CP, s. 13.2.01 *Know your client – trusted contact person*
- NI 31-103 and related NI 31-103CP, s. 11.5 *General requirements for records*
- NI 31-103CP, Appendix G – Part 13 *Addressing Issues of Financial Exploitation and Concerns About Clients' Mental Capacity*
- CSA Notice of Amendments to NI 31-103 and NI 31-103CP *to Enhance Protection of Older and Vulnerable Clients*

2.2.6 Awards / ranking contests for advisers (All)

Many registered firms and/or their registered individuals participate in recognition programs to distinguish the firm or individual from their competition, such as contests or lists that identify certain firms or individuals as "top" or "best", or as providing superior service.

In some cases, registrants also pay a fee to be considered or to participate in these ranking contests or lists. These awards, recognitions, or the results of the ranking contests or lists are subsequently published on websites or in media or industry publications. In many cases, they are also referenced on a registered firm's website or a registered individual's webpage, LinkedIn profile, or other sites accessible to the public.

All registered firms and individuals must comply with the requirements set out in section 13.18 of NI 31-103 with respect to misleading communications. These requirements apply to both internal and external awards, recognitions or contests.

A registered individual's sales activity or revenue generation is distinct from their proficiency, experience and qualifications. If a prestigious-sounding award or recognition considers the registered individual's sales activity, revenue generation or assets under management, this could reasonably be expected to deceive or

mislead a client as to the proficiency, experience or qualifications of that registered individual, which is prohibited by paragraph 13.18(1)(a) of NI 31-103.

Furthermore, these ranking contests/lists generally use sales activity or revenue generation as a factor to determine an individual's inclusion in the ranking contest/list. Paragraph 13.18(2)(a) of NI 31-103 prohibits a registered individual who interacts with clients from using an award or recognition if the award or recognition was based partly or entirely on the registered individual's sales activity, revenue generation or assets under management. Referencing the results of these types of ranking contests or lists on the firm's website or a registered individual's webpage, LinkedIn profile, or other public site will be considered a compliance deficiency.

A registered individual must not use that award or recognition in client-facing interactions, including:

- marketing or client communications such as webpages or LinkedIn profiles
- displaying the award or recognition in their physical or virtual office
- displaying the award or recognition in their signature block (hard copy or electronic)
- mentioning the award or recognition to clients verbally in meetings
- referencing the award or recognition in a media interview/publication
- emailing clients to tell them about the award or recognition

Even in cases where the award or recognition is not referenced in advertising or marketing materials issued directly by a registered firm or individual, the publication of the results by the contest sponsors could be seen as a compliance deficiency as a result of their participation in the contest.

The rules in section 13.18 of NI 31-103 with respect to misleading communications are principles-based, and staff will raise concerns with anything that could result in a contest ranking being misleading. Although the ranking criteria may state that the contest is not based on sales activity, revenue generation or assets under management, the results of the ranking or contest could be misleading if:

- direct payments were made to participate in a contest
- indirect payments were made, such as advertising in the publication sponsoring the contest
- there appears to be any form of bias (e.g. friends or family on the judging panel)
- the contest representation was limited and did not fairly represent the various firms and advisors operating in a particular market

We will continue to evaluate registrants' compliance with these requirements as part of our regular compliance examinations and will use all tools available along the compliance-enforcement continuum to address any non-compliance.

Registered firms should:

- ✓ outline clear written policies and procedures on whether participation is permitted or not, including specified controls to ensure compliance
- ✓ remove references to previously granted awards or recognitions in any marketing or client communications including webpages or LinkedIn profiles
- ✓ implement a process to monitor the firm's registered individuals' participation in any ranking contest (including monitoring registered individuals' webpages or LinkedIn profiles, and requiring each registered individual to certify their compliance with these provisions)

Legislative reference and guidance

- NI 31-103 and related NI 31-103CP, s. 13.18 *Misleading communications*
- Email blast - Advisor Ranking Contests/Lists – Action Items, July 31, 2023
- Client Focused Reforms - Frequently Asked Questions (updated December 6, 2023), Question 43

2.2.7 Conflicts in relation to section 11.9 / 11.10 notices (All)

Notices of proposed ownership changes in, or asset acquisitions of, registered firms required under sections 11.9 or 11.10 of NI 31-103 (**notices**) often did not adequately describe how material conflicts of interest arising out of the proposed changes have been or will be addressed in the best interest of clients. Registrants submitting notices are expected to explain what steps have been or will be taken to comply with conflicts of interest and suitability determination requirements, including:

- identifying incentives associated with the proposed transaction as material conflicts of interest that must be addressed in the best interest of clients and adequately disclosed to clients
- complying with their suitability determination obligations
- complying with their obligation to deal fairly, honestly and in good faith with clients

For instance, where a proposed transaction is structured so that a registrant could receive a higher payout tied to the number of clients moving from the target firm (**Firm A**) to the acquirer firm (**Firm B**), staff expect this to be identified as a material conflict of interest and addressed in the best interest of clients of both Firm A and Firm B, as applicable. We also expect that client communications be sent to the clients of Firm A and Firm B prior to the proposed closing date. The client communication should:

- include an explanation that is prominent, specific, and written in plain language
- describe the financial incentive and specifically explain that the quantum of such financial incentive is tied to the client's decision to move to Firm B
- explain that a move to Firm B may result in the client having access to different products or services with different fees, as applicable
- describe the choice for the client to stay with Firm A, transition to Firm B, or close the client's account and find another adviser or dealer, as applicable

Registrants are reminded to include the information in section 11.9 of NI 31-103CP under the heading *Content of the notice* to help the regulator assess the proposed transaction. Staff have updated this voluntary form, which was developed to assist filers in complying with the requirements in notices.

2.2.8 Referral arrangements between portfolio managers and unregistered firms (PM)

We continue to see instances where registered firms improperly delegated portfolio management activities that require registration to referral agents who are not registered. Firms must not delegate to non-registered parties any portfolio management activities that require registration, including:

- collecting and updating KYC information
- providing advice on investment strategies
- selection of investment mandates
- maintaining direct contact with clients to discuss account details such as investment performance or address client concerns with their accounts

If a registrant has a referral arrangement with an unregistered party, the registrant must put in place adequate monitoring procedures to assess if the unregistered party is conducting activities in relation to the referral business that require registration under securities law.

Referred clients often continue to communicate with the referral agent on topics that should be discussed with an Advising Representative (**AR**), such as questions about their portfolio holdings and changes to their KYC information. Registrants must be proactive in developing a relationship with referred clients so that the clients understand the registrant's role.

When an unregistered referral agent has a continuing relationship with referred clients (e.g. providing financial planning services), the registrant must ensure that all fees relating to portfolio management services are paid directly to the registered firm.

PMs should:

- ✓ perform adequate due diligence on prospective referral partners to verify that the registered firm will be working with a reputable third party
- ✓ establish a written referral agreement that:
  - clearly sets out each party's roles and responsibilities, such as who is responsible for collecting KYC
  - specifies restrictions on the referral agent's activities, such as requiring unregistered agents to only use pre-approved marketing materials in relation to their referral business with the registered firm
- ✓ develop written policies and procedures that establish an adequate process to:
  - evaluate the referral agent's marketing to verify that any claims or statements they make about the registered firm's products and services are accurate, substantiated, and not misleading
  - monitor the referral agent's relationship with referred clients to determine whether the referral agent is performing an activity that requires registration
  - monitor and resolve instances where clients are confused about the role of the registrant and/or referral agent
- ✓ provide training to referral agents on how to adequately conduct referrals
- ✓ ensure that, when partnering with unregistered firms, the registered firm does not delegate any portfolio management activities that require registration
- ✓ ensure that, when partnering with unregistered firms, all fees relating to registerable activities are paid directly to the registered firm

Legislative reference and guidance

- NI 31-103 and related NI 31-103CP, s. 11.1 *Compliance system and training*
- Joint CSA/CIRO Staff Notice 31-363 *Client Focused Reforms: Review of Registrants' Conflicts of Interest Practices and Additional Guidance*, item 7
- OSC Staff Notice 33-750 *2019 Summary Report for Dealers, Advisers and Investment Fund Managers*, pages 40-42
- OSC Staff Notice 33-745 *2014 Annual Summary Report for Dealers, Advisers and Investment Fund Managers*, pages 61-63

2.2.9 Foreign firms that do not rely on the international adviser exemption (PM)

A number of registered firms based outside of Canada rely on the international adviser exemption. This exemption generally allows advisers whose head office is

based in a foreign jurisdiction to provide advice to certain "permitted clients" in Canada on "foreign securities"[7], subject to certain conditions and filing requirements. For more details on the international adviser exemption, please refer to section 8.26 of NI 31-103.

Foreign advisers that do not meet the conditions in the international adviser exemption (**foreign advisers**) but wish to provide advice to Ontario clients are required to be registered with the appropriate securities regulatory authorities. During our review of foreign advisers, we continued to see representatives of these firms conducting registerable activities in Ontario without being registered as either ARs or Associate Advising Representatives (**AARs**). We noted the following registerable activities conducted by unregistered individuals with Ontario clients:

- collecting and updating KYC information
- providing advice on investment strategies, including selecting model portfolios, and allocating funds to each model portfolio
- preparing and reviewing investment policy statements with clients
- maintaining direct contact with clients to discuss account performance and addressing client concerns about their accounts

We also noted that in some cases, a firm's policies and procedures were not tailored to Ontario-specific rules and guidance.

We recognize that the registration regimes in foreign jurisdictions may differ. However, we remind firms based outside of Canada that individuals advising on securities on behalf of the firm and servicing clients in Ontario must be registered appropriately as either an AR or AAR. This includes both individuals who conduct relationship management activities and individuals who select securities for client portfolios.

If we find that a firm is not in compliance with the registration requirements in Ontario, this may raise concerns regarding the adequacy of the firm's compliance system and whether the firm is adequately supervising its representatives. Registered firms are responsible for the conduct of individuals acting on behalf of the firm.

PMs should:

- ✓ take adequate steps to understand and comply with the registration requirement in Ontario by consulting compliance and/or legal counsel before commencing registerable activities in Ontario

[7] The terms "permitted client" and "foreign securities" are defined in NI 31-103.

- ✓ assess whether an individual assigned to service an Ontario client is conducting activity that would require registration in Ontario, and if so, take immediate steps to apply to register the individual in Ontario
- ✓ have measures in place to ensure that only registered individuals are performing duties related to the firm's obligations as a registrant
- ✓ provide adequate training to employees on the registration requirements in Ontario

Legislative reference and guidance:

- Act, s. 25 *Registration*
- NI 31-103CP, s. 1.3 *Fundamental concepts*
- NI 31-103 and related NI 31-103CP, s. 11.1 *Compliance system and training*
- NI 31-103 and related NI 31-103CP, s. 8.26 *International adviser*
- Guidance on Client Relationship Management specialists and related FAQ
- OSC Staff Notice 33-750 *2019 Annual Summary Report for Dealers, Advisers and Investment Fund Managers*, page 27
- OSC Staff Notice 33-747 *2016 Annual Summary Report for Dealers, Advisers and Investment Fund Managers*, pages 52-54

2.2.10 Business continuity planning (All)

Under section 11.1 of NI 31-103, a registered firm must establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation, and to manage the risks associated with its business in accordance with prudent business practices.

Section 11.1 of NI 31-103CP states that an effective compliance system includes internal controls designed to manage the risks that affect a registrant's business, including risks that may relate to business interruption.

In January 2024, staff delivered an email blast reminding small firms and firms with few registered individuals of the requirement to establish, maintain and apply a written business continuity plan (**BCP**) to adequately manage the impact of an event causing a significant business disruption, including the impact to clients and business operations in the event of the death, incapacitation or prolonged absence of key individuals. This email blast reiterated CSA Staff Notice 31-350 published in May 2017.

When developing a BCP, small firms should consider designating an individual to execute the BCP (**BCP executor**) and, as appropriate for their size and business model, the following:

- procedures to mitigate, respond to, and recover from business interruptions and other types of disturbances that may disrupt the firm's day-to-day operations
- how the firm will communicate with clients, key personnel, third-party service providers, and regulators (e.g. provide an alternate means of communication)
- procedures to protect, backup and recover the firm's books and records (e.g. as a result of a cyber-security incident or natural disaster)
- details about the relocation of the firm's office in the event of a temporary or permanent loss of the firm's head office or principal place of business
- the firm's business succession or wind-down procedures (e.g. assignment of duties to key persons) in the event of death, incapacitation or prolonged temporary absence of the sole registered individual
- who will be responsible for notifying the regulators in the event of death, incapacitation or prolonged temporary absence of the sole registered individual
- what information clients need to know about the BCP to ensure that it can be properly executed (e.g. by providing clients with the name and contact details of the BCP executor, and explaining to clients how they can access their assets in the event of loss of the firm's key personnel, or by providing the client with the name and contact details of the relationship manager at the custodian where the clients' assets are held)
- training of firm employees, including training about their specific duties if the BCP needs to be implemented
- how often the BCP needs to be updated and its effectiveness assessed
- how the firm will assess the adequacy of the BCPs of third-party service providers

As part of a robust BCP, small firms must also include steps to make certain that the BCP executor is adequately trained on how to execute the BCP effectively and is able and authorized to provide instructions on behalf of the firm to third-party service providers and communicate with the regulators.

Small firms with only one registered individual and no other support or administrative staff may have to designate a BCP executor external to the firm (e.g. a spouse, relative, legal counsel or another registrant), provided that such external BCP executor has the knowledge, authority and qualification to carry out the responsibility in compliance with securities legislation.

If the firm designates an external BCP executor, the firm should ensure that:

- a written agreement is in place so that the BCP executor understands and acknowledges their responsibilities
- the BCP executor is familiar with the firm's BCP
- the BCP executor is familiar with the firm's business in order to properly wind down or temporarily manage the small firm or facilitate the transfer of the firm's client accounts
- a confidentiality agreement is in place if the BCP executor will have access to confidential client information and, where applicable, the firm obtains client authorization to share this confidential information (e.g. in the relationship disclosure information documentation)
- if the BCP executor is another registrant or will be appointing another registrant, conflicts of interest between both firms have been considered (e.g. an external BCP executor could be managing clients of two firms in a scenario of temporary absence)
- the BCP executor understands securities legislation, including registration requirements in order to conduct registrable activities, and is aware of costs (e.g. costs related to filing an application for exemptive relief)

At the time of applying for registration, firms are expected to have a written BCP in place and if the firm is small, a designated BCP executor as part of their proposed system of controls and supervision in accordance with section 11.1 of NI 31-103

Legislative reference and guidance

- NI 31-103 and related NI 31-103CP, s. 11.1 *Compliance system and training*
- CSA Staff Notice 31-350 *Guidance on Small Firms Compliance and Regulatory Obligations*, pages 2-3

2.2.11 Issuer-sponsored dealing representatives (EMD)

Staff noted an increase in the number of registered firms using the issuer-sponsored Dealing Representative (**DR**) business model. In this business model, a DR that works for an issuer or its affiliate is registered with an independent EMD firm to market the issuer's securities to investors. Other characteristics of this business model include:

- the issuer-sponsored DR may exclusively market the securities of the affiliated issuer (they generally do not offer clients other securities on the shelf of the EMD firm)
- the issuer-sponsored DR is paid a salary from the issuer and may also receive a commission from the issuer for sales of the security
- the EMD firm receives a sales commission from the issuer (e.g. a portion of the total sales commission paid by the issuer or a small commission by the issuer for sales of the security)

Staff's concerns with this business model include:

- the issuer-sponsored DR has an inherent material conflict of interest to sell the securities of the connected issuer to keep the issuer operating and maintain their primary means of compensation. This financial dependency increases the risk of unsuitable products being sold to clients.
- clients may not be offered a more suitable product on the firm's shelf
- the EMD firm's supervision of the issuer-sponsored DRs may be more challenging
- clients may be confused as to which entity and in what capacity the issuer-sponsored DR is acting

Given the above concerns, terms and conditions have been imposed on the registration of firms using this business model. The terms and conditions include:

- each issuer must contract with the EMD firm and agree contractually to provide certain information to the EMD firm upon request by the EMD firm or the Commission. The information is similar to information the issuer would have to provide if it was itself becoming registered as an EMD.
- the EMD firm must compensate the issuer-sponsored DR through the EMD firm
- the issuer cannot sponsor a DR that is a member of the C-suite at the issuer (e.g. CEO, COO, President, Chair, etc.)

Firms are reminded to submit a Form 33-103F5 before it commences use of this type of business model.

Registered dealers should:

- ✓ specify whether the DR will be issuer-sponsored with the EMD firm under Item 10 of Form 33-109F4
- ✓ outline the firm's change in business model on Form 33-109F5

Legislative reference and guidance

- Form 33-109F4
- Form 33-109F5
- OSC Staff Notice 33-748 *2017 Annual Summary Report for Dealers, Advisers and Investment Fund Managers*, pages 78-81

2.2.12 Dealer obligation when relying on the offering memorandum exemption (EMD / RD)

On March 8, 2023, amendments to the offering memorandum (**OM**) prospectus exemption came into force. The amendments set out new disclosure requirements for issuers that are engaged in "real estate activities" and issuers that are "collective investment vehicles" when those issuers are preparing an OM, and also include a number of general amendments which are meant to clarify or streamline parts of NI 45-106 or improve disclosure for investors.

These amendments include an appraisal requirement for issuers engaged in real estate activities in certain circumstances and, in Ontario, a requirement for issuers in continuous distribution to amend their OM to include an interim financial report for the issuer's most recently completed six-month period unless the issuer appends an additional certificate to the OM certifying that:

- the OM does not include a misrepresentation when read as of the date of the additional certificate
- there has been no material change in relation to the issuer that is not disclosed in the OM
- when read as of the date of the additional certificate, the OM provides a reasonable purchaser with sufficient information to make an informed investment decision

While these additional disclosure requirements are the responsibility of the issuer, we would like to remind registrants of their role in this process.

Registered dealers should:

- ✓ perform reasonable procedures to ensure that, when distributing securities to clients that are relying on the OM prospectus exemption, including securities of issuers engaged in "real estate activities" or issuers that are "collective investment vehicles", the OM provided to clients contains the required NI 45-106 disclosure, including any additional disclosure required by the March 8, 2023 amendments

Legislative reference and guidance

- NI 45-106, s. 2.9 *Offering memorandum*
- Form 45-106F2 *Offering Memorandum for Non-Qualifying Issuers*
- CSA Notice of Amendments to National Instrument 45-106 Prospectus Exemptions and Changes to Companion Policy 45-106CP Prospectus Exemptions Relating to the Offering Memorandum Prospectus Exemption

2.2.13 Related party receivables in excess working capital (All)

Our reviews of Form 31-103F1 identified a number of firms that include related party receivables as 'current assets' in line 1 of Form 31-103F1. Related party receivables are considered high-risk, especially when the amount is material, and particularly when a registrant is dependent on the related party receivable to meet its excess working capital requirements.

A related party receivable should not be included in a registrant's excess working capital unless the receivable:

- meets the definition of "current asset" as defined in paragraph 66 of the International Accounting Standards 1 Presentation of Financial Statements
- is recoverable and there are indicators that the amount will be collected
- is readily convertible to cash

In our reviews of Form 31-103F1s, we noted firms that did not maintain adequate evidence that these conditions were met. In particular, some firms did not demonstrate that the receivable met the definition of a 'current asset', as there was little or no collection of the receivable amount. When a related party receivable is included in current assets, the receivable should be collected within 12 months. In other cases, we noted that firms did not maintain evidence that the receivable was readily convertible to cash. In our view, unless the receivable can be converted to cash easily, promptly and without difficulty, it should be included on line 2 of Form 31-103F1 (current assets not readily convertible into cash) and excluded from excess working capital.

We also identified instances where the related party receivable included frequently reoccurring transactions. In these instances, we observed repayments by the related party to the firm, which were subsequently followed by additional, sometimes larger, advances to the related party. In our view, the economic substance of these transactions was that the loan obligation was not settled, and the receivable remained uncollected. Frequently reoccurring transactions of this nature, or a firm acting as a line of credit for related parties, raises regulatory concerns and suggests that it is not appropriate to include the receivable in the firm's excess working capital.

Registered firms should:

- ✓ document the terms of any related party receivable included in excess working capital calculations, including the parties involved, the purpose of the loan, dollar amount, interest rate, repayment terms and timeline
- ✓ reevaluate at each reporting period whether the related party receivable should be classified as current or a non-current asset and retain documentation of this reevaluation

- ✓ reassess and retain documentation on the financial viability and solvency of the related party to support whether the receivable is collectible
- ✓ reevaluate and retain documentation to support whether the related party receivable can be readily convertible to cash (e.g. evidence that the loan can be repaid easily, promptly and without difficulty)

Legislative references and guidance

- NI 31-103 and related NI 31-103CP, s. 12.1 *Capital requirements*
- Form 31-103F1
- OSC Staff Notice 33-754 *2022 Summary Report for Dealers Advisers and Investment Fund Managers*, pages 24-25

2.2.14 Capital markets participation fees (All)

During our reviews of filed Form 13-502F4s, we noted that some firms did not apply OSC Rule 13-502 correctly.

a) Deductions for revenue not attributable to capital markets activities

We noted that a number of firms made deductions for revenue they considered not attributable to "capital markets activities" (as defined in OSC Rule 13-502) on line 2 of Form 13-502F4 (**Line 2**). Though, on Line 2, a firm is permitted to deduct certain revenues that are not attributable to capital markets activities, we continue to see firms deducting revenue for activities that may reasonably be considered capital markets activities. Specifically, we noted instances where firms appeared to have incorrectly deducted revenue:

- related to activities generally requiring registration or an exemption from registration, such as mortgage origination or recommending investing options based on an asset allocation
- on the basis that they were related to the provision of corporate advisory, mergers and acquisitions, or investment banking advisory services; these activities may be considered capital markets activities depending on the particular facts and circumstances of the case
- on the basis they were earned outside of Ontario

Some firms were found to have understated their participation fees significantly for several years. These firms were required to refile their Form 13-502F4s and pay the participation fees owed for those years plus late fees.

The purpose of Line 2 is to deduct revenue that is not attributable to capital markets activities. We remind firms that capital markets activities include activities for which registration or an exemption from registration is required. Additionally, the inclusion of a revenue amount is not dependent on where the revenue was earned, or if the related clients are in Ontario.

When a firm includes an amount on Line 2, we expect the firm to have conducted, and also maintain, an analysis as to why the related activities do not require registration or an exemption from registration. This analysis should include a thorough consideration of the legislative references and guidance listed below. If it is unclear why certain revenue has been deducted on Line 2, Staff may reach out to the firm for the firm's analysis supporting the Line 2 deduction(s).

Registered and unregistered capital market participants should:

- ✓ review the definition of capital markets activities in OSC Rule 13-502, as well as the other legislative references and guidance listed below, and assess whether the revenue they plan to deduct on Line 2 are related to capital markets activities
- ✓ maintain comprehensive analysis supporting that the amounts deducted on Line 2 do not relate to capital markets activities
- ✓ deduct revenue on Line 2 only when the revenue does not relate to capital markets activities

Legislative references and guidance

- OSC Rule 13-502, s. 1 *Definitions*
- OSC Rule 13-502, s. 17(2)(a) *Calculating specified Ontario revenues for others*
- OSC Rule 13-502CP, s. 19 *Capital markets activities*
- OSC Rule 45-501CP, s. 3.6 *Soliciting purchasers*
- NI 31-103, Part 8 *Exemptions from the requirement to register*
- NI 31-103CP, s. 1.3 *Fundamental concepts*
- NI 45-106CP, s. 1.6 *Registration business trigger for trading and advising*
- NI 45-106CP, s. 3.2 *Soliciting purchasers – Ontario*
- MI 32-102CP, under *Requirement to register as an investment fund manager* of Part 1 *Fundamental Concepts*
- OSC Staff Notice 33-749 *2018 Annual Summary Report for Dealers, Advisers and Investment Fund Managers*, page 31

b) Incorrect calculation of the Ontario percentage and specified Ontario revenues

We identified some firms that incorrectly calculated their Ontario percentage, which resulted in firms understating specified Ontario revenues and participation fees payable. All firms are required to calculate their Ontario percentage in accordance with OSC Rule 13-502. The definition and meanings of "Ontario percentage" are dependent on whether a firm has a permanent establishment in Ontario, in Ontario and elsewhere, or whether all permanent establishments are outside Ontario. To properly calculate the Ontario percentage, a firm must determine where its permanent establishments are located and apply the prescribed definition and meaning of Ontario percentage.

The term "permanent establishment" is defined by the Canadian Revenue Agency (**CRA**), and so firms should obtain the appropriate tax advice when making this determination.

In our reviews, we noted instances where:

- firms with a permanent establishment only in Ontario calculated their Ontario percentage as the proportion of their total revenues earned from Ontario clients rather than using 100% as their Ontario percentage
- firms with a permanent establishment in Ontario and elsewhere calculated their Ontario percentage as the proportion of their total revenues earned from Ontario clients rather than using the percentage of total taxable income earned in Ontario
- firms without a permanent establishment in Ontario used assets under management, or the volume of debt transactions attributable to Ontario investors rather than the percentage of the total revenues attributable to capital markets activities in Ontario

Registered and unregistered capital market participants should:

- ✓ review the definition of "Ontario percentage" in OSC Rule 13-502 and apply the correct meaning depending on the location of their permanent establishments as defined by the CRA
- ✓ use the prescribed calculation basis of the applicable Ontario percentage definition

Legislative references and guidance

- OSC Rule 13-502 s. 1 *Definitions*
- Income Tax Regulations, s. 400(2) *taxable income earned in the year in a province*

c) Incorrect reporting of total gross revenues for designated financial year

We identified instances where firms:

- incorrectly reported total revenues net of certain expenses in Line 1 of Form 13-502F4
- incorrectly applied either an average exchange rate or an internally derived exchange rate when translating their total revenues to Canadian dollars

Line 1 of Form 13-502F4 reports the sum of all global gross revenues reported on the audited financial statements, except where unaudited financial statements are permitted in accordance with subsection 17(3) of OSC Rule 13-502. Revenue reported on a net basis in the financial statements must be adjusted for purposes of the fee calculation to reflect gross revenues.

Also, if a firm's annual financial statements are denominated in a currency other than Canadian dollars, section 36 of OSC Rule 13-502 requires that all amounts must be converted into Canadian dollars using the daily exchange rate for the last business day preceding its designated financial year end date as posted on the Bank of Canada website.

Registered and unregistered capital market participants should:

- ✓ report the total global gross revenues per their audited or unaudited annual financial statements in Line 1 of Form 13-502F4
- ✓ adjust all revenue reported in Line 1 of Form 13-502F4 to reflect gross revenue
- ✓ use the exchange rate noted in section 36 of OSC Rule 13-502 to translate amounts into Canadian dollars

Legislative reference and guidance

- OSC Rule 13-502, s. 36 *Currency Conversion*

d) Application of changes to OSC Rule 13-502

In last year's Summary Report, firms were reminded that effective April 3, 2023, amendments were made to revise OSC Rule 13-502 that included several changes in respect of participation fees. However, we continued to find firms that:

- calculated their participation fees using the incorrect "designated financial year"
- completed Form 13-502F4 using thousands instead of whole numbers
- used an estimate of their annual financial data to calculate participation fees
- used unaudited annual financial statements to calculate participation fees, despite being registered

Registered and unregistered capital market participants should:

- ✓ review the definitions of designated financial year in OSC Rule 13-502 and use the most recently completed financial year, at the filing due date (November 2nd of each year), to calculate their participation fees
- ✓ report all figures on Form 13-502F4 in whole numbers and not thousands
- ✓ avoid using estimates of their annual financial results to calculate participation fees

Legislative references and guidance

- OSC Rule 13-502, Part 1 *Definitions and Interpretation*

- OSC Rule 13-502, Part 3 *Capital Markets Participation Fees*

2.2.15 Incomplete applications (All)

We have observed a trend of registration applications being filed that are incomplete or have insufficient information.

In particular, new firm applications are being filed with missing or insufficient information required by Form 33-109F6, including with respect to:

- business plans and policies and procedure frameworks (question 3.3 of Form 33-109F6)
- constating documents (question 3.7)
- organization and ownership charts (questions 3.11 and 3.12)
- directors' resolutions approving insurance (question 5.7)
- audited financial statements and letters of direction to auditors (question 5.13)

We have also seen instances where firm applicants delay filing the associated individual applications for their 'mind and management', as well as for key registrants, such as a CCO, DR (required for EMD registration) or an AR (for a new PM firm). Without the concurrent filing of these individual applications with the firm applications, firm applications cannot be approved.

In other instances, the individuals put forward are unsuitable for registration because they lack proficiency and experience. This may lead to the firm withdrawing the applications and putting forward different individuals. These changes, as well as changes in firm business names and business plans, require further checks and reviews, leading to longer processing times.

It is important that applicants file complete applications, as incomplete applications lead to longer processing times and draw staff resources away from applications that are ready to be processed.

Staff will not review registration applications that are incomplete or where not all required supporting information has been provided. Pursuant to section 27 of the Act, all information and material required for a registration application must be provided before an OSC Director can make a decision on registration. Form 33-109F6 states that applicants are required to submit a complete application and must include all supporting documents with their submission. Staff may request that filers withdraw incomplete applications until such time as they are ready to submit a complete application. Incomplete applications are not subject to the OSC Service Commitment for processing registration applications.

We have also seen a trend of insufficient information provided to support relevant investment management experience (**RIME**) for AR registration applications, requiring the Registration Team to follow up for clarification, which in turn leads to longer processing times.

AR registrants must demonstrate a high degree of proficiency and quality RIME as ARs can have discretionary authority over client investments. However, applications are being submitted with vague supporting information, such as:

- descriptions of the firm instead of information specific to the individual
- unclear descriptions of the individual's experience, using phrases such as 'involved in' instead of clear descriptions of the individual's role and what the individual did
- titles that do not match the roles described for these individuals

Some applicants for AR registration are better suited for registration in the AAR or Client Relationship Manager AR categories (**CRM AR**) which have lesser proficiency and experience requirements.

Applicants seeking AR registration should carefully review the instructions for documenting experience requirements found in Form 33-109F4, Schedule F *Proficiency*, Item 8.4 *Relevant securities industry experience*, and provide sufficient detail with their applications, which may include:

- the level of the individual's responsibility
- value of accounts under direct supervision
- number of years of experience in performing securities research and analysis for the purpose of portfolio securities selection, portfolio construction and analysis
- experience in performing client relationship management
- number of years of experience collecting KYC information
- number of years of experience conducting suitability assessments

CSA Staff Notice 31-332 provides guidance on information that may support an application for AR versus AAR. In June 2020, the CSA also put forward a framework for CRM ARs that do not have sufficient stock picking experience required for registration as an AR but who can demonstrate that they have all other proficiencies in addition to client relationship management experience. Firms have since registered CRM ARs to fulfill this role.

Filers with any questions about filing requirements should contact the compliance, registration or legal departments of their sponsoring firm, or visit the National Registration Database (**NRD**) information website at www.nrd-info.ca.

Where there are novel areas of an application, or areas where the requisite supporting information may be unclear, applicants and their advisers should communicate these issues to the Registration Team at the outset of a registration filing, which helps focus the issues in the application and supports efficient processing.

Legislative reference and guidance

- Act, s. 27 *Registration, etc.*
- Form 33-109F4, Schedule F, *Proficiency*, Item 8.4
- Form 33-109F6
- CSA Staff Notice 31-332 *Relevant Investment Management Experience for Advising Representatives and Associate Advising Representatives of Portfolio Managers*
- *Client Relationship Management specialists*, webpage on osc.ca
- OSC Staff Notice 33-752 *2021 Summary Report for Dealers, Advisers and Investment Fund Managers*, pages 12-13
- OSC Staff Notice 33-754 *2022 Summary Report for Dealers, Advisers and Investment Fund Managers*, page 43
- *OSC Service Commitment: Our Service Standards and Timelines*, footnotes 1 and 2

2.2.16 Investment Fund Manager proficiency (IFM)

Regulatory obligations and functions of an IFM differ from those of a PM or EMD, given the activities an IFM is required to carry out regarding an investment fund's operations (e.g. net asset value calculations, fund and trust accounting, recordkeeping, regulatory filings, etc.).

There are instances where staff may have follow-up questions for individuals who are applying to register as UDP and CCO with IFM firms to assess whether they have relevant and sufficient experience to meet the proficiency requirements. These questions are part of our program "Registration as the First Compliance Review" and in furtherance of our gatekeeper function.

Part 3.4 of NI 31-103 is a general proficiency requirement, in addition to the specific education and experience requirements for a CCO and UDP. This Part requires that individual registrants must not perform an activity that requires registration unless the individual has the education, training and experience that a reasonable person would consider necessary to perform the activity competently.

UDP and CCO applicants for registration with IFM firms should provide sufficient detail in their applications regarding their experience with IFM operations. Where applicants are aware of experience gaps, applicants and their advisers should bring issues to the attention of staff at the outset of their applications so that they can be efficiently addressed.

Legislative reference and guidance

- NI 31-103 and related NI 31-103CP, s. 3.4 *Proficiency – initial and ongoing*

2.3 Crypto asset trading platforms registration matters and compliance deficiencies (RD)

2.3.1 Crypto asset trading platform registration applications

2.3.2 Crypto asset trading platform registration inquires and resources

2.3.3 Marketing of crypto asset trading platforms

2.3.4 Conflicts of interest considerations specific to crypto asset trading platforms

2.3.5 Guidance for crypto asset trading platforms that are registered in the category of restricted dealer for an interim period

2.3.6 Mandatory arbitration clauses that are unconscionable and/or contrary to public policy

2.3.1 Crypto asset trading platform registration applications

Filers interested in submitting an application for crypto asset trading platform (**CTP**) registration are encouraged to review recent CTP decisions as they include the terms and conditions to which registered CTPs are typically subject. Recent CTP decisions can be found on the OSC website under Registered crypto asset trading platform.

As described in the 2022 Summary Report, we continue to review CTPs seeking registration as part of the "Registration as the First Compliance Review" process. Firms should refer to the guidance in the 2022 Summary Report as it highlights common issues and provides guidance for CTPs applying for registration in a dealer category.

To facilitate the "Registration as the First Compliance Review" process, applications for CTP dealer registration should be as complete and comprehensive as possible, and include the following detailed information:

Know your client and account appropriateness assessment

- how the firm intends to meet KYC and account appropriateness obligations
- a copy of the account appropriateness questionnaire and messaging used to communicate to clients
- process for applying and monitoring investment limits
- process for determining, applying and monitoring client limits

Know your product

- list of crypto assets that will be made available on the platform, including any value-referenced crypto assets as defined in CSA Staff Notice 21-332 *Crypto Asset Trading Platforms: Pre-Registration Undertakings – Changes to Enhance Canadian Investor Protection*
- whether the firm has or intends to issue its own crypto assets or those of a connected issuer
- process for evaluating whether each crypto asset made available by the platform is a security or a derivative
- process to remove a crypto asset from trading on its platform should the crypto asset be determined to be a security or a derivative
- process to allow clients to liquidate their position in crypto assets that will no longer be made available to clients

Conflicts of interest

- identification of material conflicts of interest and conflicts of interest that are reasonably foreseeable between the firm (including individuals acting on

behalf of the firm) and a client, and how they will be addressed in the best interest of the client

- copies of conflicts of interest disclosure to be provided to clients

Custody

- information on how the firm intends to custody crypto assets and fiat balances of its clients
- for custodians who will be holding clients' crypto assets, how the custodian meets the definition of an "acceptable third-party custodian" in CSA Staff Notice 21-332
- the firm's understanding of the custodian's operations, including how the custodian segregates client assets from other property; the custodian's knowledge and expertise in holding crypto assets; how the custodian safeguards crypto assets; key aspects of the custodian's IT security, cyber resilience, disaster recovery capabilities and business continuity plan; the custodian's insurance coverage over the crypto assets it holds
- explanation of the firm's assessment that client assets held by the custodian will be viewed as property held in trust for the benefit of clients and will not be used to satisfy the custodian's liabilities in the event of an insolvency or bankruptcy of the custodian
- with respect to client crypto assets held by the firm for operational purposes:
    - how the firm intends to hold the crypto assets, including a description of any wallets developed by third-party service providers
    - what steps the firm has taken to ensure custodial risks with respect to client assets custodied for operational purposes are appropriately managed and mitigated, including whether the firm holds client crypto assets separate and apart from the firm's own property (e.g. client crypto assets are stored in a separate wallet than the firm's wallet) and designates such property to be that of its clients
    - proficiency and experience of the firm to hold crypto assets
    - the firm's practices to safeguard the crypto assets, including the safeguarding of private keys and the controls governing key generation, key storage, seed back-up and key access
    - the firm's practices to mitigate risks relating to security breaches and cyber incidents
    - the firm's IT security, cyber resilience, disaster recovery capabilities and business continuity plan
    - the firm's insurance coverage over the crypto assets it holds directly, including insurance coverage in respect of cybercrime

2.3.2 Crypto asset trading platform registration inquiries and resources

We receive inquiries regarding applications for registration and related relief from firms that propose to operate a CTP.

A frequent inquiry relates to whether firms claiming to provide immediate delivery of crypto assets (as outlined in CSA Staff Notice 21-327) need to be registered and require related exemptive relief.

Some firms claim that they are not subject to securities legislation as they currently provide or propose to provide immediate delivery of crypto assets, as outlined in CSA Staff Notice 21-327. One rationale provided to support this position is that the firm engages in payment-services activities that facilitate users sending a crypto asset, including a value-referenced crypto asset, to the platform solely to have the crypto asset converted to fiat.

The definition of "security" in subsection 1(1) of the Act is broad and includes both "evidence of indebtedness" and "any investment contract". The guidance in CSA Staff Notice 21-327 explains that a transaction involving a crypto asset may be subject to securities legislation if the transaction does not result in an obligation to make and take delivery of the crypto asset immediately following the transaction. We generally will consider immediate delivery to have occurred if:

- the platform immediately transfers ownership, possession, and control of the crypto asset to the platform's user, and the user is free to use, or otherwise deal with, the crypto asset without further involvement with or reliance on the firm or its affiliates, and without the firm or any affiliate retaining any security interest or any other legal right to the crypto asset
- following the immediate delivery of the crypto asset, the platform's user is not exposed to insolvency risk (credit risk), fraud risk, performance risk or proficiency risk on the part of the firm

In many instances, firms claiming to make immediate delivery of crypto assets do not immediately transfer ownership, possession, and control of the crypto asset to the platform's user. Platforms often provide a wallet functionality, which in some cases includes a software or hardware developed or offered by the firm or its affiliate, exposing users to insolvency, fraud, performance or proficiency risk, and resulting in clients not having the sole ownership, possession and control of the wallet.

Assessing whether immediate delivery of crypto assets is provided to platform users is dependent on several factors, including:

- how long a typical transaction would take
- when trades would be posted to the blockchain

- how long the platform or the firm's affiliate would hold onto client assets, including crypto assets and fiat
- following the confirmation or trade, how long it would take for the platform to send the crypto assets to the client's wallet address
- percentage of transactions where immediate delivery is made on the platform
- how the firm ensures it has sufficient crypto asset and fiat currency balances in its inventory to fill client trades

For an overview of who needs to consider registration, exemptions from registration, explanation of registration categories, as well as the initial registration requirements for firms and individuals, the following resources are available:

- Getting registered, webpage on osc.ca
- Amendments to OSC Rule 13-502 Fees, OSC Rule 13-503 (Commodity Futures Act) Fees, Changes to their Companion Policies and Related Consequential Amendments and Changes
- CSA Staff Notice 46-307 *Cryptocurrency Offerings*
- CSA Staff Notice 21-327 *Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets*
- Joint CSA/IIROC Staff Notice 21-329 *Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements*
- CSA Staff Notice 21-332 *Pre-Registration Undertakings – Changes to Enhance Canadian Investor Protection*
- CSA Staff Notice 21-333 *Crypto Asset Trading Platforms: Terms and Conditions for Trading Value-Referenced Crypto Assets with Clients*

A money service business license from Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) does not indicate that a firm is registered for the purposes of Ontario securities law. See Example #1 in Appendix A in Joint CSA/IIROC Staff Notice 21-330 *Guidance for Crypto-Trading Platforms - Requirements relating to Advertising, Marketing and Social Media Use*.

It is important to consult with Canadian securities law counsel to discuss whether your firm's current or proposed activities require registration under Ontario securities law or the similar requirements of the other jurisdictions in Canada.

2.3.3 Marketing of crypto asset trading platforms

Joint CSA/IIROC Staff Notice 21-330 provides advertising and marketing guidance to CTPs. Additional guidance was also provided in the 2022 Summary Report, based on findings in relation to advertising, marketing, and use of social media from our pre-registration reviews of CTPs.

We continue to raise comments and concerns with CTPs' advertising and marketing practices, and their use of social media.

a) Misleading, incorrect, or false statements and unsubstantiated claims

Some CTPs created and posted lists on their websites where they ranked themselves in comparison to other CTPs. This was done without consent from those other CTPs and without evidence to substantiate the claims made on how one CTP was ranked as better than another CTP. We also identified misleading statements in these ranking lists as there was inadequate disclosure about the affiliation between CTPs that created the list and those that ranked highly on the list.

b) Improper use of logos and trademarks

We noted instances where registered CTPs used the OSC logo in their advertising and marketing. The inclusion of the OSC's logo may imply that we have passed on the financial standing, fitness or conduct of a registrant, which is a prohibited representation pursuant to section 46 of the Act.

c) Concerns over improper "gambling style" promotions and schemes

We noted instances where CTPs held contests encouraging users to perform transactions to win crypto assets. We also identified statements CTPs made in social media posts which conveyed or implied a recommendation to purchase or hold crypto assets to users, and encouraged users to engage in trading and to act quickly for fear of missing out on an investment opportunity.

Joint CSA/IIROC Staff Notice 21-330 reminds CTPs that there are concerns with using advertising or marketing strategies that include contests, promotions, bonuses and time-limits to encourage investors to engage in trading and to act quickly for fear of missing out on an investment opportunity or a reward. Some of these strategies may encourage investors to engage in excessively risky trading, taking on risks that they would normally avoid.

Advertising and marketing strategies designed to encourage trading may be considered a form of solicitation or invitation to trade, triggering suitability obligations for registered CTPs, pursuant to section 13.3 of NI 31-103. These suitability obligations can apply to recommendations relating to overall trading strategies as well as individual securities. CTPs that rely on or will seek to rely on an exemption from suitability on the condition that they do not provide recommendations or advice must verify that they are not actively soliciting trading through advertising in a manner inconsistent with the conditions of their exemption.

Registered CTP dealers and CTP dealer applicants should:

- ✓ only make accurate statements in advertisements that can be substantiated
- ✓ provide adequate context and reference to the information supporting advertising claims, including third-party identification of sources

- ✓ refrain from including regulator logos in marketing materials
- ✓ obtain written authorization from other registrants if the firm chooses to use the name of another registrant
- ✓ avoid "gambling style" promotions and schemes

Legislative reference and guidance

- Act, s. 43 *Use of name of another registrant*
- Act, s. 46 *Prohibited representation re Commission approval*
- OSC Rule 31-505, s. 2.1(1) *General Duties*
- Joint CSA/IIROC Staff Notice 21-330 *Guidance for Crypto-Trading Platforms: Requirements relating to Advertising, Marketing and Social Media Use*
- OSC Staff Notice 33-754 *2022 Summary Report for Dealers, Advisers and Investment Fund Managers*, pages 32-33
- Digital Engagement Practices: *Dark Patterns in Retail Investing*

2.3.4 Conflicts of interest considerations specific to crypto asset trading platforms

Staff conducted a desk review of six registered CTPs, for which the OSC is principal regulator, to understand key practices and controls around custody arrangements for clients' crypto assets, corporate governance structures, insurance bonding policies and management of conflicts of interest. Guidance on custody arrangements and corporate governance structures was provided in last year's Summary Report.

With respect to conflicts of interest, we noted instances where CTPs did not:

- identify existing material conflicts of interest, or material conflicts of interest that were reasonably foreseeable
- address material conflicts of interest in the best interest of the client
- disclose all material conflicts of interest to clients or the disclosure did not comply with the requirements of subsection 13.4(5) of NI 31-103

Most CTPs identified a limited number of material conflicts of interest. Based on our understanding of the crypto asset sector and CTPs' operations, we are of the view that there are additional conflicts of interest that may be common to all CTPs, which should be identified and appropriately addressed, including:

- employee outside business activities, including any involvement with crypto asset issuer or development (e.g. any compensation received and services provided)
- employee personal trading activities and use of proprietary or confidential information

- referral arrangements with other service providers or affiliates
- fees or compensation earned from buying and selling of crypto assets, including crypto assets held by the CTP as its inventory for resale (as counterparty)
- relationships with related entities, particularly those also involved in the distribution (trading) or handling of crypto assets
- issuance and trading in proprietary crypto assets or related/connected issuer crypto assets
- handling of airdrops derived from client asset holdings held in trust on behalf of clients
- pricing of crypto assets on platform, including any fees and spreads earned on trades

A CTP should assess the materiality of each conflict of interest raised by its specific circumstances and determine how the conflict will be addressed in the best interest of its clients. While disclosure of material conflicts of interest on its own is insufficient to address those conflicts, material conflicts of interest must be disclosed to clients whose interests are affected by those conflicts of interest if a reasonable client of the CTP would expect to be informed of them.

Registered CTP dealers and CTP dealer applicants should:

- ✓ identify existing and reasonably foreseeable material conflicts of interest that are relevant to the CTP's operation
- ✓ develop policies and procedures and internal controls to address material conflicts in the best interest of the client
- ✓ maintain records to demonstrate the CTP's assessment of material conflicts of interest, the conflicts of interest which are managed through avoidance, and the controls implemented to address material conflicts of interest that are not avoided
- ✓ provide adequate training to employees on the CTP's conflicts of interest policies and procedures
- ✓ provide disclosure to clients that is prominent, specific, and written in plain language regarding material conflicts of interest at a time and manner that will be meaningful for a reasonable client

Legislative reference and guidance:

- NI 31-103 and related NI 31-103CP, s. 13.4 *Identifying, addressing and disclosing material conflicts of interest – registered firm*
- NI 31-103 and related NI 31-103CP, s. 13.4.1 *Identifying, reporting and addressing material conflicts of interest – registered individual*

- Joint CSA/CIRO Staff Notice 31-363 *Client Focused Reforms: Review of Registrants' Conflict of Interest Practices and Additional Guidance*
- OSC Staff Notice 33-754 *2022 Summary Report for Dealers, Advisers and Investment Fund Managers*, pages 33-34
- Client Focused Reforms - Frequently Asked Questions (updated December 6, 2023)

2.3.5 Guidance for crypto asset trading platforms that are registered in the category of restricted dealer for an interim period

In addition to the extensive review process that CTPs undertake before becoming registered with the CSA for an interim period as a RD, CTPs that subsequently apply for CIRO membership should expect to undergo an extensive review with respect to CIRO's financial and operations compliance, business conduct compliance, trading conduct compliance, and registration requirements.

Firms are encouraged to review CIRO rules (specifically, the Investment Dealer and Partially Consolidated Rules (IDPC Rules)) to adequately prepare for the membership application process and ensure that the application moves forward in an efficient manner. Many of those rules will be new for CTPs, including those registered as RDs. For example:

- CIRO's capital requirements differ from capital requirements for RDs
- CIRO has specific rules regarding a Dealer Member's system of books and records (refer to IDPC Rule 3800) and proper segregation and custody of client assets (refer to IDPC Rule 4300)
- Applicants need to engage an auditor approved by CIRO well in advance of applying for CIRO membership to leave sufficient time to obtain audited financial statements and other auditor reporting that are required as part of the CTP's application for CIRO membership (refer to subsections 4171(1) and 4172(1) of IDPC Rules)
- CIRO has specific rules regarding the proficiency and experience of Approved Persons, which may differ from the proficiency and experience requirements of individual registrants at a restricted dealer (refer to IDPC Rule 2602)

CTPs are encouraged to refer to the Becoming a Dealer Member section of CIRO's website for guidance and materials on applying for CIRO membership. CTPs can also arrange for a pre-filing discussion with CIRO staff by contacting MembershipCoordinator@ciro.ca.

2.3.6 Mandatory arbitration clauses that are unconscionable and/or contrary to public policy

Some firms seeking registration to operate a CTP have standard terms of use or service (**Terms of Use**) clauses that restrict the client's ability to take legal action against the firm if they have a dispute with the firm. These clauses may require the

client to use mandatory arbitration, often in a foreign jurisdiction and in accordance with the rules of a foreign arbitration regime.

Mandatory arbitration clauses included in CTP standard Terms of Use have been found to be unenforceable and void by courts in Ontario[8] and the United Kingdom[9] on the grounds that they are contrary to public policy and unconscionable. Staff takes the view that the use of mandatory arbitration clauses may constitute a breach of the obligation to deal fairly, honestly and in good faith with clients set out in section 2.1 of OSC Rule 31-505.

The use of mandatory arbitration clauses does not in any way lessen a registrant's obligation to make dispute resolution services available to clients under section 13.16 of NI 31-103, regardless of whether or not the clauses are drafted in a manner consistent with the obligation to deal fairly, honestly and in good faith with clients.

[8] See Lochan. v. Binance Holdings Limited, 2023 ONSC 6714 (CanLII)

[9] See Payward Inc., Payward Ventures, Inc., and Payward Limited v. Maxim Chechetkin [2023] EWHC 1780 (Comm)

Part 3: Initiatives impacting registrants

3.1 2024 Risk Assessment Questionnaire

3.2 Dual registered firms

3.3 Voluntary surrenders of registration

3.4 Ombudsman for Banking Services and Investments authority to issue binding decisions

3.5 Proprietary trading (day-trading) firms

3.6 Exemption to allow Exempt Market Dealer participation in selling groups in offerings of securities under a prospectus

3.7 Fee rule amendments to OSC Rule 13-502

3.8 OSC TestLab initiatives

3.1 2024 Risk Assessment Questionnaire

In May 2024, firms registered with the OSC in the categories of IFM, PM, RPM, EMD and RD were asked to complete the 2024 RAQ, which consisted of questions covering various business operations related to the different registration categories. The RAQ is a fundamental component of our risk-based approach used to select firms for compliance or targeted reviews.

Each response in the RAQ is assigned a risk score which is aggregated up to the firm level. This identifies firms whose business activities we perceive to be of higher risk. This aggregate risk score is an input in determining whether a firm will be recommended for a compliance review. In addition, responses to the RAQ are aggregated based on areas of interest and firms are selected for review based on their responses to questions in these areas of interest.

We have enhanced the RAQ process based on feedback received. This year, we launched a new Microsoft-based platform that is dynamic, includes greater functionality (for example, there is a delegation function for firms to add employees, other than the CCO and UDP, to the platform to assist with completing the RAQ) and incorporates a new single sign-on solution with two-factor authentication.

Similar to prior years, the new platform pre-populates certain non-financial information in the RAQ with a firm's previous responses and enhances security by requiring both the firm's CCO and UDP to each create their own unique account in our system to access the 2024 RAQ.

3.2 Dual registered firms

In 2023, the OSC worked with CIRO and the CSA to establish a new registration process to enable firms to become registered as both an investment dealer and a mutual fund dealer (a dual registered firm). The OSC registered five dual registered firms this fiscal year and continues to work with firms that have expressed an interest in seeking dual registration.

The OSC also worked with CIRO and the CSA to publish the Dual Registered Firm Guide, which was updated on August 17, 2023, to assist existing firms and new applicants seeking dual registration. The guide outlines steps required for dual registration in three scenarios: (a) new firm applicants; (b) firms with one registration adding another registration (i.e. an existing ID or MFD that would like to add the other registration category); and (c) firms combining operations (i.e. an existing ID and MFD).

Dual registration is a two-part process. Firms must submit a membership application or the 'Dual-Registration Questionnaire' and supporting documents to CIRO; and a Form 33-109F6 or Form 33-109F5 with supporting documents to its principal regulator.

If operations of an existing ID and MFD are combined through a share or asset acquisition, a section 11.9 or 11.10 notice filing under NI 31-103 may be required depending on the structure of the transaction. If the firms do not combine via amalgamation and one of the firms will cease to exist or no longer require registration, a surrender of registration application must be submitted to the firm's principal regulator.

3.3 Voluntary surrenders of registration

Numerous firms have submitted applications to surrender their registration very late in the calendar year.

Voluntary surrender applications should be submitted well in advance of the cutoff date the OSC publishes in our annual email blast regarding *Capital Markets Participation Fees and Related Matters*. See Email Blast – 2023 Capital Markets Participation Fees and Related Matters (including a new Fee Form filing deadline) – Action Items.

Any applications received after the cutoff date may not be processed in time for the firm to be excluded from the capital markets participation fees which become due in January of the following calendar year, and therefore the firm would be responsible for the payment of these fees.

Firms are reminded that we will not process voluntary surrender applications that are incomplete, and that we are unable to recommend suspension or termination of registration where a firm has not yet certified and evidenced that it has ceased conducting registerable activities. Guidance on the voluntary surrender process is set out in the OSC's Guide to Completing and Filing a Voluntary Surrender Application on our website.

3.4 Ombudsman for Banking Services and Investments authority to issue binding decisions

On November 30, 2023, the CSA Notice and Request for Comment – *Registered Firm Requirements Pertaining to an Independent Dispute Resolution Service* was published regarding a proposed regulatory framework for a designated or recognized independent dispute resolution service that would have the authority to issue binding final decisions. Under the proposed framework, it is expected that the Ombudsman for Banking Services and Investments (OBSI) would be the designated or recognized independent dispute resolution service for the investment industry, and would be subject to coordinated oversight by CSA jurisdictions.

As part of the proposed framework, all CSA members except the British Columbia Securities Commission published proposed rule amendments to complaint handling provisions in NI 31-103 and changes to NI 31-103CP for a 90-day comment period which ended on February 28, 2024. The CSA received 42 comment letters from a

range of respondents including industry groups, investor representatives and professional associations.

The CSA is reviewing comments received in response to the consultation and preparing recommendations for next steps.

3.5 Proprietary trading (day-trading) firms

From time to time, we have considered the situation of market participants that, although not dealers in the traditional sense, nevertheless appear to be trading securities with regularity and for a business purpose. In these cases, we assess whether the entity may reasonably be considered "in the business" of trading securities or holding themselves out as such and therefore subject to the dealer registration requirements under the Act. As explained in section 1.3 of NI 31-103CP, this test is commonly referred to as the "business trigger" for registration.

To assess whether an entity meets the business trigger for registration as a dealer, we first consider whether the entity engages in activities that may be considered a "trade" as defined in subsection 1(1) of the Act. The definition of "trade" is broad and includes "any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of" a trade.

We then consider whether the entity may be considered to engage in such activities with regularity and for a business purpose in accordance with the guidance in section 1.3 of NI 31-103CP and applicable caselaw. We also consider whether any exemptions from registration may be available for the conduct of such registerable activities.

A firm describing itself as a proprietary trading firm offering day-trading services to its clients in Canada and around the world was recently registered as an investment dealer and accepted as a dealer member of CIRO.[10]

These types of day-trading firms typically:

- advertise that they can provide access to capital, training materials, trading software and administrative and management services to allow their clients to engage in electronic day trading on equity marketplaces in Canada and worldwide
- generally have an omnibus trading account in their own name with an investment dealer in Canada and similar accounts with broker-dealers in foreign jurisdictions and will then provide direct electronic access to these trading accounts to their clients

[10] There are a number of investment dealer/CIRO dealer members that operate as "proprietary trading firms". See page 2 of the following link: https://www.iiroc.ca/sites/default/files/2022-04/List-of-IIROC-Dealer-Members-by-Peer-Group-April-2022-en.pdf.

- may have a large number of unregistered day-trading representatives located in Canada and/or in foreign jurisdictions all purporting to trade the firm's capital through the firm's direct electronic access account with the investment dealer or other broker-dealer

A regulatory consideration for this trading model is the ability of the firm, and investment dealers providing electronic access to the firm, to monitor and take reasonable steps to prevent improper trading, including spoofing, layering, wash trading.

Terms and conditions were placed on this firm's registration and membership to ensure appropriate monitoring of all trading-related activity. The firm was required to have a supervision system reasonably designed to prevent and detect orders or trades that may interfere with market integrity or fair and orderly markets. With registration, persons and companies in the business of trading must also meet prescribed standards of integrity, proficiency and solvency, and comply with requirements applicable to registered dealers.

Staff have been of the view that the registration exemption in section 8.5 of NI 31-103 is not available to such day-trading firms or representatives of the day-trading firm who trade through the firm's account, and that an unregistered arrangement is inconsistent with the framework for "direct electronic access" arrangements set out in NI 23-103. In other words, entities purporting to rely on an exemption from the dealer registration requirement ought not have electronic access to marketplaces unless the firm is registered as an investment dealer and subject to regulatory oversight by CIRO[11].

A matter is currently before the Capital Markets Tribunal regarding a day-trading firm that has remained unregistered.

3.6 Exemption to allow Exempt Market Dealer participation in selling groups in offerings of securities under a prospectus

EMDs play an important role in supporting early-stage, small- and medium-sized businesses by raising capital for them. As the businesses grow and mature, they may seek financing through the distribution of their securities under a prospectus. When that occurs, EMDs are often unable to continue to support these businesses as EMDs are limited under paragraph 7.1(2)(d) of NI 31-103 to acting in respect of distributions of securities under a prospectus exemption. In particular, EMDs are not able to participate as a member of a selling group in prospectus offerings.

Generally, the appropriate dealer registration category for dealers participating in distributions of securities under a prospectus is the investment dealer category.

[11] Subsection 4.2(2) of NI 23-103CP.

However, allowing EMDs to participate as a member of a selling group in prospectus offerings may:

- allow EMDs to build and maintain their relationships with these businesses and support these businesses' capital needs throughout their lifecycles
- make additional channels of potential sources of capital available to early-stage, small- and medium-sized businesses
- provide investors with additional investment opportunities

On June 20, 2024, the OSC made Ontario Coordinated Blanket Order 31-930 *Exemption to allow Exempt Market Dealer Participation in Selling Groups in Offerings of Securities under a Prospectus* (**Blanket Order 31-930**), which provides an exemption from the restriction on the activities an EMD is permitted to undertake. An EMD may act as a member of a selling group in the distribution of securities under a prospectus, provided the terms and conditions of Blanket Order 31-930 are met. These terms and conditions include:

- the EMD acts in accordance with the terms of the selling group agreement
- the EMD acts as a dealer only to a person or company in respect of whom an exemption from the prospectus requirement would be available if the distribution of securities had been made under an exemption from the prospectus requirement
- the EMD does not act as an underwriter in connection with the distribution of the securities under the prospectus and limits its interest in the transaction in accordance with paragraph (a) of the definition of "underwriter" in the Act
- the total compensation to the EMD does not exceed 50% of the lowest total compensation paid or payable to any selling group member that is an investment dealer

Blanket Order 31-930 is a CSA coordinated blanket order. A number of other jurisdictions also issued a similar blanket order as the OSC. For additional details on Blanket Order 31-930, please see CSA Notice Regarding Coordinated Blanket Order 31-930 *Exemption to allow Exempt Market Dealer Participation in Selling Groups in Offerings of Securities under a Prospectus*.

EMDs that intend to rely on Blanket Order 31-930 are required under NI 33-109 to report a change in business activity by filing a Form 33-109F5 indicating that they will be participating as a member of selling groups in prospectus offerings.

3.7 Fee rule amendments to OSC Rule 13-502

On July 2, 2024, certain amendments to OSC Rule 13-502 (**the Fee Rule**) came into effect. The amendments introduced two additional fees applicable to restricted dealers:

- an additional fee of $24,500 at the time of OSC registration; and
- if applicable, an additional exemptive relief application fee of $24,500 for restricted dealers operating as a marketplace.

The fees reflect the additional work that is required to assess the appropriate regulatory framework considering business models that are complex, as typically seen with most restricted dealers. There is no change to the annual participation fees paid by restricted dealers.

The amendments also include a change to the definition of "registrant firm" in both the Fee Rule and OSC Rule 13-503. The definition now includes "a person or company registered *or required to be registered*". Accordingly, any unregistered firm that participates in Ontario's capital markets in non-compliance with the relevant dealer, adviser or investment fund manager registration requirements in either the Act or the Commodity Futures Act, will be held responsible for paying participation fees.

3.8 OSC TestLab initiatives

In May 2024, the OSC announced a set of initiatives that are aimed at supporting early-stage capital raising with appropriate investor protections. The initiatives are part of the OSC TestLab program. OSC TestLab is an OSC program that uses testing to accelerate the evaluation of capital market innovations and new approaches to regulation that advance responsible innovation in Ontario's capital markets and economic growth for Ontario.

These initiatives are:

a) Ontario Instrument 32-508 *Not-for-profit Angel Investor Group Registration Exemption (Interim Class Order)* (the **Angel Investor Group Registration Exemption**) – a time-limited dealer registration exemption for not-for-profit angel investor groups that bring together angel investors and introduce them to Ontario early-stage businesses that are seeking capital

b) Ontario Instrument 32-509 *Early-Stage Business Registration Exemption (Interim Class Order)* (the **Early-Stage Business Registration Exemption**) – a time-limited dealer registration exemption for eligible early-stage businesses:

   - to engage in permitted advertising of their capital needs and to engage in limited (up to $3 million) capital-raising from accredited investors and self-certified investors without engaging a dealer
   - to raise capital through an EMD, a not-for-profit angel investor group relying on the Angel Investor Group Registration Exemption, or a crowdfunding funding portal

c) *OSC Rule 45-508 Extension to Ontario Instrument 45-507 Self-Certified Investor Prospectus Exemption* – a rule that extends Ontario Instrument 45-507 *Self-Certified Investor Prospectus Exemption (Interim Class Order)* (**the Self-Certified Investor Prospectus Exemption**) for an additional 18-month period

d) a streamlined form for reporting distributions made by early-stage businesses relying on the Self-Certified Investor Prospectus Exemption (as set out in Ontario Instrument 45-509 *Report of Distributions under the Self-Certified Investor Prospectus Exemption (Interim Class Order)*) or relying on the Early-Stage Business Registration Exemption

e) a campaign by the staff to businesses, investors, industry groups and other key stakeholders to raise awareness, provide resources and reduce information barriers

Details regarding these exemptions and the terms and conditions to be satisfied may be found here. More information may also be found in the Frequently Asked Questions at OSC TestLab: Early-Stage Capital.

OSC staff will be collecting data on the use of the exemptions and will be contacting businesses, investors and other key stakeholders in the early-stage capital raising ecosystem in Ontario for their perspectives as part of the OSC TestLab Initiatives. The data and information collected will be used by OSC staff to evaluate the OSC TestLab Initiatives and consider future policymaking. For inquiries on this matter, registrants can reach out to the OSC Innovation Office.

Part 4: Acting on registrant misconduct

4.1 Annual trends and highlights

4.2 Prompt and effective regulatory action

4.3 Regulatory responses to failure to comply with working capital or audited financial statement requirements

4.4 Failure by registered individuals and applicants to be truthful with sponsoring firms

4.5 Director's decisions and settlements

4.1 Annual trends and highlights

The Registrant Conduct Team 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.

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

Identifying and acting on registrant misconduct

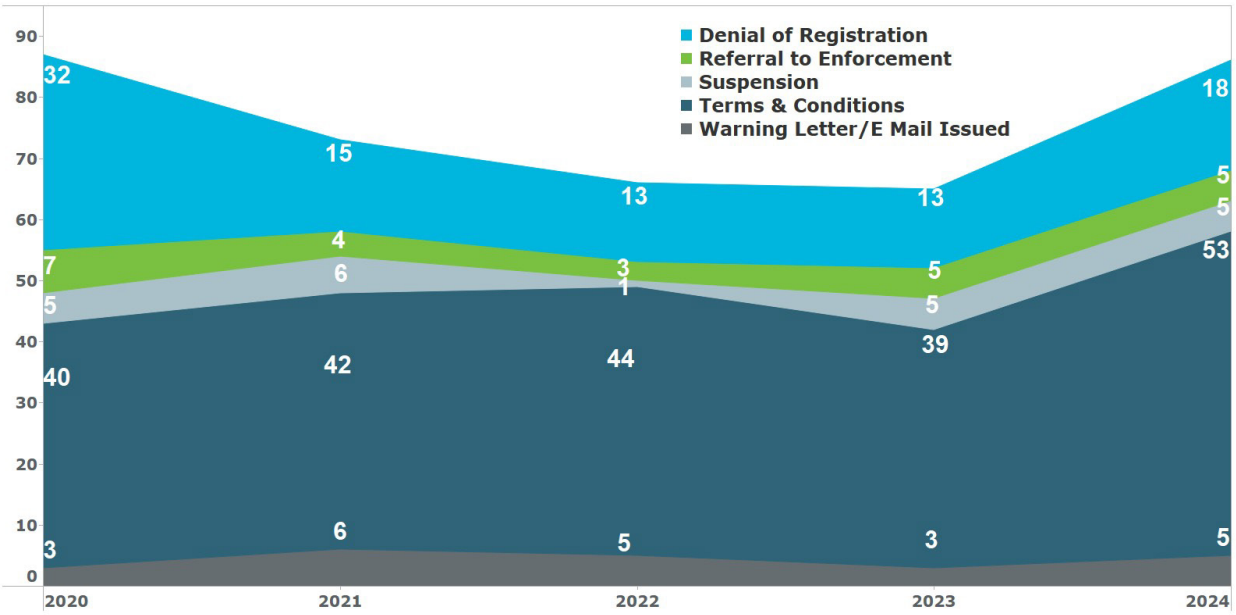
Potential registrant misconduct is identified through compliance reviews, applications for registration, disclosures on NRD, complaints, inquiries, referrals or tips. Acting on registrant misconduct matters is central to effective compliance oversight and promotes confidence in Ontario's capital markets. Registrants must remain alert and monitor for potential misconduct by implementing appropriate policies and procedures and ensuring that controls are in place to detect and address instances of misconduct.

The Registrant Conduct Team is responsible for overseeing terms and conditions on registered firms and individuals as a result of a regulatory decision, including a Director's decision or Tribunal Order. For registered firms, terms and conditions might require them to engage an independent compliance consultant or restrict business activity that is not compliant while remediation takes place. Terms and conditions might also require specific reporting by registered firms to the OSC.

Where there appear to be issues with an application that could bear on an individual's suitability for registration, such as past misconduct or misleading information given in the application itself, the file may be referred by the Registration Team to the Registrant Conduct Team for further investigation, requiring a longer review time. Each phase in the registration process when applications transition from the Registration Team to the Registrant Conduct Team are illustrated in this process chart.

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

Regulatory actions for fiscal year end 2020 - 2024[12]



The chart shows that actions were taken across the compliance-enforcement continuum. The Director can impose terms and conditions, deny registration, and suspend or revoke registration in the event of serious non-compliance, depending on the facts at issue.

Compared to the previous fiscal year, the Registrant Conduct Team imposed terms and conditions and denied registration more frequently. In part, this is because a number of previously undisclosed reportable events came to light as firms completed their filing updates required by the amendments to NI 33-109. We also took action in response to an increased number of matters in which individuals were not truthful or cooperative with their former sponsoring firms (see 4.4 - *Failure by registered individuals and applicants to be truthful with sponsoring firms* discussed below).

Sponsoring firms can expect applications made using the amended registration application forms that do not disclose solvency events to be taken out of the ordinary course and be subject to in-depth review by the Registrant Conduct Team. Similarly, the Registrant Conduct Team will conduct an in-depth review of applications or current registrants when the individual fails to disclose any criminal convictions or charges, as required. Additionally, even if criminal convictions or charges are appropriately disclosed, we may consider whether certain criminal charges or convictions bear on the integrity of an applicant or registered individual. For example, some *Criminal Code* offences relate to dishonest conduct, such as theft, fraud, identity theft, perjury or forgery. Other offences might reflect

[12] Figures for 2020 have been revised to correctly include the regulatory actions for the 2019–2020 fiscal year.

disregard for court orders, such as failure to comply with recognizance, breaching an undertaking or driving while disqualified.

Although the most common concern with individual applicants and registrants is non-disclosure of material information, a significant number of files were based on dismissals for cause or other identified misconduct by individuals while registered with former sponsoring firms. In these cases, we will make inquiries of both the applicant and the former sponsoring firm to determine whether the identified conduct bears on the applicant's suitability for registration. Typically, we will conduct an interview of the applicant before making a recommendation. The timely co-operation of registered firms in these investigations is vitally important.

Referrals are made to Enforcement in cases where the appropriate tool is a power that can only be exercised by the Tribunal. In fiscal 2023-2024, there were five referrals to Enforcement.

4.2 Prompt and effective regulatory action

We will recommend that terms and conditions be placed on the registration of a firm with an inadequate compliance system, a large number of significant compliance deficiencies, or supervision and control deficiencies that result in undue risk or harm for investors. While these situations do not rise to the level of recommending that a firm's registration be suspended, terms and conditions are needed to protect investors and remediate identified compliance deficiencies. The terms and conditions may require the firm to engage a compliance consultant to develop a comprehensive plan to address the deficiencies, require the firm to engage a monitor to review their business activities, or impose business restrictions which typically remain in place until the compliance deficiencies are addressed.

This past fiscal year, we imposed terms and conditions on several firms designed to address novel and complex compliance deficiencies. These terms and conditions were drafted to increase the likelihood of compliance remediation to the benefit of present and future clients of the firm, while promoting fairness in the capital markets.

Three cases of novel or complex terms and conditions imposed on consent were:

Case 1

A PM firm was found to have an inadequate compliance system and many other significant compliance deficiencies in its operations. The firm's business model involves individuals formerly registered with CIRO dealer members joining the firm (some in an unregistered capacity) by forming corporations through which these individuals hold their interest in the firm. Some of the firm's unregistered individuals (who had brought over their clients to the firm from their former CIRO firms) provided registerable advising services to clients after they opened managed accounts at the firm.

The firm substantially outsourced its compliance functions, as well as its trading function, accounting and back-office services to its unregistered affiliated service provider. The firm did not adequately oversee the service provider. Further, the firm did not maintain its own independent records of its clients' cash and security holdings.

Terms and conditions were imposed on the firm requiring it to engage a compliance consultant to foster an effective compliance system, to assess the firm's arrangement with the service provider, including the substantial outsourcing of its compliance function and the UDP's and CCO's employment with the service provider, and to develop recommendations in a compliance plan to address all identified deficiencies. The compliance plan was to include recommendations for the effective oversight of the service provider if the arrangement continued, to ensure that all of the firm's registerable activities are performed by the firm and its registered individuals, and that the firm maintains its own records for its clients' cash and security positions that are regularly reconciled to the clients' custodian's records.

A monitor was also required to be engaged to approve new clients, assess if an AR or AAR was advising the new clients, and assess if clients understood who their AR or AAR was and that any non-registered client-facing individuals could not provide them with registerable advising services. The Registrant Conduct Team also imposed business restrictions, on consent, to otherwise limit the firm's growth until substantial remediation was completed.

Case 2

A PM firm was found to have an inadequate compliance system and many other significant compliance deficiencies in its operations. The firm's business model is to recruit and pay former representatives of CIRO dealer member firms to join the firm and to bring over their clients to the firm's managed account platform. In many cases, these individuals were not proficient to be registered as an AR or AAR with the firm, but continued to provide services to the clients, such as financial planning, but also registerable advising activities.

Terms and conditions were imposed on the firm requiring it to engage a compliance consultant to assess the firm's business model and practices, and to develop recommendations in a compliance plan to rectify all identified deficiencies. This included enhancing the firm's compliance system and addressing the conflicts of interest from paying recruitment fees, the use of different client fee schedules when clients receive similar investments and services, and to make clients aware of all services covered by their fees, such as financial planning. The compliance plan is also required to include recommendations on the steps that the firm is to take so that there would be:

- an adequate number of AR and AARs to service the firm's clients
- enhanced supervision of each AAR by an AR
- clear disclosure to clients of who their AR or AAR is (and the roles of any client-facing non-registered individuals)
- proper documentation of client discussions and suitability determinations
- effective procedures in place to ensure that all of the firm's registerable activities are performed by ARs or AARs

In addition, the firm was required to engage a monitor to approve new clients and assess if an AR or AAR was servicing the new clients. Business restrictions were also imposed to otherwise limit the firm's growth until substantial remediation was completed.

Case 3

An IFM/PM firm was found to have many significant compliance deficiencies in its operations, including some that could potentially require reimbursement to its investment funds or clients. The firm decided to wind down its investment funds and close its clients' accounts rather than remediating its deficiencies.

Before allowing the firm to wind down its investment funds, close its client accounts, and surrender its registrations, we imposed terms and conditions on the firm. The terms and conditions restricted the firm from performing registerable activities other than as necessary to address certain deficiencies that potentially required the firm to return money to its investment funds or clients, and for its wind-down and closure activities. This is consistent with the surrender of registration requirements in subsection 30(1) of the Act for all financial obligations to clients to be discharged.

The terms and conditions also require the firm to engage a compliance consultant to develop a plan for the firm to remediate certain deficiencies, including any repayment to the investment funds or clients, and for the firm to notify its clients and service providers of the terms and conditions. Then, upon the satisfactory implementation of the plan, the firm is to wind down its investment funds and close its accounts. Once the wind down and account closures are complete, the firm's registrations are to be suspended.

4.3 Regulatory responses to failure to comply with working capital or audited financial statement requirements

We have developed an enhanced process for when registered firms are late in delivering annual or interim financial filings required by Ontario securities law or are experiencing unresolved capital deficiencies. Firms can expect an escalating series

of regulatory actions if they do not bring themselves promptly into compliance or if they are repeatedly deficient in these areas.

Maintaining adequate working capital and delivering annual audited financial statements on time are both fundamental requirements of registration.

4.4 Failure by registered individuals and applicants to be truthful with sponsoring firms

The Registrant Conduct Team has recently reviewed applications where applicants were not truthful with their sponsoring firm about the circumstances of the end of their employment with a former sponsoring firm. We have also reviewed matters where the applicant failed to comply, or provided false information, to internal investigators at their former sponsoring firm. Even if the applicant is later candid with the Registrant Conduct Team, the fact that the applicant provided false or misleading information to their current or former sponsoring firm is taken into consideration when assessing the applicant's suitability for registration and may impugn the applicant's integrity.

The CSA previously published CSA Staff Notice 33-320 *The Requirement for True and Complete Applications for Registration* to remind applicants and registrants of their obligation to provide true and complete applications for registration. The requirement for truth and candor extends beyond the formal application form, as the sponsoring firm has a duty prescribed in subsection 5.1(1) of NI 33-109 to "make reasonable efforts to ensure the truth and completeness of information that is submitted in accordance with this instrument for any individual." Sponsoring firms cannot fulfill this obligation without the honest cooperation of individual applicants.

Though honesty in dealing with the Registrant Conduct Team may be considered a mitigating factor in determining the appropriate regulatory action, there may be regulatory consequences to this dishonest conduct in dealing with sponsoring firms, such as a recommendation that the application be refused. At a minimum, applicants who have not dealt truthfully with sponsoring firms can expect an in-depth review by the Registrant Conduct Team.

4.5 Director's decisions and settlements

Director's decisions on OTBH proceedings are published in the OSC Bulletin and on the OSC website at Opportunity to be heard and Director's decisions, where they are presented by topic and by year. Director's decisions are an important resource for registrants, as they highlight matters of concern to the OSC, and the regulatory action that was taken as a result of misconduct or noncompliance. The publication of Director's decisions makes our response to serious misconduct visible to market participants and investors.

Seven Director's decisions were published in the fiscal year 2023-2024. Two decisions were issued in contested OTBH proceedings, two decisions resulted from uncontested recommendations to suspend firms, and three decisions approved settlement agreements with the registrant/applicant. A settlement agreement typically contains an agreed statement of facts and a joint recommendation to the Director. Proceeding by way of a settlement agreement allows the registrant to participate in setting out the factual narrative that becomes the basis for the Director's decision.

A summary of the Director's decisions and settlements for fiscal 2023-2024 follows:

Emerge Canada Inc. (May 11, 2023)

Topic: Financial Condition (Firm) (Including Requirement to Report Capital Deficiencies)

Emerge Canada Inc. (**Emerge Canada**) was registered as an IFM and was required to maintain a minimum of $100,000 of working capital, which is a fundamental requirement for registered firms. For the first time, a registrant argued in an OTBH that it should be permitted to operate indefinitely with an ongoing working capital deficiency. In its September 30, 2022 excess working capital calculation, Emerge Canada disclosed that it was owed $4,503,782 from Emerge Capital Management Inc. (**Emerge US**), a related party. Emerge Canada included this receivable as a current asset. Staff argued that this receivable was not a current asset, and if it was, it was not readily convertible to cash and therefore must be deducted from working capital.

The Director found the related-party receivable owed by Emerge US to Emerge Canada could not be readily converted into cash because despite Emerge US's attempts to raise cash to pay the receivable, it was not able to do so. If an asset cannot be converted into cash "easily, promptly; without difficulty", it must be deducted from current assets. Without this receivable, Emerge Canada did not have the required minimum of $100,000 of working capital.

Additionally, Emerge Canada had included crypto assets of 1.5 million DIGau tokens held in an investment account in its adjusted current assets calculation, but had not made the required 100% deduction to its working capital calculation for market risk. When the value of the crypto assets was deducted, Emerge Canada again did not have the required minimum of $100,000 of working capital.

The Director found that Emerge Canada had failed to maintain the required minimum working capital, contrary to section 12.1 of NI 31-103, and that suspension of registration was the appropriate remedy, as Emerge Canada was working capital deficient and had no certainty or timeline for bringing itself into compliance. Prior to suspension, the Director imposed terms and conditions

restricting the registerable activities Emerge Canada could conduct to allow for the wind-down of its business.

Gravitas Securities Inc. (June 16, 2023)

Topic: Other Orders Made Against Registrant

Gravitas Securities Inc.'s (**GSI**) membership with CIRO was suspended on June 8, 2023 after CIRO staff obtained a protective order from a CIRO hearing panel, due to GSI becoming capital deficient and advising of its intent to wind up its business. Upon suspension from CIRO, GSI's registration as an investment dealer was automatically suspended, but its registration as an IFM was not. GSI did not object to staff's recommendation that its IFM registration in Ontario be suspended. The Director found that it would be otherwise objectionable and inconsistent with the OSC's mandate to permit GSI to continue to be registered as an IFM given the circumstances under which its registration as an investment dealer had been suspended.

Additionally, GSI had been under terms and conditions since 2019 limiting its IFM activities to the remediation and orderly termination or sale of its investment funds under the oversight of a compliance consultant. The compliance consultant confirmed that GSI's investment funds had been sold or terminated, and fund assets returned to investors.

Marco Tulio Pagoada Vallecillo (July 7, 2023)

Topic: Misleading Staff or Sponsor Firm

Marco Tulio Pagoada Vallecillo (**Pagoada Vallecillo**) applied for initial registration as a mutual fund dealing representative. He had a conviction for driving with an excessive blood alcohol level and an outstanding criminal charge arising out of a separate incident. Pagoada Vallecillo did not disclose either the charge or the conviction in his application for registration. Pagoada Vallecillo argued that he was unaware of his pending criminal charges, but the Director was not persuaded that his efforts to clarify the charges against him were reasonable. Meanwhile, Pagoada Vallecillo explained that he did not disclose his criminal conviction because he believed it to be irrelevant to his registration application, and because he thought that the conviction had been removed from his record. Following an opportunity to be heard, the Director did not accept Pagoada Vallecillo's explanations as reasonable and refused the application for registration on the basis that the individual lacked the requisite integrity for registration.

Ensign Capital Inc. (September 18, 2023)

Topic: Appointing an Ultimate Designated Person or Chief Compliance Officer

Ensign Capital Inc. was registered as an EMD. On July 2, 2023, the individual acting as the firm's UDP, CCO and sole director, officer and shareholder passed away, following which the firm no longer had a registered individual performing the functions of a UDP or CCO, contrary to the requirements of sections 11.2 and 11.3 of NI 31-103. The individual's family indicated that they intended to wind down the firm and did not object to the recommendation to the Director that the firm's registration be suspended. The Director suspended the firm's registration on the basis that it would be objectionable for it to continue to be registered without anyone performing the functions of a UDP and CCO.

Theresia Fonny Hofan (December 18, 2023)

Topic: Misleading Staff or Sponsor Firm

Theresia Fonny Hofan was a mutual fund dealing representative who resigned from one mutual fund dealer (the **Former Dealer**) to join another (the **Proposed Dealer**). Staff became aware of Hofan's conduct during an application for reactivation of registration of Hofan's former colleague, who was dismissed for cause by the Former Dealer for providing information to Hofan after she moved to the Proposed Dealer. Hofan contacted her former colleague at the Former Dealer to specifically solicit confidential information relating to her former clients, including portfolio statements. Before Hofan moved from the Former Dealer to the Proposed Dealer, she forwarded a list of email addresses of her clients to her personal email. The Former Dealer reported that after her departure, Hofan also visited one of her former clients with a portfolio-related document originating from the Former Dealer's internal system. During the voluntary interview by the Registrant Conduct Team, Hofan made misleading statements about her conduct and then refused to cooperate.

Staff made a recommendation to the Director to suspend Hofan's registration. Hofan initially requested an OTBH, however, the Director ultimately approved a settlement agreement with Hofan whereby her registration was suspended for ten months, and her reactivation of registration was subject to the successful completion of further education.

Pollitt Investment Counsel Inc. (December 19, 2023)

Topic: Financial Condition (Firm) (Including Requirement to Report Capital Deficiencies)

Pollitt Investment Counsel Inc. (**Pollitt**) was a PM and IFM. A compliance review of Pollitt identified significant deficiencies, including repeat deficiencies from a

previous review. Pollitt's CCO, who was also the firm's UDP, was compelled for an interview to inquire about the compliance report after he refused to be interviewed voluntarily. However, the CCO/UDP did not make himself available for a compelled interview and subsequently retired. After the CCO/UDP's departure, Pollitt could not find a proficient CCO and UDP. The firm was also deficient in excess working capital for more than two days and failed to submit its annual audited financial statements to the OSC despite numerous reminders. Staff recommended the Director suspend the firm's registration. The Director approved a settlement agreement whereby Pollitt's registration was suspended with no possibility of reactivation for at least six months and all the client accounts were transferred to other firms prior to the suspension.

Samer Shamshum (January 26, 2024)

Topic: Misleading Staff of Sponsor Firm

Samer Shamshum had been registered as a mutual fund dealing representative on three prior occasions; each time he was also employed by the registered firm's parent bank. When Shamshum applied to reactivate his registration, three past conduct issues were identified which raised concerns that he did not possess the requisite integrity for registration.

First, Shamsun falsely represented in his initial application form in 2015 that he had resigned from a bank teller job to pursue other opportunities, when in fact he had been terminated for cause. Second, Shamshun falsely denied making a series of inappropriate workplace comments during a 2019 human resources internal investigation. Third, Shamshum again falsely denied making an inappropriate workplace comment during a 2022 human resources internal investigation at a different employer.

To address the concerns about his integrity and suitability for registration, Shamshum entered into a settlement agreement pursuant to which he agreed to withdraw his application for a period of at least six months to complete the Ethics and Professional Conduct Course, and to be subject to close supervision for a period of at least one year should he become registered in the future. The Director approved this resolution in a decision dated January 26, 2024.

ONTARIO SECURITIES COMMISSION

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