



ONTARIO
SECURITIES
COMMISSION

Annual Summary Report for Dealers, Advisers and Investment Fund Managers

Compliance and Registrant Regulation

OSC Staff Notice 33-745

September 25, 2014

Table of Contents

Introduction	6
1. Key policy initiatives impacting registrants	9
1.1 Ongoing amendments to registration requirements, exemptions and ongoing registrant obligations	9
1.2 Exempt market review.....	10
1.3 Best interest standard	11
1.4 Cost disclosure, performance reporting and client statements.....	12
1.5 Independent dispute resolution services for registrants.....	13
1.6 PM - IIROC dealer service arrangements.....	14
1.7 Derivatives regulation.....	15
2. Outreach to registrants	18
2.1 Registrant Outreach program	18
2.2 Registrant Advisory Committee.....	19
2.3 Communication tools for registrants	20
2.4 Impact of "Heartbleed" vulnerability on registrants	21
3. Registration of firms and individuals	23
3.1 New rules and initiatives for registrants.....	23
3.2 Trends in registration.....	27
3.3 Proposed amendments to NI 31-103.....	32
3.4 Trends in applications for PM registration	33
4. Information for dealers, advisers and investment fund managers	36
4.1 All registrants.....	36
4.2 Dealers (EMDs and SPDs)	58
4.3 Advisers (PMs)	67
4.4 Investment fund managers	70
5. Acting on registrant misconduct.....	81
6. Additional resources.....	88
Appendix A – Compliance and Registrant Regulation Branch and contact information for Registrants.....	89



DIRECTOR'S MESSAGE

The Ontario Securities Commission (OSC) expects strong compliance by registrants and articulates its expectations through its oversight, guidance and outreach. Registrants have an obligation to deal fairly, honestly and in good faith with their clients so they can invest with confidence, which is essential to the integrity of the capital markets of Ontario.

To assist registrants with meeting their regulatory obligations, the OSC's Compliance and Registrant Regulation Branch (CRR) has focused its efforts on enhancing communication with registrants and providing tools to assist them with maintaining effective compliance systems. We launched a new Registrant Outreach Program in September, 2013 with the objective of opening the lines of communication between registrants and CRR and creating a central repository of tools and information that will assist registrants in maintaining effective compliance systems. Since the launch of the program, more than 2,000 people have attended educational seminars either in-person or via webinar and the feedback has been overwhelmingly positive. As we continue to add more resources to the Registrant Outreach Program, we encourage registrants to check the [program's](#) webpage frequently for updates.

In addition to this report, CRR staff has published topic-specific guidance to assist registrants with meeting their regulatory obligations. For example, we published guidance to help registrants meet their Know Your Client (KYC), Know Your Product (KYP) and suitability obligations as well as guidance to help investment fund managers avoid common issues when managing their investment funds. KYC, KYP and suitability obligations are among the most fundamental obligations owed by registrants to their clients, and we continue to see issues with the way registrants fulfill these obligations, so this will remain a focus for CRR.

We also use the traditional tools of on-site compliance reviews and sweeps to identify compliance deficiencies, where appropriate, at each firm we review. The remediation of these deficiencies through dialogue with CRR staff provides an opportunity to enhance compliance systems. Also, the data collected from the 2014 Risk Assessment Questionnaire

will help us to focus our resources on higher-risk issues and registrants. CRR staff will commence on-site reviews based on this new data by the end of the year.

To better serve the registrant community, we created a new registration team within CRR and added the position of Manager, Registration. By pooling our registration resources under this one team, we will gain efficiencies and enhance internal practices. Also, registration is an important gatekeeper function and the team is enhancing the registration process by developing a new initiative that will move the initial registration for firms closer to a “first compliance review.” This initiative is under development, but firms that seek registration for the first time can expect that we will request additional information and potentially an in-person meeting as part of the registration process. This will allow us to focus on the firm’s fitness for registration, enhancing the firm’s understanding of regulatory obligations prior to registration and establishing positive communications with the registrant. Registrants and CRR staff will benefit from open communications about current regulatory obligations and practices.

Increasing our engagement with registrants was one of CRR’s goals which aligned with the expansion of the OSC’s direct outreach to market participants in 2013-14. Open communication with registrants gives CRR staff valuable insights into how registrants are adapting to the changes in the market environment and investor expectations. We are delighted with the participation and feedback we have received regarding our efforts to engage with our registrant community. It has been a constructive dialogue about strengthening the culture of compliance with Ontario securities law in the shared interest of protecting investors and fostering fair and efficient capital markets. We look forward to continuing the dialogue with our registrant community.

Debra Foubert
Director, Compliance and Registrant Regulation Branch



INTRODUCTION

Introduction



The regulatory framework for Ontario's capital markets is designed to provide protection to investors while fostering fair and efficient capital markets.

Ontario Securities Commission Notice 11-769 – Statement of Priorities

This annual summary report prepared by the CRR Branch (the annual report) provides information for registered firms and individuals (collectively, registrants) that are directly regulated by the OSC. These registrants primarily include:

- exempt market dealers (EMDs)
- scholarship plan dealers (SPDs)
- advisers (portfolio managers or PMs) and
- investment fund managers (IFMs).

The OSC's CRR Branch registers and oversees firms and individuals in Ontario that trade or advise in securities or act as IFMs.

Individuals	Firms			
66,210	1,056¹			
	PMs	EMDs	SPDs	IFMs
	310²	261²	3²	482³

(i) Registrants overseen by the OSC

Although the OSC registers firms and individuals in the category of mutual fund dealer and firms in the category of investment dealer, these firms and individuals are directly overseen by their self-regulatory organizations (SROs), the Mutual Fund Dealers Association of Canada (MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC), respectively. This report focusses primarily on registered firms and individuals directly overseen by the OSC.

In this report, we summarize new and proposed rules and initiatives impacting registrants, current trends in deficiencies from compliance reviews of registrants (including acceptable

¹ This number excludes firms solely registered in the category of investment dealer, mutual fund dealer, commodity trading manager, futures commission merchant, restricted PM, and restricted dealer.

² This number includes firms solely registered in this category.

³ This number includes sole IFMs and IFMs registered in multiple categories.

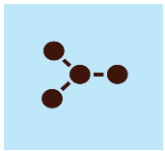
practices to address them and unacceptable practices to prevent them), and current trends in registration. We provide an update on our Registrant Outreach program that helps strengthen our communication with registrants on compliance practices. We also provide a summary of some key registrant misconduct cases, explain where registrants can get more information about their obligations, and provide CRR contact information.

This report is a key component of our outreach to registrants. We strongly encourage registrants to thoroughly read and use this report to enhance their understanding of:

- initial and ongoing registration and compliance requirements,
- OSC staff expectations of registrants and our interpretation of regulatory requirements, and
- new and proposed rules and other regulatory initiatives.

As a means of promoting pro-active compliance, we recommend registrants use this report as a self-assessment tool to strengthen their compliance with Ontario securities law, and as appropriate, to make changes to enhance their systems of compliance, internal controls and supervision.⁴

⁴ The content of this report is provided as guidance for information purposes and not as advice. We encourage firms to seek advice from a professional advisor as they conduct their self-assessment and/or implement any changes to address issues raised in the report.



KEY POLICY INITIATIVES IMPACTING REGISTRANTS

- 1.1 Ongoing amendments to registration requirements, exemptions and ongoing registrant obligations**
- 1.2 Exempt market review**
- 1.3 Best interest standard**
- 1.4 Cost disclosure, performance reporting and client statements**
- 1.5 Independent dispute resolution services for registrants**
- 1.6 PM-IIROC dealer service arrangements**
- 1.7 Derivatives regulation**

1

Key policy initiatives impacting registrants



“There is a sea of change occurring in today’s financial markets....This requires regulation that promotes confidence in our capital markets, is responsive to changes in the economic and business environment, and reflects the reality of today’s global, competitive capital markets.

March 27, 2014 Speech by Howard Wetston, Chair, OSC to the Toronto Region Board of Trade

1.1 Ongoing amendments to registration requirements, exemptions and ongoing registrant obligations

Since the implementation of [National Instrument 31-103 Registration](#)

[Requirements, Exemptions and Ongoing Registrant Obligations](#) (NI 31-103) in September 2009, and the amendments which came into force in July 2011, we have monitored this relatively new regulatory regime for registrants and engaged in discussions with stakeholders about their practical experiences working with the regime. With the Canadian Securities Administrators (CSA), we developed additional technical and substantive amendments to NI 31-103 and NI 33-109 *Registration Information* (NI 33-109) arising from this ongoing consultation.

On December 5, 2013, the CSA published for comment [Proposed Amendments to NI 31-103, NI 33-109, NI 52-107, OSC Rule 33-506 and OSC Rule 35-502 and Related Forms](#) (NI 31-103 Proposed Amendments). The purpose of the NI 31-103 Proposed Amendments are to:

- codify current exemption orders,
- refine certain exemptions,
- provide guidance and clarification that will enhance investor protection and improve the day-to-day operation of the registration regime for industry participants and regulators,
- implement consequential amendments to other national instruments and rules as a result of the NI 31-103 Proposed Amendments (consequential amendments to NI 33-109, NI 52-107, OSC Rule 33-406 and OSC Rule 35-502), and
- further clarify the legislative intent of NI 31-103.

The NI 31-103 Proposed Amendments comment period is closed. The CSA has reviewed comments submitted by various stakeholders and is considering these comments in relation to the future NI 31-103 amendments.

For your ease of reference, the majority of the NI 31-103 Proposed Amendments are summarized in relevant sections throughout this report. For more information, see the published [NI 31-103 Proposed Amendments](#) on the OSC website.

1.2 Exempt market review

EXEMPT MARKET REVIEW ⁵		
\$104 BILLION	90%	74%
Ontario capital exemption distributions	Capital raised through accredited investor exemption	Capital raised through debt-related securities

As part of our continued work to enhance and expand the exempt market, we published proposals for both the CSA policy review of the existing minimum amount and accredited investor prospectus exemptions (accredited investor exemption) and the OSC’s expanded review of potential new prospectus exemptions. These initiatives, discussed briefly below, will impact investors, issuers, EMDs and other registrants distributing exempt market products.

On February 27, 2014, the CSA published proposed amendments relating to the accredited investor exemption and the minimum amount investment prospectus exemption (MA exemption) in [National Instrument 45-106 Prospectus and Registration Exemptions](#) (NI 45-106).

The amendments include:

- a new risk acknowledgement form for individual accredited investors that describes, in plain language, the individual accredited investor categories and the

⁵ Source: OSC Filings – based on reports of exempt distributions filed with the OSC in 2012

protections an investor will not receive by purchasing under the accredited investor exemption,

- restricting the MA exemption to distributions involving non-individual investors, and
- amending the definition of accredited investor in Ontario to allow fully managed accounts to purchase investment fund securities using the managed account category of the accredited investor exemption, as is permitted in other Canadian jurisdictions.

For more information, see [Proposed Amendments to Accredited Investor and Minimum Amount Investment Prospectus Exemptions](#).

On March 20, 2014, the OSC published a proposal setting out four new prospectus exemptions. The publication of these proposals follows a comprehensive review of the exempt market. As part of that review, we considered the written comments received on earlier proposals. We also conducted extensive consultations with a broad range of stakeholders through a series of one-on-one meetings and town hall meetings, and an online survey designed to gauge the views of retail investors on investing in start-ups and small and medium-sized enterprises.

The OSC also published for comment two new reports of exempt distribution: a report for investment funds and a report for all other issuers. For additional information on these reports and the proposed exemptions, see [Introduction of Proposed Prospectus Exemptions and Proposed Report of Exempt Distribution in Ontario](#).

1.3 Best interest standard

We are re-evaluating the advisor-client relationship by considering whether an explicit statutory fiduciary (or "best interest") standard should apply to dealers and advisers and on what terms. A fiduciary duty is essentially a duty to act in a client's best interest.

In Ontario, [section 116 of the Securities Act \(Ontario\)](#) (Act) applies a best interest standard to IFMs in their dealings with the investment funds they manage. There is no equivalent provision under the Act that explicitly applies a best interest standard to dealers and advisers in their dealings with their clients, although section 2.1 of OSC Rule 31-505 *Conditions of Registration* requires dealers and advisers to deal fairly, honestly and in good

faith with their clients. While there is no statutory best interest duty for dealers and advisers in Ontario, Canadian courts can find that a given dealer or adviser owes a best interest duty to his or her client depending on the nature of their relationship.

[CSA Consultation Paper 33-403 *The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients*](#) was published on October 25, 2012. We received numerous comment letters on the consultation paper and conducted three roundtables in June and July 2013 (all comment letters and the transcripts from the roundtables are available on the [OSC website](#)). On December 17, 2013, we published [CSA Staff Notice 33-316 – Status Report on Consultation under CSA Consultation Paper 33-403: The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients](#), which summarized the consultation work conducted to date in respect of the best interest consultation initiative, and identified the key themes that emerged from the best interest consultation process.

We continue to work with our CSA colleagues on this project. The continued work required will depend in part on the outcome of the research we conduct this year. Once this research and analysis has been completed, we will publish the results and our decision on how we plan to move forward with the best interest duty initiative, including timing.

1.4 Cost disclosure, performance reporting and client statements

On July 15, 2013, the Client Relationship Model - Phase 2 (CRM2) amendments to NI 31-103 came into effect. They are being phased-in over a three-year period. The amendments introduce new requirements for reporting to clients about the costs and performance of their investments, and the content of the investments in their accounts. The requirements apply to dealers and PMs in all categories of registration, with some application to IFMs as well. For more information about these amendments, see [CSA Notice of Amendments to NI 31-103 and to Companion Policy 31-103CP \(Cost Disclosure, Performance Reporting and Client Statements\)](#).

As of July 15, 2013, minor clarifications to NI 31-103 took effect, such as enhancements to relationship disclosure information. Beginning July 15, 2014, dealers and PMs were required to:

- provide pre-trade disclosure of charges, and

- report on compensation from debt securities transactions.

IIROC and MFDA member rules are harmonized with the CSA's CRM2 requirements and will be implemented on the same schedule. SRO members who comply with equivalent member rules will be exempted from the CRM2 requirements in NI 31-103.

To help industry implement the changes, on March 7, 2014 we sent an [email blast on CRM2 planning tips](#) directly to the chief compliance officers (CCOs) of all registered dealers and PMs. We have also initiated a CRM2 discussion forum with industry associations and regulators, including IIROC and the MFDA.

Beginning July 15, 2015, expanded account statement requirements will be implemented. These include requirements to provide position cost information and to determine market values using a prescribed methodology for most securities owned by clients, including those held in client name.

For additional information on future requirements, see section 1.1 of [OSC Staff Notice 33-742 – 2013 OSC Annual Summary Report for Dealers, Advisers and Investment Fund Managers](#) (OSC Staff Notice 33-742) and the frequently asked questions and additional guidance in [CSA Staff Notice 31-337 Cost Disclosure, Performance Reporting and Client Statements – Frequently Asked Questions and Additional Guidance as of February 27, 2014](#).

1.5 Independent dispute resolution services for registrants

On May 1, 2014, NI 31-103 was amended to make the Ombudsman for Banking Services and Investments (OBSI) the common dispute-resolution service for the securities industry in Canada except in Québec.

The transition period for existing registrants expired on August 1, 2014. All dealers and PMs registered in Ontario were required as of August 2, 2014 to be OBSI "Participating Firms" requiring registrants to take reasonable steps to make OBSI's services available to clients who have "eligible complaints" (as defined in section 13.16). There are also new related client disclosure requirements. For more information about these amendments, see [CSA Notice of Amendments to NI 31-103 and to 31-103CP \(Dispute Resolution Services\)](#).

We remind all dealers and PMs of their existing requirements in section 13.15 of NI 31-103 to have internal complaint handling policies in place to ensure that all client complaints are addressed appropriately.

On May 1, 2014, the CSA published [CSA Staff Notice 31-338 Guidance on Dispute Resolution Services Client Disclosure for Registered Dealers and Advisers that are not members of a Self-Regulatory Organization](#). This Notice provides guidance regarding the disclosure firms must provide to their clients about the availability of OBSI's services and internal complaint handling procedures that meet the requirements of the rule. The notice also provides a sample client disclosure document.

The participating CSA jurisdictions have entered into a [Memorandum of Understanding \(MOU\) with OBSI](#) concerning its oversight of this initiative. For additional information please refer to the MOU.

1.6 PM - IIROC dealer service arrangements

Working together, CSA and IIROC staff are reviewing service arrangements between CSA-regulated PMs and investment dealers that are members of IIROC to assess if rules and/or guidance is needed.

Typically under these arrangements, an IIROC dealer provides trading and custody services to a PM and its clients, but may also provide recordkeeping, client account statements, and margin services. These arrangements are similar to introducing broker-carrying broker arrangements between IIROC dealers that are governed under [IIROC Dealer Member Rule 35](#), but are not subject to any specific rules or guidance.

We identified a number of issues with PM-IIROC dealer service arrangements, including:

- agreement between the PM and the dealer,
- disclosure to the PM's clients, and
- in some cases, the PM relying on the dealer's books and records, and account statement delivery to the PM's clients, to meet its own obligations without being responsible and accountable for the services, and without adequate supervision.

The CSA is working with IIROC to address these issues. The working group is also considering whether PM clients need to continue to receive dual account statements

separately from their respective PM and custodian, and if instead the delivery of one account statement (such as a joint account statement from the PM and custodian) is a viable option, keeping in mind investor protection and other regulatory concerns.

Until this work is complete, PMs are to comply with their existing account statement delivery obligations in section 14.14 of [NI 31-103](#), and prepare for the new additional statement requirements in section 14.14.1 of NI 31-103 which come into force on July 15, 2015.

See section 4.3.3 of [OSC Staff Notice 33-742](#) for more information on OSC staff's current expectations and interim guidance on PM client account statement delivery practices.

1.7 Derivatives regulation

In December 2010, the Act was amended to establish a framework for derivatives regulation in Ontario. However, certain amendments relating to derivatives regulation have not yet been proclaimed into force as the necessary supporting rules are not yet in place.

We are consulting with the OSC Derivatives Branch in developing a number of rules relating to the regulation of derivatives, including a rule for determining whether products should be regulated as securities, derivatives, or exempt from regulation (the Product Determination Rule), and a rule that will set out the principal registration requirements and exemptions for derivatives' market participants, including derivatives dealers, derivatives advisers and large derivatives' market participants (the Derivatives Registration Rule).

In April 2013, the CSA Derivatives Committee published for comment [CSA Consultation Paper 91-407 – Derivatives: Registration](#). We are reviewing the comments received on the consultation paper and developing the proposed Derivatives Registration Rule.

On January 3, 2014, the OSC published a Notice of Ministerial Approval in connection with the Product Determination Rule, [OSC Rule 91-506 Derivatives: Product Determination](#), and [OSC Rule 91-507 Trade Repositories and Derivatives Data Reporting](#) (the Trade Repositories Rule). The rules were effective December 31, 2013.

Although the Product Determination Rule only currently applies to the related Trade Repositories Rule, it is anticipated that, once the remaining rules relating to the new derivatives regulatory framework are in place, the Product Determination rule will be extended to apply generally.

As a result of amendments to the Trade Repositories Rule made in April 2014, the trade reporting requirements will take effect on October 31, 2014. We encourage registrants to review their policies and procedures in relation to the reporting of over the counter derivatives transactions. We are working with the OSC Derivatives Branch in developing an oversight program for testing registrant compliance with these new requirements.



OUTREACH TO REGISTRANTS

- 2.1 Registrant Outreach program**
 - a) Registrant outreach web page**
 - b) Educational seminars**
 - c) Registrant outreach community**
 - d) Registrant resources**
- 2.2 Registrant Advisory Committee**
- 2.3 Communication tools for registrants**
- 2.4 Impact of "Heartbleed" vulnerability on registrants**

2 Outreach to registrants



“We want to provide registrants with tools to build proactive compliance systems.”

April 9, 2013 speech by Debra Foubert, Director, Compliance and Registrant Regulation at the Strategy Institute: Annual Registrant Regulation, Conduct & Compliance Summit

We continued to interact with our stakeholders through our outreach program to registrants which was launched in 2013. The objectives of our Registrant Outreach program are to strengthen our communication with Ontario registrants that we directly regulate and other industry participants (such as lawyers and

compliance consultants), promote stronger compliance practices and, enhance investor protection.

2.1 Registrant Outreach program

REGISTRANT OUTREACH STATISTICS		
16 <ul style="list-style-type: none">In-person & webinar seminars provided to June 30, 2014	2000 <ul style="list-style-type: none">Individuals attended outreach sessions to June 30, 2014	Key features <ul style="list-style-type: none">dedicated web pageeducational seminarsregistrant outreach communityregistrant resources

The Registrant Outreach program continues to provide Ontario registrants with practical knowledge on compliance-related matters and gives them the opportunity to hear first-hand from OSC Staff about the latest issues impacting them. Since the launch of the program in July 2013, approximately 2,000 individuals have attended registrant outreach sessions, either in-person or via webinar. The feedback from these participants has been very positive.

The outreach program is interactive and has the following features to enhance the dialogue with registrants:

a) Registrant outreach web page

We set up a [Registrant Outreach](#) page on the OSC's website at www.osc.gov.on.ca, which was designed to enhance awareness of topical compliance issues and policy initiatives. Registrants are encouraged to check the web page on a regular basis for updates on regulatory issues impacting them.

b) Educational seminars

Anyone interested in attending an event can go to the [Calendar of Events](#) section of the Registrant Outreach page of the OSC website, for seminar descriptions and registration.

c) Registrant outreach community

Registrants are also encouraged to join our [Registrant Outreach Community](#) to receive regular e-mail updates on OSC policies and initiatives impacting registrants, as well as the latest publications and guidance on our expectations regarding compliance.

d) Registrant resources

The registrant resources section of the web page provides registrants and other industry participants with easy, centralized access to recent compliance materials. If you have questions related directly to the Registrant Outreach program or have suggestions for seminar topics, please send an email to RegistrantOutreach@osc.gov.on.ca.

2.2 Registrant Advisory Committee

The OSC's Registration Advisory Committee (RAC) was established in January 2013. The RAC, which is currently comprised of 11 external members, advises OSC staff on issues and challenges faced by registrants in interpreting and complying with Ontario securities law, including registration and compliance related matters. The RAC also acts as a source of feedback to OSC staff on the development and implementation of policy and rule making initiatives that promote investor protection and fair and efficient capital markets. The RAC meets quarterly and members serve a two year term. The initial two year term will expire in December 2014 and a call for new members will be made in the fall of 2014. You can find a [list of current RAC members](#) on the OSC website.

Topics of discussion with the RAC this year have included the proposed mutual fund risk classification methodology for use in the Fund Facts, the proposed exemptions included as part of the exempt market review process (discussed briefly above), current topics related to PMs and IFMs, the electronic delivery of documents to the OSC, the new proposed OSC derivatives rules (discussed briefly above), and proposed changes to the [OSC Rule 13-502 Fees](#) (the Fees Rule).

2.3 Communication tools for registrants

We use a number of tools to communicate initiatives that we work on and the findings of those initiatives to our registrants, including OSC Compliance annual reports, Staff Notices (OSC and CSA) and e-mail blasts. The information provided to registrants via e-mail blasts is discussed in various sections of this report. The table below provides a listing of recent e-mail blasts sent to registrants.

Date of email blast	E-mail blast topic and additional information
June 19, 2014	OSC Staff Notice 33-743 – <i>Guidance on sales practices, expense allocation and other relevant areas developed from the results of the targeted review of large investment fund managers</i> (OSC Staff Notice 33-743) See section 4.4 b) of this report.
June 10, 2014	Risk Assessment Questionnaire (RAQ) See section 4.1 a) (ii) of this report.
May 1, 2014	Requirement to make OBSI available to clients See section 1.5 of this report.
March 12, 2014	Requirement to make OBSI available to clients See section 1.5 of this report.
March 7, 2014	CRM2 FAQ published; planning tips See section 1.4 of this report.
February 11, 2014	Requirement to deliver documents electronically to the Ontario Securities Commission (Effective February 19, 2014) See section 4.1 d) (ii) of this report.
January 9, 2014	CSA Staff Notice 31-336 - <i>Guidance for Portfolio Managers, Exempt Market Dealers and Other Registrants on the Know-</i>

	<i>Your-Client, Know-Your-Product and Suitability Obligations</i> See section 4.1 c) (i) of this report.
November 20, 2013	Guidance for changes in calculating capital markets participation fees by registrant firms, unregistered exempt international firms and unregistered IFMs effective April 1, 2013 See section 4.1 e) of this report.
September 9, 2013	Calculation of excess working capital and the use of subordination agreements See section 4.1 c) (iv) 3) of this report.

For more information, see [OSC E-mail blasts](#).

2.4 Impact of “Heartbleed” vulnerability on registrants

On April 17, 2014, we sent a survey to registrants with head offices in Ontario in response to the “Heartbleed” bug. The “Heartbleed” bug presented a vulnerability to Internet services that allowed an attacker/hacker to read encrypted information which could expose sensitive data such as passwords and bank account information. The purpose of the survey was to gauge the degree to which the “Heartbleed” bug impacted our registrants.

The survey results indicated that 66% of registrants transacted with or for their clients or others through web sites, social media, file transfers or remote connections. This indicates that a large number of survey respondents not only use the Internet, but do so in such a way that sensitive information is likely exchanged over the web either with clients or service providers.

Strong and tailored cyber security measures are an important element of a registrant’s controls in promoting reliability of their operations and the protection of confidential information. To manage the risks of a cyber threat, registrants and regulated entities should be aware of the challenges of cybercrime and should take the appropriate protective measures necessary to safeguard themselves and their clients and stakeholders.

For additional information on guidance to strengthen cyber security, refer to [CSA Staff Notice 11-326 Cyber Security](#) published on September 26, 2013.



REGISTRATION OF FIRMS AND INDIVIDUALS

- 3.1 New rules and initiatives for registrants**
 - a) Pre-registration reviews**
 - b) NI 31-103 Proposed Amendments to registration requirements**
 - c) Registration service commitment**
- 3.2 Trends in registration**
 - a) Registration of not for profit issuers**
 - b) Tax shelter products**
 - c) Desk review of supervisory terms and conditions**
 - d) Registration of online portals**
 - e) Registration of online advisory businesses**
 - f) Fees for late document filings**
 - g) Registration related conflicts of interest**
- 3.3 Proposed amendments to NI 31-103**
 - a) Proficiency of registrants**
- 3.4 Trends in applications for PM registration**

3 Registration of firms and individuals



“Participation as a registrant in Ontario’s capital markets is a privilege that comes with significant responsibilities to investors and the public at large”

June 13, 2012 speech by Mary Condon, Vice-Chair, Compliance & Risk Management Strategies Summit for Portfolio Managers and Fund Managers

The registration requirements under securities law help to protect investors from unfair, improper or fraudulent practices by market participants. The information required to support a registration application allows us to assess a firm’s and an individual’s fitness for

registration. When assessing a firm’s fitness for registration we consider whether it is able to carry out its obligations under securities law. We use three fundamental criteria to assess an individual’s fitness: proficiency, integrity and solvency. These fitness requirements are the cornerstones of the registration regime.

In this section, we discuss current trends in registration, discuss novel business activities potentially requiring registration, provide an update on supervisory terms and conditions (T&Cs), outline a new pre-registration process recently implemented and provide a snapshot of the NI 31-103 Proposed Amendments that will impact registration requirements.



3.1 New rules and initiatives for registrants

a) Pre-registration reviews

We commenced pre-registration reviews by incorporating compliance review procedures as part of the registration process. We are referring to this process as “Registration as the first Compliance Review”. The procedures include reviewing a firm’s financial condition, business plan and at a high level the policies and procedures manual. Additional procedures may also be conducted with a focus on proposed operations, compliance systems, and proficiency of the firms’ individuals. Information is gathered by OSC staff through written inquiries, requests for documentation and/or interviews of a firm’s key representatives.

The purpose of the pre-registration review is to assess compliance with Ontario securities law at the time of registration. Noted deficiencies are raised with firms and corrective

action of all issues is required prior to firm registration. The pre-registration review will enhance firms' awareness of their obligations to establish an adequate compliance system.

Suggested practices to prepare for an OSC pre-registration review:

Firms must:

- Establish an effective compliance system prior to commencing registerable activities.
- Ensure that written policies and procedures adequately address all aspects of business operations.
- Be prepared to answer detailed questions (in writing or in person) regarding the firm's business plan and compliance systems including:
 - products and services that will be offered,
 - business growth plans,
 - details on referral arrangements, if any,
 - supervisory structure within the context of the firm's growth objectives,
 - marketing plans,
 - material business contracts, and
 - oversight for outsourced business arrangements.
- Be prepared to provide
 - the firm's application or membership in OBSI, if applicable,
 - details regarding planned custodial arrangements,
 - copies of business plans and policies and procedures manual, and
 - copies of other information such as offering documents, referral agreements, KYC documents, and disclosure documents.

Firms are encouraged to:

- Compile records requested on a timely basis.
- Perform an initial self-assessment to determine compliance with Ontario securities law, or engage a compliance consultant to perform the assessment prior to registration, and rectify all deficient areas prior to applying for registration.

Unacceptable practices

Firms are encouraged to avoid the following practices:

- Conduct the following after submission of a registration application:
 - draft the written policies and procedures manual, and
 - search for possible service providers.
- Provide documents related to the registration process in stages; complete

documentation relating to the registration application should be provided at the time of registration including audited financial statements.

b) NI 31-103 Proposed Amendments to registration requirements

The following chart provides a high level overview of the NI 31-103 Proposed Amendments to registration requirements that will impact registrants.

Proposed amendment ⁶	Topic	Purpose
Section 3.3 of NI 31-103	Proficiency: review of time-limits used to stale date exams	Technical amendment to codify blanket/omnibus relief dated February 26, 2010 currently being relied on related to examinations and programs for dealing representatives of EMDs and SPDs.
Section 4.1 of NI 31-103	Prohibition in s. 4.1(1)(b) regarding dually registered individuals	To clarify that the dual registration prohibition applies to a firm registered in any jurisdiction of Canada.
Section 13.4 of the Companion Policy to National Instrument 31-103 (31-103CP)	Identifying and responding to conflicts of interest	To add guidance relating to conflicts of interest in relation to registered representatives that serve on the boards of reporting issuers or have outside business activities (OBAs).
NI 33-109	Amendments to NI 33-109 forms	To update and enhance certain NRD forms.

For additional information see sections 1.1 and 3.3 of this report.

⁶ Subject to change and final approval

c) Registration service commitment

In May 2014, we issued the [OSC service commitment](#) in which our service standards are set out in detail. The following standards, conditions and timelines pertain to registrants and registration-related filings where the OSC is the principal regulator.

Service Commitment Summary	
Item	Service commitment
New business submissions	<ul style="list-style-type: none"> • A registration officer will: <ul style="list-style-type: none"> ○ contact your representative and provide instructions on fee payment and provide notification that the system is ready to accept applications from the "mind and management" of your business within 5 working days upon receipt of your application ○ best efforts target: 95% of the filings. • Aim to provide a decision to your application within 90 working days where the following conditions are met: <ul style="list-style-type: none"> ○ you are a non-SRO applicant, ○ all questions are answered with sufficient detail, ○ all regulatory obligations are met, ○ there are no concerns with your fitness for registration, and ○ you respond to our request for information in a timely manner ○ best efforts target: 80% or more of these filings.
Dealing representatives – new applications and reactivations	<ul style="list-style-type: none"> • Aim to review, analyze, and provide a decision to your application with 5 working days where the following conditions are met: <ul style="list-style-type: none"> ○ your application is complete, ○ your application is not associated with a new business application, and ○ there are no concerns with your fitness for registration ○ best efforts target: 80% or more of these filings.

Advising representatives (ARs), associate advising representatives (AARs) and CCOs – new applications and reactivations	<ul style="list-style-type: none"> • Aim to apply a decision to your application within 20 working days where the following conditions are met: <ul style="list-style-type: none"> ○ your application is complete, ○ your application is not associated with a new business application, and ○ there are no concerns with your fitness for registration ○ best efforts target: 80% or more of these filings.
Notices of termination (where individuals leave former firm in good standing)	<ul style="list-style-type: none"> • Aim to complete a notice of termination within 5 working days. <ul style="list-style-type: none"> ○ best efforts target: 95% or more of these filings

In relation to the service commitments summarized above, if we do not receive a response within three weeks of making a request relating to a registration filing, we will generally consider the file to be dormant and will take steps to close it. Prior to closing the file, we will send the filer another notification asking for a status update and informing them of the imminent files closure within two weeks unless we receive a response to our notification. In cases where a re-activation of the file is requested, an additional fee may be required.



3.2 Trends in registration

a) Registration of not for profit issuers

We became aware of a number of not for profit issuers that are distributing their own securities. [NI 45-106](#) provides an exemption from the prospectus requirement in section 2.38 for certain not for profit issuers distributing their own securities provided they comply with certain conditions. However, as of March 27, 2010, the registration exemption previously available under section 3.38 of NI 45-106 is no longer available. A not for profit issuer is required to consider whether it is engaged in the business of trading in securities (please refer to the [31-103CP](#) section 1.3 *Factors in determining business purpose*). If an issuer is in the business of trading its securities, then registration as a dealer is required.

b) Tax shelter products

We remind registrants that tax shelter products, including ones that involve leveraged donations of property (for instance, artwork and medical supplies) to charities and ones that are marketed to investors on the basis of tax credits or deductions that are claimed to be available, are typically considered “securities” and require registration. See section 4.2 b) of this report for further information.

c) Desk review of supervisory T&Cs

We conducted a desk review of non-SRO registrant firms whose sponsored individuals have been or are currently subject to supervisory T&Cs. The types of T&Cs reviewed included strict supervision, close supervision, OBAs, and requirement to deliver disclosure documents to clients. The objective of the review was to ensure adequate supervision by the firm over these T&Cs. We also compared the T&Cs to the original activities that led to their imposition and concluded that the T&Cs were fitting for the types of activities reported. The review concluded that most firms were adhering to the T&Cs imposed on their individual registrants and were conducting adequate supervision. One firm was identified as not fulfilling their supervisory obligations. We are following up with this firm.

d) Registration of online portals

We have seen a number of firms applying to register as EMDs that plan to operate accredited investor only internet portals. EMDs can operate portals to facilitate distributions of securities in reliance on prospectus exemptions (e.g. the accredited investor exemption) provided they comply with all normal requirements applicable to the EMD category, including KYC and suitability.

In contrast, [Multilateral Instrument 45-108 Crowdfunding](#), the proposed crowdfunding rule, contemplates that funding portals will register in the restricted dealer category. The crowdfunding prospectus exemption is aimed at allowing retail investors to participate in the capital raising of businesses in Canada. The crowdfunding portal is subject to important conditions (e.g. it can only distribute securities in reliance on the new crowdfunding prospectus exemption, which includes investment limits of \$2,500 per investment/\$10,000 per annum) and will not be able to distribute securities in reliance on other exemptions, e.g. the accredited investor exemption.

e) Registration of online advisory businesses

We have seen increasing interest in advisers providing advice through online platforms. We have recently registered a small number of PM firms that will operate online and expect to see others enter the market. The online advice model that we have considered to be acceptable involves an interactive website used to collect KYC information, which will be reviewed by a registered AR. The AR will communicate with the client by telephone, video link, email or internet chats. The AR must ensure that sufficient KYC information has been gathered to support the PM firm's obligation to make suitability determinations for the client.

Each of the firms that we have registered to provide online advice operates on a discretionary managed account basis, using portfolios of unleveraged exchange traded funds (ETFs) or low cost mutual funds. In most cases, these are model portfolios which are selected for a client based on a profile generated by the KYC collection process. An AR will review and approve the suitability of the portfolio for the client. The client's account is periodically rebalanced to the parameters set for their portfolio.

This is not the so-called "robo-advice" model seen in the United States, where online advice has seen rapid growth in the last few years. The online advisers operating in Ontario are offering hybrid services that utilize an online platform for the efficiencies it offers, while ARs remain actively involved in decision making.

We do not think that an entirely automated decision making process would be acceptable at this stage. The KYC and suitability obligations of PMs that provide their services through online platforms remain the same as for any other PM. A PM's obligations under securities law does not change as a result of the delivery method of providing the services to a client. We expect firms that are interested in implementing an online advice operating model in Ontario to submit their proposed online KYC questionnaire and related processes for a due diligence review by CRR staff. This review in no way diminishes the firm's ongoing responsibilities under applicable securities law.

f) Fees for late document filings

We continue to see late regulatory filings related to registration documents including, but not limited to:

- financial and civil disclosures,
- other business activities,
- ownership of securities and derivatives firms, and
- acquisition notices under sections 11.9 and 11.10 of NI 31-103 (see section 4.1 b) in this report for additional information).

Most registration updates must be filed within 10 days of a change to a registered firm's information in [Form 33-109F6 – Firm Registration Form](#) or [Form 33-109F4 – Individual Registration Form](#).

When required documents are filed late, late fees will apply and be charged. The applicable fee is \$100 per business day, subject to a maximum aggregate fee of \$5,000 for all documents required to be filed within a calendar year. Please see the full list found in Appendix D – Additional Fees for Late Document Filings in the Fees Rule.

We remind firms that they are expected to have an effective compliance system in place to minimize late filings.

g) Registration related conflicts of interest

The CSA provided clarification and guidance regarding OBAs in the NI 31-103 Proposed Amendments dated December 5, 2013. Disclosure is and will continue to be required for all officer or director positions and any other equivalent positions held as well as positions of influence per Item 10 – Current employment, other business activities, officer positions held and directorships in Form 33-109F4 (the F4). Guidance has also been added in the 31-103CP which clarifies that disclosure is required for certain paid or unpaid roles with charitable, social or religious organizations and for owners of a holding company.

We continue to place restricted client T&Cs on individuals with a position of influence (particularly over potentially vulnerable clients). These T&Cs restrict the individual from trading or advising clients met through the OBA (and close family members of those clients). For example, this year restricted client T&Cs were placed on:

- teachers (elementary, secondary and college),
- registered nurses (hospital and nursing home),
- early childhood educators (daycare and school),

- a volunteer minister, and
- support workers (work with clients with mental health issues, abused women or the elderly).

Suggested practices to adequately address OBA

Registrants Must:

- Assess OBAs to identify conflicts of interest, determine the level of risk, and respond appropriately (for example, approve each new OBA before it begins).
- Promote compliance with OBA requirements through an annual attestation and questionnaire, ongoing monitoring, and education.
- When onboarding a new registered or permitted individual:
 - review and discuss all pre-existing OBAs,
 - review and vet responses to all conflict of interest questions in Schedule G (Item 10 of the F4),
 - ensure OBA disclosure on NRD is complete and correct, and
 - remind the individuals that any change to this disclosure must be reported to the firm and filed on NRD within 10 days of the change.

Unacceptable practices

Registrants must not:

- Permit an OBA if it cannot properly control the potential conflict of interest.
- State in the F4 disclosure- Item 10 that there is no actual or potential conflicts of interest and client confusion when that is not true (e.g., individual holds an elected office or provides free investment management services to a social organization).
- Sponsor an individual with an OBA until the firm is ready to discuss what additional supervisory/oversight policies and procedures they are willing to perform to ensure compliance with the restricted client T&Cs.

3.3 Proposed amendments to NI 31-103⁷

a) Proficiency of registrants

Experience for CCOs of Dealers

In the course of compliance reviews, we identified a number of dealer firms that have CCOs who are not adequately performing their responsibilities. This deficiency is often associated with a finding that the CCO does not have relevant experience. As a result, we proposed amendments to add a requirement that CCOs of mutual fund dealers, SPDs and EMDs have 12 months of relevant securities industry experience in the 36-month period prior to applying for registration. These new requirements will apply to new firm applications only.

Proficiency Principle – CCOs of dealers, advisers and IFMs

The experience requirement being proposed for dealer CCOs is consistent with the proficiency principle in section 3.4 of NI 31-103 which states that a CCO 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. We have further elaborated on this principle in 31-103CP to clarify that this must include a good understanding of the regulatory requirements applicable to the firm (and individuals acting on its behalf) as well as the knowledge and ability to design and implement an effective compliance system.

Experience for ARs and AARs

We provided further guidance in 31-103CP clarifying what we may consider relevant investment management experience for AR and AARs. This guidance incorporates content from [CSA Staff Notice 31-332 *Relevant Investment Management Experience for Advising Representatives and Associate Advising Representatives of Portfolio Managers*](#) (CSA Staff Notice 31-332) published on January 17, 2013. Firms should continue to refer to the CSA Staff Notice 31-332 for specific examples. We expect firms and individuals to consider CSA Staff Notice 31-332 and 31-103CP as guidance at appropriate times, such as during the job application, hiring process and submission of applications for registration.

⁷ Subject to change and final approval

3.4 Trends in applications for PM registration

We are receiving a number of registration applications for small and one person PM firms (which may also include the categories of IFM and EMD) where none of the applicants have been previously registered as an AR, employed at a registered PM firm or been employed in a compliance capacity.

In order for these individuals (and firms) to be registered, they must provide evidence that they have the required courses and relevant investment management experience to qualify as an AR or CCO, as is the case for all new CCO and AR applicants. The individuals must also demonstrate how they meet the requirements of the proficiency principle in section 3.4 of NI 31-103 to competently perform the activities requiring registration.

Suggested practices to adequately prepare individual registration applications

Applicants must:

- Send evidence of course completion.
- Provide information on experience that is clear, accurate and relevant. For example, the information should:
 - provide details of relevant past duties and responsibilities, including the dates and employers where the experience was obtained,
 - provide an estimate of the percentage of time spent on the more relevant activities,
 - focus on the experience of the individual; where it is helpful or necessary to include information about the individual's team or firm to put the information in context, ensure that the duties and responsibilities of the particular individual are clear, and
 - ensure that past experience is distinguished from proposed activities that the individual will conduct upon registration.
- Be prepared to provide evidence of the experience being described upon request (for example, a letter from a former supervisor confirming and describing the experience).
- Be prepared to answer questions about their understanding of the regulatory requirements for the category of registration applied for.
- For CCO applicants, provide information on how their past experience has provided them with the knowledge and ability to design and implement an effective compliance system.

Unacceptable practices

Applicants must not:

- Provide information that has not been reviewed for accuracy. By filing the application, the individual is certifying that the information is true and complete. It is also the firm's obligation under Part 5 of NI 33-109 to make reasonable efforts to ensure the truth and completeness of the information submitted.
- Expect that the discretionary management of the individual's own investment portfolio will qualify as relevant investment management experience or be sufficient to demonstrate the experience or competencies required for registration as a CCO.
- Rely solely on third parties such as legal counsel and compliance consultants to meet proficiency and other regulatory requirements. While we encourage registrants to make use of external supports, such as legal counsel and compliance consultants, the obligations set out in Part 5.2 of NI 31-103 are those of the registrant.



INFORMATION FOR DEALERS, ADVISERS AND INVESTMENT FUND MANAGERS

4.1 All registrants

- a) Compliance review process**
- b) Failure to provide notice of ownership changes or asset acquisitions**
- c) Current trends in deficiencies and acceptable practices**
- d) Proposed rules and initiatives impacting all registrants**
- e) Fees**
- f) Conflicts of interest**

4.2 Dealers (EMDs and SPDs)

- a) Current trends in deficiencies and acceptable practices**
- b) Charitable donation/taxable donation tax schemes**
- c) Update on results of SPD reviews**
- d) New and proposed rules and initiatives impacting dealers**
- e) EMDs and direct electronic access**
- f) Review of prospectus exemptions**
- g) Permitted activities in EMD category**
- h) Proposed amendments to NI 33-105**


4.3 Advisers (PMs)

- a) Current trends in deficiencies and acceptable practices**
- b) New and proposed rules and initiatives impacting PMs**

4.4 Investment fund managers

- a) Current trends in deficiencies and acceptable practices**
- b) Sweep of large "impact" IFMs**
- c) Sweep of newly registered IFMs**
- d) New and proposed rules and initiatives impacting IFMs**

4 Information for dealers, advisers and investment fund managers



“Our job as a regulator is to create the framework and set the rules of the game to make Ontario’s capital markets fairer and more efficient, and provide an appropriate level of investor protection.”

May 2, 2013 speech by Howard Wetston, Chair, OSC to the 2013 EMDA Exempt Market

The information in this section includes the key findings and outcomes from our ongoing compliance reviews of the registrants we directly regulate. We highlight current trends in deficiencies from our reviews and provide suggested practices to address the deficiencies. We also discuss new or proposed

rules and initiatives impacting registrants.

This part of the report is divided into four main sections. The first section contains general information that is relevant for all registrants. The other sections contain information specific to dealers (EMDs and SPDs), advisers (PMs) and IFMs, respectively. This report is organized to allow a registrant to focus on reading the section for all registrants and the sections that apply to their registration categories. *However, we recommend that registrants review all sections in this part, as some of the information presented for one type of registrant may be relevant to other registrants.*

4.1 All registrants

This section discusses our compliance review process, current trends in deficiencies and suggested practices to address them, and new and proposed rules and initiatives impacting all registrants.

a) Compliance review process

We conduct compliance reviews of registered firms on a continuous basis. The purpose of compliance reviews is primarily to assess compliance with Ontario securities law; but they also help registrants to improve their understanding of regulatory requirements and our expectations, and help us to learn about a specific industry topic or practice we may have concerns with. We frequently conduct compliance reviews on-site at a registrant’s premises, but also perform desk reviews from our offices. For information on “What to

expect from, and how to prepare for an OSC compliance review” see the slides from the Registrant Outreach session provided on October 22, 2013 on “[Start to finish: Getting through an OSC compliance review](#)”.

(i) Risk-based approach

Firms are generally selected for review using a risk-based approach. This approach is intended to identify firms that are most likely to have material compliance issues (including risk of harm to investors) or significant impact to the capital markets if there are compliance breaches. To determine which firms should be reviewed, we consider a number of factors, including firms’ responses to the most recent RAQ, their compliance history, complaints or tips from external parties, and referrals from another OSC branch, an SRO or another regulator.

(ii) Risk Assessment Questionnaire



“This process is essential for gathering data from the firms we regulate, which in turn, informs our approach to compliance...We use this data to make evidence-based decisions about which firms require further attention and oversight.”

June 10, 2014 press release re Ontario Securities Commission Issues 2014 Risk Assessment Questionnaire

We issue a comprehensive RAQ periodically to collect information about our registrants’ business operations. The [2014 RAQ](#) was sent on June 10, 2014 to firms that were registered with the OSC in the categories of PM, restricted PM, IFM, EMD, and/or restricted dealer. Firms had approximately 40 days to complete and

submit the RAQ online.

The RAQ supports our risk based approach to select firms for on-site compliance reviews or targeted reviews. Based on the responses to this year’s RAQ, we will select higher risk firms for on-site compliance reviews.

(iii) Sweep reviews

In addition to reviewing firms based on risk selection, we also conduct sweeps which are compliance reviews on a specific topic on firms in an industry sector. Sweeps allow us to respond on a timely basis to industry-wide concerns or issues. We regularly perform sweeps of newly registered firms to assess if they are off to a good start and to help them to understand their requirements and our expectations. We also regularly review large or “impact” firms as discussed in (i) above.

Some of the sweep reviews we performed this year are highlighted below:

- We completed the reviews of a sample of “impact” PMs, IFMs and EMDs. The results of this sweep produced staff guidance in relation to IFMs only. See section 4.4 b) on *Sweep of large “impact” IFMs* for a summary of this sweep’s findings and the guidance issued.
- We started on-site reviews of a sample of newly registered IFMs. We included IFMs in the sample that were registered during a specified time period and that had not previously been reviewed. See section 4.4 c) on *Sweep of newly registered IFMs* for additional information.
- We performed a desk review of the 2013 capital markets participation fees provided to the OSC for 123 registrants. See section 4.1 e) on *Ongoing review of capital markets participation fees* for additional information.
- We performed a desk review of supervisory T&Cs. See section 3.2 c) on *Desk review of supervisory T&Cs* for this sweep’s findings.

(iv) Outcomes of compliance reviews

In most cases, the deficiencies found in a compliance review are set out in a written report to the firm so that they can take appropriate corrective action. After a firm addresses its deficiencies, the expected outcome is that they have enhanced their compliance. If a firm had many significant deficiencies, once it addresses these, the expected outcome is that they have significantly enhanced their compliance.

In addition to issuing compliance deficiency reports, we take additional regulatory action when warranted (including when we identify potential registrant misconduct or fraud).

The outcomes of our compliance reviews in fiscal 2014, with comparables for 2013, are presented in the following table and are listed in their increasing order of seriousness. Firms are shown under the most serious outcome obtained for a particular review. The percentages in the table are based on the registered firms we reviewed during the year and not the population of all registered firms.

Outcomes of compliance reviews (all registration categories)	Fiscal 2014	Fiscal 2013
Enhanced compliance	53%	38%
Significantly enhanced compliance	28%	52%
Terms and conditions on registration	10%	3%
Surrender of registration	3%	1%
Referral to the Enforcement Branch	5%	2%
Suspension of registration ⁸	9%	4%

For an explanation of each outcome, see Appendix A in [OSC Staff Notice 33-738 - 2012 OSC Annual Summary Report for Dealers, Advisers and Investment Fund Managers](#) (OSC Staff Notice 33-738).

(v) Contacting investors as part of compliance reviews

We continue to contact investors as part of our ongoing, normal course reviews of dealers and advisers. For additional information, see the section titled “Contacting investors as part of compliance reviews” in [OSC Staff Notice 33-742](#).

b) Failure to provide notice of ownership changes or asset acquisitions

We continue to have significant concerns with some registrants not providing us with the required notice under sections 11.9 or 11.10 of NI 31-103 of proposed ownership changes in, or asset acquisitions of, registered firms. For example, we continue to find a number of cases where:

- Registrants (including the Ultimate Designated Person (UDP), CCO, AR, or dealing representative of the firm) acquired 10% or more of the securities of another registered firm, or their sponsoring firm, without first providing us with the required notice.
- Registered firms have not provided us with the required notice as soon as the registered firm knew, or had reason to believe, that 10% or more of its voting securities were going to be acquired by a non-registrant, including an officer,

⁸ This percentage includes registrants suspended in the period reported on as a result of compliance reviews occurring in the reporting period and registrants suspended in the reporting period based on compliance reviews that occurred prior to the reporting period.

director, permitted individual or employee of the firm (barring exceptional circumstances, we expect to receive notice of these transactions at least 30 days prior to the transaction taking place).

- Registrants acquired all or a substantial part of the assets of another registered firm without first providing us with the required notice. Examples of scenarios where we would expect to receive (and have, in fact, received) a section 11.9 or 11.10 notice in this context include:
 - the acquisition (whether structured as a “purchase” for compensation or not) of another registered firm’s book of business, including where the other registered firm is a one-person firm
 - the acquisition of a business line or division of another, large registered firm, and
 - the acquisition of all of the investment fund management contracts of another registered firm that is an IFM.

We also found that some IIROC or MFDA member firms did not file the required notices under sections 11.9 or 11.10 based on the view that their SRO notice process was sufficient. This is not the case. The notice obligations apply to all registrants, including member firms of IIROC and the MFDA, and arise from the OSC’s responsibility to register, among others, dealer firms.

In the cases where registrants did not provide us with the required notice for their completed acquisitions, we required them to file the notice materials for review and pay the applicable filing fees. Although in all of these cases to date we issued a letter to each firm warning them of the seriousness of their failure to provide notice, we may in appropriate circumstances also take other regulatory action. As we mentioned in last year’s report, registrants that do not give us the required notice (or provide the notice after the specified deadline) will most likely also be charged late fees for the late notice, as well as applicable late fees for each related securities regulatory filing that is also filed late. For a further discussion regarding late fees generally, see section 3.2(f) of this report.

In addition to filing notices under sections 11.9 or 11.10 of NI 31-103, a change in share ownership of a registered firm, or an acquisition of its assets, typically triggers additional securities regulatory filings. In addition to any SRO filings (discussed above), these additional filings could include:

- filings under NI 33-109 (including, in particular, filings of [Form 33-109F5 Change of Registration Information](#)), and
- change of manager approval requests under section 5.5 of [National Instrument 81-102 Mutual Funds](#).

Registrants must take care to ensure that all applicable securities regulatory filings are filed in accordance with their specified timelines in the event of a change in share ownership of a registered firm, or an acquisition of its assets.

Finally, NI 31-103 Proposed Amendments include proposed amendments that will streamline and clarify the filing requirements for notices under sections 11.9 and 11.10 of NI 31-103. For further information about these amendments, see sections 1.1 and 4.1 d) (i) of this report.

c) Current trends in deficiencies and acceptable practices

In this section, we summarize key trends in deficiencies from recent compliance reviews of EMDs, PMs, and IFMs. For each deficiency, we summarize the applicable requirements under Ontario securities law which must be followed. In addition, where applicable, we provide acceptable and unacceptable practices relating to the deficiency discussed. *The acceptable and unacceptable practices throughout this report are intended to give guidance to help registrants address the deficiencies, and provide our expectations of registrants. While the best practices set out in this report are intended to present acceptable methods registrants can use to prevent or rectify a deficiency, they are not the only acceptable methods. Registrants may use alternative methods, provided those methods adequately demonstrate that registrants have met their responsibility under the spirit and letter of securities law.*

We strongly recommend registrants review the deficiencies and suggested practices in this report that apply to their registration categories and operations to assess and, as needed, implement enhancements to their compliance systems and internal controls.

(i) Non-compliance with KYC, KYP and suitability requirements and accredited investor requirements

We continue to have concerns that some dealers and advisers are not adequately meeting their KYC, KYP and suitability obligations. We also remain concerned that some EMDs are

selling securities to investors that do not qualify under a prospectus exemption (such as the accredited investor exemption).

On January 9, 2014, we published [CSA Staff Notice 31-336 - Guidance for Portfolio Managers, Exempt Market Dealers and Other Registrants on the Know-Your-Client, Know-Your-Product and Suitability Obligations](#) (CSA Staff Notice 31-336).

The notice provides additional guidance to registrants in the areas of KYC, KYP and suitability obligations and sets out our expectations of registrants on how to comply with these important regulatory requirements. In particular, we expect registrants to take extra care in complying with their KYC, KYP and suitability obligations when dealing with clients who are seniors or those who may be in a position of vulnerability. Some of the suggested practices and unacceptable practices are highlighted below:

Suggested practices to adequately address KYC, KYP, suitability and accredited investor requirements

Registrants must:

- Engage in a meaningful discussion with clients to obtain a solid understanding of the client's personal and financial circumstances.
- Update KYC information at least annually or more often if there is a significant change to the client's life circumstances or a significant change in market conditions.
- Conduct product due diligence and be able to explain clearly to clients a security's risks, key features, any conflicts of interest and initial and ongoing costs and fees.
- Maintain adequate documentation to support the suitability analysis of each trade and be able to explain to clients how the proposed investment strategy is suitable for the client and how it aligns with their investment needs and objectives.

Unacceptable practices

Registrants must not:

- Delegate KYC and the suitability obligation to an unregistered individual.
- Solely ask the clients to "tick a box" that best describes their investment objectives or risk tolerance without engaging in a discussion with the clients about their personal and financial circumstances.
- Fail to fully understand the structure and features of products before recommending them to clients.

We strongly encourage our registrants to use CSA Staff Notice 31-336 as a self-assessment tool to strengthen their compliance and to improve their systems of internal control and supervision.

(ii) Written policies and procedures are not tailored to a registrant's operations

During our reviews of newly registered IFM firms (see section 4.4 c) for additional information), we noted instances where some firms did not have a written policies and procedures manual that was tailored to their operations and did not adequately cover the processes and procedures that a firm should have in place to establish an adequate compliance system.

To meet the requirements of section 11.1 of NI 31-103, we expect firms to establish, maintain and apply policies and procedures that are tailored to their respective business operations in order to establish a system of controls and supervision to ensure compliance with securities law and to manage the risks associated with their business in accordance with prudent business practices.

Part 11 of 31-103CP provides guidance on the content and maintenance of written policies and procedures. We also expect firms to have a process in place to ensure that written policies and procedures are regularly updated for changes in the firm's business operations, industry practice and securities law.

Suggested practices to adequately tailor written policies and procedures to a registrant's operations

Registrants must:

- Develop and enforce policies and procedures that are applicable to their firm's business operations.
- Develop policies and procedures that are sufficiently detailed and cover areas relevant to a firm's business operations.
- Provide adequate training to all employees to ensure that employees understand the established policies and procedures and understand how to incorporate them in their daily business activities.
- Review the written policies and procedures on a frequent basis to confirm that the policies and procedures are current and adequately reflect the firm's business

operations, industry practice and securities law.

- Remove sections from a policies and procedures manual that are not applicable to the firm's operations.
- Add sections to a policies and procedures manual that are specific to the firm's operations.

Unacceptable practices

Registrants must not:

- Use a template of written policies and procedures provided by another firm or a consultant without reviewing and tailoring the template to the firm's operations and security law obligations.

Section 11.1 of NI 31-103 requires you to establish, maintain and apply policies and procedures that establish a system of controls and supervision to ensure compliance with securities law and manage the risks associated with your business in accordance with prudent business practices. You must also have processes in place to ensure that your written policies and procedures are regularly updated, such as for changes in your business practice, industry practice or securities law.

Please refer to Part 11 of 31-103CP, under the heading "Detailed policies and procedures", for guidance on the content, accessibility and maintenance of written policies and procedures.

(iii) Inadequate insurance coverage

Some IFMs that were part of the newly registered IFM reviews (discussed in section 4.4 b) of this report) did not maintain an adequate financial institution bond (FIB). In these cases, the FIB provided insurance coverage for the benefit plan of the firm's employees under the same insurance rider maintained by the firm to meet its obligations under section 12.6 of NI 31-103. Although this coverage is not offside securities law, the FIB did not include specific provisions to ensure that the claims made by and paid in relation to the employee benefit plan would not affect the limits or coverage applicable to the firm under the FIB.

We also noted that the firms that had this type of insurance coverage in place were not aware of the affect that the coverage could have on the limits available to the firm under the FIB.

Section 12.6 of NI 31-103 prohibits a firm from maintaining bonding or insurance that benefits, or names as an insured, another person or company unless certain conditions are met. One of these conditions is that the individual or aggregate limits under the FIB may only be affected by claims made by or on behalf of the firm or the firm's subsidiary whose financial results are consolidated with the firm's. Additional guidance related to this issue is also found in section 12.6 of 31-103CP.

There is a risk of harm to investors when a firm is not adequately meeting its insurance requirements. The requirement to maintain insurance exists to protect investors in the case of adverse circumstances.

Suggested practices to maintain adequate insurance coverage

Registrants must:

- Carefully read all sections of the insurance policy and understand the firm's insurance coverage.
- Fully understand the implications of insuring additional entities under the FIB on the limits available to the firm.
- Verify by reviewing the insurance policy that the limits available to the firm will not be affected by also insuring other entities and confirm this with the insurance provider.
- Confirm that the insurance coverage in place meets securities law requirements at all times.
- Have written policies and procedures in place to make sure that the insurance policy is regularly reviewed and approved for all of the above and for compliance with securities law.

Unacceptable practices

Registrants must not:

- Solely rely on their insurance provider to use a template insurance policy and FIB to meet the insurance requirements under Division 2 of NI 31-103.
- Sign off on an insurance policy without carefully reading the policy and understanding

all of the implications to the firm's coverage by providing coverage to other entities.

(iv) Repeat common deficiencies

The following includes the deficiencies that we continue to find in reviews of our registrants that have been reported on in previous annual reports and prior guidance. We encourage you to review the information sources provided as the previously published guidance is still applicable to these issues.

Repeat common deficiency	Information source
1) Inadequate compliance system and UDP and CCO not meeting their responsibilities	<ul style="list-style-type: none"> • Section 4.1.2 in OSC Staff Notice 33-742 under the heading <i>Inadequate compliance systems and UDPs and CCOs not meeting their requirements</i> • Section 11.1 of 31-103CP • May 2012 OSC e-mail blast to CCOs and UDPs on Inadequate Compliance Systems
2) Inadequate or no annual compliance report	<ul style="list-style-type: none"> • Section 4.1.2 in OSC Staff Notice 33-742 under the heading <i>Inadequate or no annual compliance report</i> • Section 5.1.2 in OSC Staff Notice 33-738 under the heading <i>Failure by CCO to submit an annual compliance report</i>
3) Inaccurate calculations of excess working capital	<ul style="list-style-type: none"> • Section 4.1.2 in OSC Staff Notice 33-742 under the heading <i>Inaccurate calculations of excess working capital</i>
4) Insufficient working capital and failure to report capital deficiency	<ul style="list-style-type: none"> • Section 4.1.2 in OSC Staff Notice 33-742 under the heading <i>Insufficient working capital and failure to report capital deficiency</i>
5) Inadequate relationship disclosure information	<ul style="list-style-type: none"> • Section 4.1.2 in OSC Staff Notice 33-742 under the heading <i>Inadequate relationship disclosure information</i> • CSA Staff Notice 31-334 - CSA Review of Relationship Disclosure Practices

<p>6) Incorrect calculation of capital markets participation fees</p>	<ul style="list-style-type: none"> • Section 4.1.2 in OSC Staff Notice 33-742 under the heading <i>Incorrect calculation of capital markets participation fees</i> • Section 3.5 of OSC Staff Notice 33-742 under the heading <i>Amendments to calculation of capital markets participation fees</i> • OSC Staff Notice 33-741 - Report on the Results of the Reviews of Capital Markets Participation Fees
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d) Proposed rules and initiatives impacting all registrants



(i) NI 31-103 Proposed Amendments

The following chart provides a high level overview of the NI 31-103 Proposed Amendments to requirements that impact all registrants.

Proposed amendment ⁹	Topic	Purpose
Sub-sections 8.0, 8.22.2 and 8.26.2 of NI 31-103	Availability of exemptions to registered firms [“prohibition on concurrent reliance”]	To ensure that registration exemptions are applied in a harmonized fashion across the CSA by ensuring that all activities undertaken by a registered firm are conducted by the firm pursuant to its registration, and not in reliance on an exemption available in Part 8 of NI 31-103.
Section 12.2 of NI 31-103	Subordination agreement	To clarify registered firms’ obligations in deducting non-current related party debt from their working capital and delivery

⁹ Subject to change and final approval

		obligations regarding subordination agreements.
Form 31-103F1 - <i>Calculation of excess working capital</i>	Margin rate applicable to US money market funds when calculating a registered firm's working capital	To codify discretionary exemptive relief granted to certain US based registered firms.
Sections 1.3, 11.9 and 11.10 of NI 31-103	Clarify sections 11.9 and 11.10 (acquisitions of a registered firm's securities or assets)	To provide increased clarity to industry regarding when notices must be filed and to streamline the filing process.
Section 1.3 of 31-103CP	Securities issuers guidance in 31-103CP	To incorporate internal guidance on the application of the business trigger for issuers at the start-up stage.

For additional information refer to section 1.1 in this report.

(ii) Mandatory electronic delivery of documents to the OSC

Effective February 19, 2014, [OSC Rule 11-501 Electronic Delivery of Documents to the Ontario Securities Commission and Consequential Policy Amendments](#) (OSC Rule 11-501) required certain documents identified under Ontario's securities law, that were previously filed with the Commission in paper format, to be delivered electronically through the OSC's filing portal page. The new requirements include documents associated with forms, notices and other materials required under Ontario's securities law that are not already filed through the National Registration Database (NRD).

Each required document must be delivered to the OSC electronically in accordance with instructions on the OSC's website. For registered firms and exempt international firms, a list of these documents and submission methods can be found on the [OSC's website](#).

For certain filings where a fee is due with the filing, payment may be made via NRD, cheque or submitted electronically (e.g. debit/credit/wire transfer). See further instructions on [paying registrant-related fees](#).

For further filing instructions in Ontario, see [OSC's electronic filing portal](#). For more information see OSC Rule 11-501.



e) **Fees**

(i) **Capital markets participation fees**

Each year, registered firms, exempt international firms and unregistered IFMs are required to pay participation fees to the OSC based on the firm's revenues attributable to their capital markets activities in Ontario.

The [Fees Rule](#) requires registered firms, exempt international firms relying on sections 8.18 [international dealer] and 8.26 [international adviser] of NI 31-103 and unregistered IFMs to complete [Form 13-502F4 Capital Markets Participation Fees](#) (Form 13-502F4) based on information from their financial statements for their "reference fiscal year".

Ongoing review of capital markets participation fees

We conducted a review of the 2013 capital markets participation fees for one hundred and twenty-three firms that were submitted to the OSC under the Fees Rule using Form 13-502F4. In addition, we identified over seven hundred firms that calculated the participation fees using the incorrect "reference fiscal year".

If the firm was registered or relying on an exemption from registration under the Act at the end of its last fiscal year ending before May 1, 2012, the "reference fiscal year" used to calculate participation fees is the firm's last fiscal year ending before May 1, 2012. Most firms will fit in this category.

For all other firms, the "reference fiscal year" used to calculate participation fees is their last fiscal year ending in the calendar year. For specific examples of how to apply the "reference fiscal year" concept, see the [e-mail sent to all firms on November 30, 2013](#).

Also refer to section 4.1 c) (iv) 6) on *Incorrect calculation of capital markets participation fees* in this report for additional information.

We will continue to review capital markets participation fees on an ongoing basis.

2014 Capital Markets Participation Fees

Firms are required to continue using the “reference fiscal year” concept to complete Form 13-502F4 due no later than December 1, 2014 (i.e. same fiscal reference year as that used for their 2013 calculation). For unregistered IFMs only, Form 13-502F4, along with the participation fee, are due no later than 90 days after the end of their fiscal year.

All firms are required to complete the participation fee calculation electronically through the OSC website. The participation fee calculation can be accessed through the [OSC's website](#).

Capital markets participation fee relief

On February 20, 2014, the OSC published [OSC Staff Notice 13-704 Applications for Participation Fee Relief for Certain Small Registered Firms and Reporting Issuers](#) (the Fee Relief Notice).

A total of twenty-one registered firms that applied by the deadline and met the criteria outlined in the Fee Relief Notice, were granted a one-time 50% refund (or reduction) of their participation fee, subject to payment of the minimum participation fee of \$800.

For more information, see [OSC Staff Notice 13-704](#).

For additional information on fees, see the [Fees Rule](#).

(ii) Amendments to capital markets participation fees

Amendments are currently being made to the Fees Rule. These amendments were published for comment on September 18, 2014 and can be found under [Proposed Amendments to OSC Rule 13-502 Fees and Companion Policy 13-502CP Fees](#). The amendments do not apply to the calculation and payment of the 2014 capital markets participation fees.



f) Conflicts of interest

A registered firm is responsible for having a compliance system that promotes compliance by the firm and its individuals with securities law. Registrants often encounter conflict of interest situations during their daily operational activities. A conflict of interest is any circumstance where the interests of different parties, such as the interests of a client and those of a registrant, are inconsistent or divergent. Registered firms are responsible for identifying and appropriately responding to any conflicts of interest under Part 13 of NI 31-103. In this section, we highlight common conflict of interest situations noted for each registration category and provide suggestions on how to address these conflict of interest issues.

(i) EMD related conflicts of interest:

We continue to have significant concerns with EMDs that trade in, or recommend, the products of related and/or connected issuers (often referred to as “related party products”), particularly those EMDs that trade *solely* in these products¹⁰. Material conflicts of interest arise with these relationships, in large part due to the lack of separation between the mind and management of the EMD and the issuer.

Simply disclosing this conflict of interest to investors (e.g., providing the information required by [National Instrument 33-105 Underwriting Conflicts](#) (NI 33-105) is not acceptable. The conflict of interest may need to be (1) avoided because the risk of harming a client or the integrity of the markets is too high or (2) controlled, for instance through the establishment of an independent review committee (IRC) and the provision of the issuer’s audited financial statements.

EMDs that trade in, or recommend, related party products are not exempt from registrant obligations, including those relating to KYC, KYP and suitability (refer to section 4.1 c)(i) and section 4.2 a)(ii) in this report for a discussion of an EMDs’ KYC, KYP and suitability obligations). We continue to take corrective action, including suspension or sanctions or

¹⁰ Significant deficiencies that we have continued to identify include misappropriation of investor funds; concealment of poor financial condition of related and/or connected issuer; sale of unsuitable, high-risk investments to investors; and high investment concentration in related party products.

referrals to the Enforcement Branch, against EMDs that do not comply with applicable securities law requirements.

We continue to work toward our policy objective of increasing investor protection and deterring the misuse of investor funds by registrants and their related and/or connected issuers. In the interim, we have issued the Questionnaire (see section 4.1 a) (ii) of this report) that includes questions to aid us in identifying EMDs with significant conflicts in their business models.

Acceptable practices to deal with conflicts of interest

EMDs are encouraged to:

- Avoid conflicts of interest that are contrary to the interests of investors. In some situations, controls and/or disclosure are not appropriate responses to these conflicts.
- Ensure organizational structures, lines of reporting and physical locations will enable the firm to control these risks and conflicts of interest effectively.
- Provide specific and clear disclosure to investors about the relationships that raise potential conflicts so that investors can assess the conflict and ask appropriate questions if needed. Refer to [OSC Staff Notice 33-742](#) under the sections titled "Conflicts of interest when selling securities of related or connected issuers" and "Inadequate disclosure of conflicts of interest" for more detailed guidance.

Unacceptable practices

EMDs must not:

- Assume that disclosure of the conflict of interest is sufficient, without avoiding or controlling the conflict as needed.
- Assume that the firm is exempt from registrant obligations by virtue of its related and/or connected issuer relationship.
- When disclosing the conflict of interest, provide generic, partial or overly detailed or complex disclosure, or rely on previous disclosure that may not be up to date or timely.

(ii) IFM related conflicts of interest:

We generally see two types of conflicts that arise in the operation of an investment fund:

- **Operational conflicts** – those relating to the operation by the fund manager of its investment funds that are not specifically regulated under securities law, except through the standard of care imposed on the fund manager under section 116 of the Act and the general conflict of interest requirements in Part 13 of NI 31-103
- **Structural conflicts** – those resulting from proposed transactions by the IFM with related entities of the IFM, investment fund or PM currently prohibited or restricted by securities law.

For investment funds that are reporting issuers, IFMs are required to comply with the requirements of [National Instrument 81-107 Independent Review Committee for Investment Funds](#) (NI 81-107). The conflict of interest provisions provided in NI 31-103 do not apply to investment funds that are subject to NI 81-107. The type of conflicts of interest that arise with investment funds that are reporting issuers can also apply to private investment funds that are not reporting issuers since public and private investment funds have similar operational areas and functions. As a result, we often turn to the conflicts of interest addressed by NI 81-107 and the methods used to deal with these conflicts as a guide on managing conflicts of interest for private investment funds as well.

Some of the operational conflicts of interest that arise with IFMs and the investment funds they manage, include, but are not limited to the following:

- **Fund Valuation** – if an IFM receives a performance fee that is based on the assets under management of the fund it manages, there is a conflict of interest if the IFM is also solely responsible for valuing the assets of the fund
- **Net Asset Value (NAV)/Error Correction** – conflicts of interest can arise through an IFM's obligation to monitor NAV errors and reimburse investment funds that are affected by a NAV error.

An example of a structural conflict of interest that may arise with IFMs and the investment funds they manage, include, but are not limited to the following:

- **Fund on Fund Arrangements** - if a registered firm acts in the capacity of IFM for both a top and bottom fund in a fund of fund arrangement, there is a potential conflict of interest in the IFM meeting its best interest standard under section 116 of

the Act for both investment funds in ensuring that the best interests of both funds are not compromised by the IFMs actions for one fund versus another.

A comprehensive, but not an exhaustive list of the type of conflict of interest situations that may arise can be found in section 2.3 of [OSC Staff Notice 81-713 Focussed Disclosure Review – National Instrument 81-107 Independent Review Committee for Investment Funds](#).

Suggested practices to address conflicts of interest

IFMs must:

- Assess the IFMs operations and daily interaction with the investment funds to identify conflicts of interest that may arise.
- Establish written policies and procedures to identify and respond to material conflicts of interest between the IFM and the investment funds managed.
- Adequately respond to each conflict of interest that arises by either:
 - avoiding the conflict,
 - controlling the conflict, and
 - disclosing the conflict.
- Disclose, in a timely manner, the nature and extent of a conflict of interest to fund investors to allow them to make an informed investment decision.
- Establish standing instructions reviewed and approved by the IRC.
- Review standing instructions on a regular basis and update the IRC as required.
- Consult the IRC in situations where a standing instruction does not exist and even in variations to a situation where a standing instruction does exist.

IFMs are encouraged to:

- Consult the IRC (if the IFM has an IRC) for conflict of interest matters that arise in investment funds that are not reporting issuers; many IFMs have an IRC established for their reporting issuer investment funds, and also use the IRC for conflict of interest matters that arise with the private investment funds managed.

Unacceptable practices

IFMs must not:

- Enter into conflict of interest situations that result in a benefit to the IFM at the expense of the fund and its investors. In these circumstances, the IFM must avoid the conflict entirely. Disclosure and control of a conflict of interest situation that is

detrimental to a fund and its unitholders is not an acceptable method to deal with a detrimental conflict of interest.

(iii) PM related conflicts of interest:

We generally see two types of conflicts of interest that arise for PMs when dealing with their clients:

- **Competing PM and client interests** – where the interests of the PM are not aligned with the interests of its clients
- **Competing client interests** – where the interests of a client of the PM are not aligned with the interests of another client of the PM.

PM/client conflicts

Some transactions that cause conflicts of interest between PMs and their clients are prohibited. Subsection 13.5(2)(b) of NI 31-103 provides further details, however examples include:

- **Restricted Trades** - A PM must not knowingly cause a managed account of a client¹¹ to purchase or sell a security from or to another managed account, of the PM or an officer of the PM
- **Personal trading** – employees or other individuals at PMs that have access to clients' trading and investment information (Access Persons) must not use the information for their personal gain.

Some activities that create conflicts of interest between PMs and their clients are permitted, provided that the PM responds appropriately to the conflict of interest. Appropriate responses include control and/or disclosure of the conflicts of interest. Such activities include, but are not limited to:

- **Use of client brokerage commissions** – PMs direct trades involving clients' brokerage commissions to a dealer and receive goods and services (e.g. research reports) from the dealer or a third party.

A PM using client brokerage commissions has to comply with [National Instrument 23-102 Use of Client Brokerage Commissions](#) (NI 23-102), which states that PMs must:

¹¹ Including investment funds for which the PM acts as an adviser.

- only direct trades involving clients' brokerage commissions to a dealer in return for order execution and research goods and services provided by the dealer or a third party,
- ensure that the goods or services are used to assist with investment or trading decisions, or with effecting securities transactions, on behalf of clients,
- make a good faith determination that clients receive a reasonable benefit considering the use of the goods or services and the amount of client brokerage commissions paid, and
- disclose specific information¹² to a client on their use of client brokerage commissions of that client that have been or might be directed to a dealer in return for goods or services.

Suggested practices to address conflicts of interest related to PM and client services

PMs must:

- Make a reasonable allocation for using client brokerage commissions to pay for "mixed-use" items according to the use of the goods or services.
- Maintain records of the analysis conducted to determine the allocation for using client brokerage commissions to pay for "mixed use" items.
- Establish, maintain and apply written personal trading policies and procedures for their Access Persons¹³.
- Maintain records of personal trade pre-approvals and personal trading records of Access Persons.
- Assess compliance with the personal trading policies as part of the CCO's annual compliance report to the board.

Unacceptable practices

PMs must not:

- Use client brokerage commissions to pay for goods and services that relate to the overhead associated with the operation of the PM's business. Examples of non-permitted goods and services that should not be paid with client brokerage

¹² See section 4.1 of NI 23-102, Part 5 of the Companion Policy to NI 23-102 and section 5.2 of OSC Staff Notice 33-736 - 2011 Annual Summary Report for Dealers, Advisers and Investment Fund Managers for more details of disclosure obligations to clients.

¹³ See section 4.3.1 of OSC Staff Notice 33-742 for more details of what to include in a PM's personal trading policy.

commissions include office furniture and equipment, and trading surveillance or compliance systems.

- Receive Access Persons' personal trading records from the Access Persons. PMs should require direct receipt of Access Persons' personal trading records (such as account statements) from the Access Persons' brokers.

Competing interests of clients

PMs need to manage conflicts of interest where the interests of a client of the PM are not aligned with the interests of another client. Examples include:

- **Allocation of investment opportunities** – an investment opportunity may be suitable for a number of clients of a PM, but may be of limited supply, forcing the PM to allocate the trade among client accounts. A PM must deliver a summary of its policy to ensure fairness in allocating investment opportunities (Fairness Policy)¹⁴ to its clients when it opens an account for the client and when there has been a significant change to the summary previously delivered
- **Trades between client accounts** – the sale of a security from one client's account to another client's account may not be in the best interest of both clients involved.

Suggested practices to manage competing interests of clients

PMs must:

- Allocate suitable investment opportunities to their clients using a systematic and fair process, for example using a pro-rata, rotational or statistically random allocation methodology.
- Establish policies and procedures for executing trades between client accounts, including the review and approval, pricing, execution cost, and execution through a dealer of trades between client accounts.

Unacceptable practices

PMs should not:

- Consistently allocate investment opportunities in favor of one client or group of clients over others, for example, allocation to clients with a smaller portfolio size, or to clients whose portfolios are underperforming.

¹⁴ See section 14.10 of 31-103CP and OSC Staff Notice 33-738 for more details of what to include in a PM's Fairness Policy.

- Justify unfair allocation of investment opportunities by disclosing the practice to clients.
- State in their fairness policy that judgment is used to allocate investments. A fairness policy should be sufficiently objective and specific to permit independent verification of the fairness of the allocation.
- Knowingly direct a trade in portfolio securities from one investment fund to another investment fund (inter-fund trades) unless these trades are approved by the investment funds' IRC and the trades comply with other prescribed conditions under section 6.1 of NI 81-107¹⁵. PMs should take particular care when directing trades for investment funds for the same portfolio security, but in opposing directions (i.e. buy and sell) at the same time and to the same broker, to ensure they are not knowingly causing inter-fund trades.

4.2 Dealers (EMDs and SPDs)

This section contains information specific to EMDs and SPDs, including current trends in deficiencies from compliance reviews of EMDs (and acceptable practices to address them), an update on the results of the SPD reviews, and new and proposed rules and initiatives.



a) Current trends in deficiencies and acceptable practices

Our EMD reviews continued to focus on areas that we found to be problematic in recent years, and also focused on large EMD firms with branches and sales representatives across the country. The areas of focus included:

- maintaining adequate compliance and supervision systems, including the UDP and CCO performing their responsibilities,
- identifying and responding to conflicts of interest,
- adequate collection and documentation of KYC information and assessing the suitability of trades,
- sufficient product review process and knowledge of products recommended, by both the firm and the individual dealing representatives (KYP), and
- fair sales and marketing practices, including how referral arrangements are used in the sales process.

We will continue to focus our compliance resources on these areas.

¹⁵ Also, see section 13.5 of 31-103CP, under the heading "Restrictions on trades with certain investment portfolios", for further guidance.

In addition to the deficiencies included in [CSA Staff Notice 31-336](#) (see section 4.1 c)(i)) the following are trends in deficiencies and other areas of concern identified during this year's reviews of EMDs. Where applicable, we also highlight recent regulatory proceedings brought against EMDs to demonstrate our response when we identify registrant misconduct and the consequences to EMDs that fail to comply with securities law.

(i) Ineffective compliance systems

We continue to find firms that do not maintain an adequate compliance system and firms where the UDP and CCO are not meeting their responsibilities. This is most evident amongst EMDs that distribute related party products (e.g. securities of related or connected issuers), where the same individuals form the management of both the EMD and the issuer. We found significant compliance issues across many areas including:

- failure to address and respond to material conflicts of interests, particularly with respect to handling of conflicts of interest between the firm and the related party products being sold,
- allowing non-registered entities and individuals to trade on the firm's behalf without appropriate registration,
- selling of securities of related party products when they were not suitable and permitting high investment concentration in related issuers, and
- insufficient product review process by the dealer prior to distribution, including relying on an issuer's own analysis.

There were serious consequences to firms who had deficiencies of this nature and we took appropriate regulatory action including recommendations for suspension of the firm's registration or referrals to Enforcement. See section 5.1 of this report in relation to registrant misconduct cases.

Registrants are required to maintain internal controls and a sufficient supervisory system to ensure compliance with securities law and to manage business risks (see section 32(2) of the Act and section 11.1 of NI 31-103). A firm's UDP and CCO have extremely important compliance roles. They are ultimately responsible for ensuring that a compliance system is in place to ensure that the firm, and its representatives, comply with securities law. It is critical that they understand and fulfill their required responsibilities and roles under sections 5.1 and 5.2 of NI 31-103.

See section 4.1 c) (iv)(1) of this report for more information.

(ii) Failure to conduct sufficient and/or independent assessment of products

We continue to identify a number of firms that are not performing a sufficient assessment of the issuers/products they are distributing. We noted deficiencies in the following areas:

- failure to perform sufficient due diligence on the issuer being distributed, including failure to obtain financial statements or other financial information related to the issuer and failing to understand the key features of the issuer (e.g. risks, redemption features),
- failure to perform background checks on the issuer, its principals and where applicable the underlying business operations of the issuer,
- performing due diligence on the issuer only after distributing units of the issuer to clients of the firm, and
- relying solely on a third party due diligence assessment of the issuer (e.g. without independently reviewing the facts or the assumptions built into the assessment).

Registered firms are required to ensure that, before they make a recommendation or accept a client's instruction to buy or sell a security, the purchase or sale is suitable for the client (see section 13.3(1) of NI 31-103). To meet this suitability obligation, registrants should have an in-depth knowledge of all products they sell or recommend to clients and be able to explain to their clients the product's risks, key features, initial and ongoing costs and fees and other relevant information. Registrants are required to have conducted sufficient due diligence on the issuer prior to soliciting any clients or distributing securities of the issuer.

For further guidance on meeting KYP and suitability obligations, please refer to [CSA Staff Notice 31-336](#) and [CSA Staff Notice 33-315 – Suitability Obligation and Know Your Product](#).

Acceptable practices to conduct a KYP assessment

EMDs must:

- Perform sufficient due diligence on an issuer prior to recommending the security to clients.

- Understand the key features, financial information, and product risks of the security and be able to explain them to their clients.
- Analyze and review any third party assessment of the issuer for completeness, reasonableness and accuracy.

Unacceptable practices

EMDs must not:

- Wait to perform due diligence of an issuer after beginning to distribute its securities to clients.
- Rely solely on the issuer's information or third parties to fulfill their KYP obligation, e.g. information in the offering memorandum.
- Recommend or sell a product without understanding the product's risk and key features.

(iii) Referral arrangements and finders

Referral arrangements¹⁶ entered into by EMDs must comply with securities law requirements, including those in Part 13, Division 3 of NI 31-103. These requirements include:

- that referral arrangements must be set out in a written agreement,
- all referral fees¹⁷ must be recorded,
- clients must receive specified written disclosure, and
- an EMD must not refer a client to a person or company unless it first takes reasonable steps to ensure that the person or company is appropriately qualified and/or registered.

Firms must monitor and supervise all referral arrangements. Although dealing representatives can be parties to referral agreements, the registered firm itself must be a party, since it must be aware of the agreement in order to ensure compliance with applicable requirements. The obligation to monitor and supervise compliance continues for as long as the referral arrangement is in place.

¹⁶ Any arrangement in which a registrant agrees to pay or receive a referral fee.

¹⁷ Any form of direct or indirect compensation for the referral of a client to or from a registrant.

A client that is referred to an EMD becomes that EMD's client for the purposes of the services provided under the referral arrangement. As a result the EMD must meet all of its registrant obligations, including those relating to KYC, KYP and suitability. Refer to section 4.1 c) (i) and section 4.2 a) (ii) of this report for a discussion on an EMD's KYC, KYP and suitability obligations. An EMD must also address conflicts of interest arising from the referral arrangement.

We understand that some finders inappropriately rely on section 8.5 of NI 31-103, which provides an exemption from the dealer registration requirement if a trade is made solely through a registered dealer. If a finder is "in the business of trading", as a result of it frequently or regularly contacting prospective investors, it cannot rely on this exemption and must be appropriately registered.

Acceptable practices to adequately address referral arrangements

EMDs must:

- Ensure that all parties to referral arrangements are registered, if required, including finders.
- Ensure that the roles and responsibilities of the parties to the written agreement are clear.
- Provide clients with disclosure about the referral arrangement to help them evaluate the arrangement, including any potential conflicts of interest. This disclosure must be provided before or at the time the referred services are provided.
- Manage conflicts of interest that arise from the referral arrangement in accordance with Part 13, Division 2 of NI 31-103.

Unacceptable practices

EMDs must not:

- Interpret "referral arrangement" and "referral fee" narrowly, since NI 31-103 defines these terms broadly.
- Overlook unreasonably high referral fees that could motivate dealing representatives to act contrary to their duties towards clients.
- Use a referral arrangement to assign, contract out of or otherwise avoid its regulatory obligations (e.g. by using an unregistered finder to contact potential investors, instead of a properly registered dealing representative).

- Assume that registrant obligations can be reduced by contracting with unregistered individuals or firms through a referral arrangement.

b) Charitable donation/taxable donation tax schemes

We remind market participants that tax shelter products, including ones that involve leveraged donations of property (for instance, artwork and medical supplies) to charities and ones that are marketed to investors on the basis of tax credits or deductions that are claimed to be available, are typically considered “securities” as defined in subsection 1(1) of the Act.

Consistent with the recent decision of the Alberta Court of Appeal Re Synergy Group¹⁸, these arrangements typically constitute securities on one or more grounds, including that they are “investment contracts”. Accordingly, we expect promoters and distributors of these products to comply with the necessary registration, disclosure and other Ontario securities law requirements.

When we review these products, to determine whether they are (1) securities and (2) suitable investments for investors, we will consider factors that include:

- Clients’ objectives in participating. For example, in the case of a leveraged donation of property, is the client genuinely seeking to contribute to the charity or is the client seeking a financial return (and, therefore, making an investment decision)?
- If tax credits or deductions are being marketed to clients, what is the basis for doing so? For example, is there a legal opinion – and, if so, is it addressed to the clients or to the promoter/distributor? How is the quantum of these tax credits or deductions valued?
- Does the product have a tax shelter number for identification by the Canada Revenue Agency (CRA)?
- Has the CRA previously challenged the claims or deductions of clients in similar tax shelter arrangements or tax shelter arrangements facilitated by the same promoter/distributor of the current arrangement?
- Has the promoter/distributor been involved in any regulatory and/or legal proceedings involving the tax status of a similar arrangement?

¹⁸ Synergy Group (2000) Inc. v. Alberta (Securities Commission), 2011 ABCA 194 (June 28, 2011).

We remind registrants to carefully consider their KYC, KYP and suitability obligations when promoting and selling tax shelter products. Refer to section 4.1 c) (i) and section 4.2 a) (ii) of this report for a discussion on an EMD's KYC, KYP and suitability obligations.

A number of promoters and distributors have marketed tax shelter products to investors using misleading claims, for instance regarding the availability of financial returns, while at the same time disclaiming responsibility for such claims. The CRA has recently challenged claims for tax credits or deductions by investors in these tax shelter products and we understand that the Royal Canadian Mounted Police has issued warnings stating that certain tax shelter products appear to be fraudulent.

We will continue to conduct reviews, including onsite compliance reviews, of entities promoting and/or distributing tax shelter products. Where necessary, we will take corrective action, including suspension, sanctions and referrals to the Enforcement Branch.

c) Update on results of SPD reviews

As noted in section 5.3.1 of [OSC Staff Notice 33-738](#) and section 4.2.2 of [OSC Staff Notice 33-742](#) we conducted compliance reviews in 2011 of the five firms solely registered in the category of SPD. We referred four of these SPDs to our Enforcement Branch after identifying serious concerns with their compliance systems and sales practices.

Regulatory proceedings were brought against the four SPDs in response to significant non-compliance by the firms. In order to address our investor protection concerns, interim T&Cs on their registration were imposed by the Commission on consent of each of Children's Education Funds Inc., Global RESP Corporation, Heritage Education Funds Inc. and Knowledge First Financial Inc. Please see Section 4.2.2 of [OSC Staff Notice 33-742](#) for more information about the key T&Cs that were imposed by temporary orders on these registrants.

The proceedings against the SPDs have been concluded and all four of the temporary orders have been revoked. In addition, separate settlement agreements were reached with each of the four SPDs in which they acknowledged that changes were required to strengthen their respective compliance systems so as to better serve the public interest.

All public information involving the SPDs is available on the OSC’s website under [All Commission Proceedings](#).



d) New and proposed rules and initiatives impacting dealers

(i) NI 31-103 Proposed Amendments for dealers

The following chart provides a high level overview of the NI 31-103 Proposed Amendments to requirements that impact dealers.

Proposed amendment ¹⁹	Topic	Purpose
Sections 3.6, 3.8 and 3.10 of NI 31-103	Dealers CCO proficiency in NI 31-103 and 31-103CP	To introduce an experience requirement for dealer CCOs.
Section 7.1 of NI 31-103 and 31-103CP	“Foreign Broker Dealer” project	To prohibit EMDs from executing trades of securities on or off a marketplace or giving instructions to execute trades of securities on a marketplace (including by establishing omnibus accounts with investment dealers and trading for their clients through that account). To clarify that EMDs may only underwrite securities in limited circumstances.
Section 8.5 of NI 31-103	Trades through or to a registered dealer	To achieve a harmonized interpretation of section 8.5 and to clarify that this exemption is not available if the person relying on the exemption solicits or contacts any person or company that is a purchaser in relation to the trade.
Subsection	Trades through a registered	To add an exemption from the

¹⁹ Subject to change and final approval

8.5.1 of NI 31-103	dealer by registered adviser	dealer registration requirement for registered advisers in order to clarify that incidental trading activities by advisers do not require registration as a dealer, provided the trades are executed through a registered dealer.
Section 8.18 of NI 31-103	International dealer exemption	To revert back to the less restrictive "permitted client" conditions in this exemption that were in force prior to July 11, 2011.

For additional information, refer to section 1.1 in this report.

e) EMDs and direct electronic access

We remind EMDs that they are prohibited from using direct electronic access (DEA) under National Instrument 23-103 *Electronic Trading* (NI 23-103), which came into effect on March 1, 2013²⁰. For additional information, refer to [the unofficial consolidation of National Instrument 23-103 and its companion policy](#) published on March 1, 2014. The CSA continue to be of the view that only dealers that are members of IIROC and subject to the Universal Market Integrity Rules (UMIR) are permitted to use DEA. However, a firm registered as both an EMD and a PM is permitted to use DEA, provided that it is only using DEA in its capacity as a PM for its managed account clients.

Please refer to section 5.2 (e) in [OSC Staff Notice 33-736 - 2011 Annual Summary Report for Dealers, Advisers and Investment Fund Managers](#) (OSC Staff Notice 33-736) under the heading *New and proposed rules impacting portfolio managers – Direct electronic access* and section 5.4(c) under the heading *New and proposed rules impacting exempt market dealers – Direct electronic access (DEA)* for a previous discussion on this topic. Please also refer to [IIROC Dealer Member Rules](#) and [UMIR](#) for additional information.

f) Review of prospectus exemptions

See section 1.2 of this report for a discussion on the review of prospectus exemptions.

²⁰ Amendments to NI 23-103 came into effect on March 1, 2014.

g) Permitted activities in EMD category

See sections 1.1 and 4.2 d)(i) of this report for a discussion of the proposed amendments relating to the permitted activities for EMDs as outlined in Section 7.1(d) of NI 31-103 and Section 7.1 of 31-103CP.

h) Proposed amendments to NI 33-105

In November 2013, the CSA published for comment (now closed) [proposed amendments to NI 33-105](#). The amendments would, if adopted, provide exemptions from certain disclosure requirements in NI 33-105 that would otherwise apply to certain private placements of foreign securities to permitted clients (generally institutional investors) in Canada.

The purpose of the proposed amendments is to eliminate the need to prepare a “wrapper” when a foreign issuer offers securities in Canada to permitted clients under a prospectus exemption. A wrapper contains prescribed Canadian disclosure and other optional disclosure that is attached to the face of the foreign offering document.

The proposed amendments are intended to streamline the process for offering foreign securities to institutional investors in Canada, and are intended to codify for all market participants certain exemptive relief that was granted to certain international dealers in the decision *Re Barclays Capital Inc.* dated April 23, 2014.

The comment period for the request for comments expired in February 2014. OSC staff in consultation with staff in the other CSA jurisdictions are currently considering the comments received.

4.3 Advisers (PMs)

This section contains information specific to PMs, including current trends in deficiencies from compliance reviews of PMs (and acceptable practices to address them) and new and proposed rules and initiatives.



a) Current trends in deficiencies and acceptable practices

(i) Repeat common deficiencies

The following includes the deficiencies that we continue to find in reviews of PMs that have been reported on in previous annual reports and prior guidance. We encourage you to

review the information sources provided as the previously published guidance is still applicable to these issues.

Repeat common deficiency	Information source
<p>1) Delegating KYC and suitability obligations to referral agents</p>	<ul style="list-style-type: none"> • Section 4.3.1 under the heading <i>Delegating KYC and suitability obligations to referral agents</i> in OSC Staff Notice 33-742 • Section 5.2A under the heading <i>Delegating know your client and suitability obligations</i> in OSC Staff Notice 33-736 • Section 13.3 of 31-103CP
<p>2) Inadequate supervision of ARs and research analysts</p>	<ul style="list-style-type: none"> • Section 4.3.1 of OSC Staff Notice 33-742 under the heading <i>Inadequate supervision of advising representatives and research analysts</i> • Sections 32(2) of the Act, 11.1 of NI 31-103 and 11.1 of 31-103CP
<p>3) Inadequate investment management agreements</p>	<ul style="list-style-type: none"> • Section 4.3.1 of OSC Staff Notice 33-742 under the heading <i>Inadequate investment management agreements</i> • Sections 11.5(1) and 11.5(2)(k) of NI 31-103
<p>4) Account statement practices</p>	<ul style="list-style-type: none"> • Section 1.6 of this report on <i>PM – IIROC dealer service arrangements</i> • Section 4.3.3 of OSC Staff Notice 33-742 under the heading <i>PM client account statement practices</i> • Section 14.14 of NI 31-103
<p>5) Lack of awareness of trade-matching requirements</p>	<ul style="list-style-type: none"> • Section 5.4.1 of OSC Staff Notice 33-738 under the heading <i>Lack of awareness of trade-matching requirements</i> • National Instrument 24-101

	<p><u>Institutional Trade Matching and Settlement (NI 24-101) and Companion Policy to NI 24-101</u></p> <ul style="list-style-type: none"> • <u>CSA Staff Notice 24-305 Frequently Asked Questions About National Instrument 24-101 – Institutional Trade Matching and Settlement and Related Companion Policy</u>
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b) New and proposed rules and initiatives impacting PMs

(i) On-going amendments to NI 31-103

The following chart provides a high level overview of the NI 31-103 Proposed Amendments to requirements that impact PMs.

Proposed amendment²¹	Topic	Purpose
Sections 3.11 and 3.12 of 31-103CP	Proficiency: “relevant investment management experience” guidance	To provide increased clarity for industry regarding who qualifies for PM registration.
Section 8.26 of NI 31-103	International adviser exemption	To revert back to the less restrictive “permitted client” conditions in this exemption that were in force prior to July 11, 2011.
Subsection 8.26.1 of NI 31-103	Adding a sub-adviser exemption (not available outside of ON and QC otherwise)	To make the non-resident sub-adviser exemption available across Canada via NI 31-103 (currently available in Ontario and Quebec, exemptive relief application required in other provinces).
Section 13.17 of NI 31-103	Exemption from certain requirements for registered sub-advisers	To provide relief from certain requirements in NI 31-103, where a registered adviser acts as a sub-

²¹ Subject to change and final approval

	adviser for another registrant.
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For additional information, refer to section 1.1 in this report.

4.4 Investment fund managers

This section contains information specific to IFMs, including current trends in deficiencies from compliance reviews of IFMs (and acceptable practices to address them), a discussion on our sweep of high impact IFMs, and new and proposed rules and initiatives.



a) Current trends in deficiencies and acceptable practices

In this section, we summarize key trends in deficiencies from recent compliance reviews of IFMs.

(i) Repeat common deficiencies

The following includes the deficiencies that we continue to find in reviews of our registrants that have been reported on in previous annual reports and prior guidance. We encourage you to review the information sources provided as the previously published guidance is still applicable to these issues.

Repeat common deficiency	Information source
1) Sales practices	<ul style="list-style-type: none">• Part I of OSC Staff Notice 33-743• OSC Staff Notice 11-760 Report on Mutual Fund Sales Practices Under Part 5 of National Instrument 81-105 – Mutual Fund Sales Practices (OSC Staff Notice 11-760)
2) Inappropriate expenses charged to investment funds	<ul style="list-style-type: none">• Section 4.4.1 under the heading <i>Inappropriate expenses charged to funds</i> in OSC Staff Notice 33-742• Part II of OSC Staff Notice 33-743
3) Inadequate oversight of outsourced functions and service providers	<ul style="list-style-type: none">• Part V of OSC Staff notice 33-743• Section 4.4.1 of OSC Staff Notice 33-742 under the heading <i>Inadequate oversight of outsourced functions and service providers</i>

	<ul style="list-style-type: none"> • Section 11.1 of NI 31-103 and 11.1 of 31-103CP
4) Non-delivery of net asset value adjustments	<ul style="list-style-type: none"> • Section 4.4.1 of OSC Staff Notice 33-742 under the heading <i>Non-delivery of net asset value adjustments</i> • Section 4.4 d) (i) of this report re Ongoing Amendments to NI 31-103

(ii) Inadequate sales practices involving promotional items and business promotion activities

We reviewed a number of IFMs that manage mutual funds and engage in sales practice activities under section 5.6 of [National Instrument 81-105 Mutual Fund Sales Practices](#) (NI 81-105). We noted some instances where the promotional items and business promotion activities provided by IFMs to sales representatives were excessive and extravagant and not in keeping with section 5.6 of NI 81-105, particularly as follows:

- the amount spent on one promotional item or business promotion activity equated to the entire annual dollar limit set by an IFM for these types of activities per representative,
- the value of a promotional item or business promotion activity provided during one event exceeded the internal maximum that can be provided to each sales representative as set by the IFM,
- the value of all promotional items and business promotion activities provided to sales representatives over several events exceeded the internal maximum set by the IFM, and
- IFMs covered the cost of travel and personal incidental expenses incurred by sales representatives attending business promotion activities. For example, IFMs paid for expenses of sales representatives related to beverages and food outside of the meals and beverages already organized by the IFM and arranged for travel to and from the business promotion activity. The provision of travel and personal incidental expenses is strictly prohibited by section 5.6 of NI 81-105.

Section 5.6 of NI 81-105 provides specific parameters regarding the provision of promotional items and business promotion activities to sales representatives. IFMs must confirm that the provision of promotional items and business promotion activities fall within these set parameters.

Suggested practices to provide adequate sales practices under section 5.6 of NI 81-105

IFMs must:

- Develop internal policies and procedures to determine the reasonability of the cost of the promotional item and business promotion activity provided to sales representatives. IFMs are encouraged to consider the following in developing policies and procedures:
 - an annual limit per representative on these type of sales practices,
 - internal parameters on what is considered a reasonable amount for promotional items and business promotion activities,
 - factors that should be considered when determining cost reasonability,
 - the individual(s) responsible for assessing reasonability and providing documented approval of expenses,
 - the type of documentation required to assess reasonability, and
 - the involvement of the IRC in evaluating sales practices for reasonability.
- Maintain evidence of their reasonability assessment and the review and approval of the promotional item and business promotion activity.

Unacceptable practices

IFMs must not:

- Spend the entire annual limit set for promotional items and business promotion activities on any one item or event provided to a sales representative. This practice would be considered excessive and extravagant and not in keeping with the spirit of Part 5 of NI 81-105.
- Pay for travel expenses related to the provision of a promotional item or business promotion activity.
- Pay for any expenses, such as personal incidental expenses, above and beyond what was organized by the IFM for the business promotion activity.
- Provide promotional items or business promotion activities that would cost more in a location outside of where the IFMs head office is located (i.e. Toronto, Ontario).

For more information, see Part I of [OSC Staff Notice 33-743](#) under section i) *reasonability of costs*, section 5.6 of [NI 81-105](#) and paragraph 7.6 (2) of the [Companion Policy of NI 81-105](#).

(iii) Inappropriate IFM organizational structure

We noted issues with IFMs that were part of larger organizational structures regarding the registration of the correct entity as an IFM and the payment of capital market participation fees.

In the cases that we reviewed, we noted that the investment funds managed by the IFM were paying a management fee to either the parent company or an affiliate of the IFM. In turn, the IFM would receive only a portion of the management fee from the parent company or affiliate for its services as a PM and not also as an IFM. The remaining management fee would be retained by the parent company or the affiliated entity, an unregistered entity.

Two key implications result from this type of organizational structure as follows:

- Registration issues: Section 7.3 of 31-103CP states that an IFM directs the business, operations or affairs of an investment fund. The management fee is being paid to an unregistered entity that may be directing the business, operations or affairs of the investment fund, which is the responsibility of the registered IFM. We would question if the firm receiving a portion of the management fee is conducting registerable activity and required to be registered as an IFM with the OSC.
- Participation fee issues: The result of paying the management fee to an unregistered entity is the calculation and payment of incorrect participation fees per Form 13-502F4 since the entire management fee is not captured in the registered IFMs revenue per its annual audited financial statements.

In each of the cases identified, we took appropriate steps to verify that the firms remitted additional participation fees to us, if necessary, based on the entire management fee paid by the investment funds and that all firms were appropriately registered with the OSC.

Suggested practices to implement an adequate IFM operational structure

IFMs must:

- Register entities that direct the business, operations or affairs of investment funds.
- Record the entire amount of management fees paid by the investment funds on the financial statements of the entity registered as an IFM.
- Include the entire amount of management fees paid by investment funds when calculating the participation fees for the IFM per Form 13-502F4.

- Confirm that the entity performing the IFM responsibilities is registered with the OSC in the category of IFM.

Unacceptable practices

IFMs must not:

- Avoid paying participation fees under OSC Rule 13-502 by diverting revenue paid by an investment fund to unregistered entities.

b) Sweep of large “impact” IFMs

In May 2013, we commenced targeted, on-site reviews of a sample of large IFMs to assess their compliance with securities law. These IFMs had over \$500 billion in assets under management and they managed a wide range of investment funds, including traditional mutual funds, pooled funds, ETFs and closed end funds. As part of these reviews, we focused on key operational areas of the IFMs, such as:

- minimum working capital requirements and custody,
- securityholder reporting/transfer agency,
- trust accounting,
- fund accounting,
- oversight of service providers,
- conflicts of interest,
- sales practices, and
- overall compliance structure.

In cases where the IFMs were dually registered or had an affiliated PM, we also performed testing of the portfolio management and trading activities in conjunction with the targeted review of large advisers being done at the same time.

On June 19, 2014, we published [OSC Staff Notice 33-743](#) to summarize the findings of the large “impact” IFM sweep reviews.

The notice summarizes our findings and sets out suggested guidance on the following areas:

- sales practices,
- allocation of expenses to investment funds,
- mutual fund borrowings,

- prohibited cross trades, and
- outsourcing and oversight of service providers.

For more information, see [OSC Staff Notice 33-743](#).

c) Sweep of newly registered IFMs

This year we commenced reviews of a sample of newly registered IFMs in Ontario to gain an understanding of each firm’s business, assess their compliance with Ontario securities law, and provide guidance on key regulatory requirements. We selected 40 firms in Ontario and are considering expanding the scope of the reviews to outside of Canada for firms for which we act as principal regulator. The firms were chosen based on their date of registration and other risk-based criteria. Our reviews focused on each firm’s compliance system, financial condition and key IFM operational areas as well as key operational areas where the IFM was also registered in other categories such as a PM and/or EMD, as well as a KYC and suitability review. We have completed the 40 reviews. The objective of the sweep is to help newly registered IFM firms better understand their key regulatory requirements and help to enhance their compliance by identifying deficiencies in their compliance system. The common deficiencies we identified from the sweep are listed below, along with where to get more information on the requirements and guidance to address the deficiencies:

- Inadequate oversight of service providers – see section 4.4 a)(i)(3) in this report on *Current trends in deficiencies and acceptable practices* and *Repeat common deficiencies*.
- Inadequate insurance coverage – see section 4.1 c)(iii) in this report on *Current trends in deficiencies and acceptable practices* under *Inadequate insurance coverage*.
- Inadequate written policies and procedures - see section 4.1 c)(ii) in this report on *Current trends in deficiencies and acceptable practices* under *Written policies and procedures are not tailored to registrant’s operations*.
- Inadequate collection, maintenance and documentation of KYC information – see section 4.1 c)(i) of this report on *Current trends in deficiencies and acceptable practices* under *Non-compliance with KYC, KYP and suitability requirements and accredited investor requirements*.
- Not determining proper reliance on accredited investor exemption - see section 4.1 c)(i) of this report on *Current trends in deficiencies and acceptable practices*

under *Non-compliance with KYC, KYP and suitability requirements and accredited investor requirements*.

- Inadequate relationship disclosure information – see section 4.1 c)(iv)(5) in this report on *Current trends in deficiencies and acceptable practices under Repeat common deficiencies and Inadequate relationship disclosure information*.

We perform sweep reviews of newly registered firms on an ongoing basis and in addition to enhancing a firm’s compliance system we also use the information we obtain to enhance our outreach to registrants.



d) New and proposed rules and initiatives impacting IFMs

(i) Ongoing Amendments to NI 31-103

The following chart provides a high level overview of the NI 31-103 Proposed Amendments to requirements that impact IFMs.

Proposed amendment²²	Topic	Purpose
Section 8.28 of NI 31-103	Capital accumulation plan	To make this exemption permanent and to clarify that this exemption is only available to plan sponsors and plan service providers in respect of activities relating to a capital accumulation plan.
Section 12.14 of NI 31-103	Form 31-103F4 <i>Net Asset Value Adjustments</i> (Form 31-103F4)	New Form 31-103F4 Net Asset Value Adjustments on which an IFM will report NAV adjustments as required by section 12.14 of NI 31-103 in order to harmonize and streamline the information provided by IFMs about NAV errors and adjustments by specifying which items of disclosure must be

²² Subject to change and final approval

		covered and the level of detail to be provided to regulators.
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For additional information, refer to section 1.1 in this report

As discussed in section 1.1 of this report, the CSA is working on NI 31-103 Proposed Amendments. A new form to report NAV adjustments in respect of investment funds managed by an IFM is being proposed as part of the NI 31-103 Proposed Amendments referred to as Form 31-103F4.

IFMs are required under section 12.14 of NI 31-103 to deliver a quarterly report describing any NAV adjustments in respect of an investment fund managed by the IFM during the period being reported on. The CSA has noted that the NAV reporting received since the implementation of NI 31-103 has been sparse and minimal and at times CSA regulators need to follow up with the IFM directly to discuss the issue, potential cause and solution of the NAV error originally reported.

As a result, as part of the NI 31-103 Proposed Amendments, CSA staff proposed Form 31-103F4 relating to reporting NAV errors. The purpose of the form is to provide additional details on NAV errors. More fulsome information will allow the regulator to detect whether or not the IFM should have more adequate policies and procedures in place to detect, prevent and correct NAV errors and will also limit the back and forth between the regulator and the IFM to obtain additional information once the NAV error is reported.

(ii) Changes to the Act

Part XXI of the Act, *Insider Trading and Self-Dealing* (Part XXI of the Act), contains conflict of interest investment restrictions which, until July 24, 2014, only applied to mutual funds. Part XXI of the Act has been amended to extend the conflict of interest investment restrictions to all investment funds, so that they apply to non-redeemable investment funds and mutual funds. Refer to the [Act](#) for additional information.

(iii) Investment Funds and Structured Products Branch

Our Investment Funds and Structured Products Branch has worked on a number of new and proposed rules with the CSA on the regulation of investment funds, and other initiatives, which impact IFMs. A number of these initiatives represent a continuation of projects previously discussed in detail in section 4.4.2 of OSC Staff Notice 33-742. A

summary of some of this work and the relevant information sources can be found in the following chart:

Project	Information source
<p>1) Mutual fund fees</p>	<ul style="list-style-type: none"> • Section 4.4.2 under the heading <i>New and Proposed Rules and Initiatives impacting IFMs</i> in OSC Staff Notice 33-742 • On December 17, 2013 the CSA published CSA Staff Notice 81-323 Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees Section which provides additional information on this initiative.
<p>2) Mutual fund risk classification</p>	<ul style="list-style-type: none"> • On December 12, 2013 the CSA published CSA Staff Notice 81-324 Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts which provides additional information on this initiative.
<p>3) Point of sale disclosure</p>	<ul style="list-style-type: none"> • On March 26, 2014, the CSA published for second comment (now closed) changes to proposed amendments to National Instrument 81-101 <i>Mutual Fund Prospectus Disclosure</i> (the Rule or NI 81-101) and Companion Policy 81-101CP to National Instrument 81-101 <i>Mutual Fund Prospectus Disclosure</i> (the Companion Policy). See CSA Notice and Request for Comment: Implementation of Stage 3 of Point of Sale Disclosure for Mutual Funds - Point of Sale Delivery of Fund Facts. • See section 4.4.2 under the heading <i>New and Proposed Rules and Initiatives impacting IFMs</i> in OSC Staff Notice 33-742

<p>4) Review of fees and expenses disclosure by investment funds</p>	<ul style="list-style-type: none"> Our Investment Funds and Structured Products Branch recently conducted a targeted review of the fees and expenses disclosure practices of investment funds. OSC Staff Notice 81-724 Report on Staff's Continuous Disclosure Review of the Fees and Expenses Disclosure by Investment Funds, summarizes the findings and provides guidance to address the findings.
<p>5) Review of high management expense ratios</p>	<ul style="list-style-type: none"> Our Investment Funds and Structured Products Branch recently completed a review of investment funds with high management expense ratios. The July 2014 Investment Funds Practitioner provides a summary on the results of this initiative.
<p>IFM Resources</p>	<p>Information source</p>
<p>1) Annual Summary Report</p>	<ul style="list-style-type: none"> Our Investment Funds and Structured Products Branch publishes an annual Summary Report for Investment Fund Issuers. Refer to the fourth annual Summary Report in OSC Staff Notice 81-723 Summary Report for Investment Fund Issuers 2013.
<p>2) Investment Funds Practitioner</p>	<ul style="list-style-type: none"> The Practitioner is an ongoing publication prepared by the OSC's Investment Funds and Structured Products Branch that provides an overview of operational issues arising from applications for discretionary relief, prospectuses, and continuous disclosure documents that are filed with the OSC.



ACTING ON REGISTRANT MISCONDUCT

- a) Regulatory action following compliance reviews**
- b) Regulatory action following an application for registration**
- c) Matters referred to the Enforcement Branch**

5 Acting on registrant misconduct



“The OSC has a responsibility to deliver strong investor protection: it’s at the core of everything we do.

April 9, 2013 speech by Debra Foubert, Director, Compliance and Registrant Regulation at Strategy Institute: Annual Registrant Regulation, Conduct & Compliance Summit

We are alert to potential misconduct by registrants and when we find evidence of this we take appropriate, timely and effective regulatory action. Our regulatory responses cover the compliance-enforcement continuum, and

include remedies imposed by the Director (such as T&Cs or suspensions of registration) as well as referrals to our Enforcement Branch.

HIGHLIGHTS OF MISCONDUCT CASES

“In my view, [the registrant’s] ongoing compliance issues,, are very serious and raise concerns about whether the business of the firm may be carried on with integrity and in the best interests of [the] securityholders and in a way that would foster confidence in the capital markets”²³

“Registration is a privilege, not a right, and it places significant obligations on registrants when they deal with members of the public who are potential investors or who are already clients. The public should not be exposed to the risk of a registrant that is under court protection from its creditors because it cannot meet its obligations as they become due... Instead it is reasonable for clients of a registered firm to expect that the firm is financially viable and not committing acts of bankruptcy. It is not in the public interest for [registrants] to continue in the business of trading in securities because it is not in a position to meet the many responsibilities that registrant firms must meet so that investors are protected.”²⁴

²³ Director’s Decision – February 28, 2014 – Pro-Financial Asset Management Inc.

²⁴ Director’s Decision – November 11, 2013 – League Investment Services Inc.

Some notable registrant misconduct cases from the past year are summarized below. Please note that some cases are still ongoing. Documents related to OSC proceedings before the Commission and before the Courts are available on the OSC's website under [All Commission Proceedings](#). Further, [Director's Decisions](#) from the CRR Branch are also available on the OSC's website.

a) Regulatory action following compliance reviews

Registrant	Date of Director's Decision	Description
Sterling Grace & Co. Ltd. and Graziana Casale	November 18, 2013	During a compliance review of this EMD, we found that the firm was selling securities of an issuer under circumstances that gave rise to a serious undisclosed conflict of interest, and that the firm had failed to properly discharge its KYC and suitability obligations. Following a contested opportunity to be heard, the firm and its sole individual registrant were suspended by the Director. The Director's decision was stayed pending a hearing and review by a panel of the Commission pursuant to section 8 of the Act. The hearing and review was held in February and March, 2014. In September 2014, the panel released its reasons for the decision in which the panel agreed with the Director's findings on most issues, and suspended both the firm and the individual registrant.
League Investment Services Inc.	November 11, 2013	During a compliance review of this EMD, the firm and a number of its related party issuers filed for protection under the <i>Companies' Creditors Arrangement Act</i> . Staff of both the British Columbia Securities Commission (the BCSC) and the OSC sought to suspend the EMD's registration on solvency grounds, which the firm contested. The Executive Director of the BCSC found that the

		EMD was not suitable for registration because it was not in a position to meet its many responsibilities as a registered firm. After the BCSC suspension, the EMD withdrew its opposition to Staff's recommendation, and the Director suspended the EMD in Ontario as well.
FCPF Corporation (formerly Redev Corporation) and Richard Crenian	October 1, 2013	During a compliance review of this EMD, we found that the firm had employed an unregistered individual to trade in securities with clients and that it had traded in securities with some clients who did not qualify for prospectus exemptions. The registration of the firm and its UDP were suspended pursuant to a settlement agreement that was approved by the Director.
Kingsmont Investment Management Inc. and Paget Warner	September 24, 2013	During a compliance review of this PM and EMD, we found that the firm had failed to adequately discharge its KYC, KYP and suitability obligations. To address these concerns, the principal of the firm agreed to sell a majority share in the firm and surrender his UDP and CCO registrations, as well as the firm's EMD registration. Following a contested opportunity to be heard, the Director additionally suspended the principal's registration as an AR for six months for making misleading statements to OSC staff about a client complaint, and for requiring clients to sign an inappropriate risk disclaimer when investing in a particular issuer.
Takota Asset Management Inc.	July 29, 2013	T&Cs were imposed on the registration of this IFM, PM, and EMD requiring that it submit monthly financial reports to the OSC. The T&Cs were imposed due to the firm's failure to meet the excess working capital requirements and failure to notify the OSC of its capital deficiency, which had been identified by OSC staff during a compliance

		review.
Adewale Gbalajobi	July 26, 2013	A compliance review found that an EMD (FCPF Corporation) had used an unregistered individual to trade in securities with clients, some of whom did not qualify for prospectus exemptions. The firm was subsequently suspended by the Director. Mr. Gbalajobi was the CCO of the firm, and separately settled proceedings with the OSC that include a suspension of his registration.
Investment Allocation International Inc. and Marshall Miller	June 4, 2013	A compliance review of this one-man PM found that the registrant was selling securities of a related issuer to clients for whom the registrant provided discretionary management services. The investments were solicited by the registrant and made with the knowledge and consent of the client. The registrant did not fully disclose to its clients that a part of the investment proceeds would be used by the issuer to pay a management fee to the registrant. The registrant also had excess working capital of less than zero. The corporate and individual registrants were both suspended in accordance with a settlement agreement approved by the Director.

b) Regulatory action following an application for registration

Registrant	Date of Director's Decision	Description
Anu Bala Jain	August 29, 2013	This individual was an approved person of a mutual fund dealer. In March 2012, the MFDA approved of a settlement agreement under which Ms. Jain was suspended as an approved person for a period of one year after she engaged in "stealth advising" (<i>i.e.</i> , signing paperwork for investments actually sold to clients by an

		<p>unregistered individual), and in an attempt to cover up her actions, misled her sponsoring firm and the MFDA during their investigation into the matter. Ms. Jain completed her suspension and the other terms required by her MFDA settlement agreement, and applied to reactivate her registration. T&Cs were imposed on Ms. Jain's registration requiring that she be strictly supervised by her sponsoring firm for a period of one year.</p>
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c) Matters referred to the Enforcement Branch

Registrant	Date of Decision	Description
Pro-Financial Asset Management Inc.	Ongoing	The Commission suspended the EMD registration of the firm, and placed T&Cs on the firm's PM registration prohibiting it from taking on new clients. The firm reported a large capital deficiency that it was not able to rectify, and also reported a discrepancy between the amount payable in respect of certain principal protected notes and the amount available to make those payments. Certain investment products managed by the firm are now subject to a cease trade order. Although the Director objected to a proposal to sell the firm's business to a purchaser, the Commission approved the transaction in July 2014 subject to T&Cs and after significant change was made to the transaction. The Enforcement Branch continues to investigate the firm's principal protected notes discrepancy.
Quadrex Asset Management Inc.	Ongoing	As reported in section 5.1 of OSC Staff Notice 33-742 , the Commission suspended the registration of this IFM, PM, and EMD, and issued a cease trade order in respect of certain investment

		<p>products managed by the firm, after the firm reported a large capital deficiency that it was unable to rectify. Since then, the firm's business activities have been wound up, and a Statement of Allegations has been issued against the firm's principals and various related companies alleging, among other things, securities fraud. A hearing regarding the matters alleged in the Statement of Allegations has not yet occurred, and those allegations have not been proven.</p>
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ADDITIONAL RESOURCES

6 Additional resources

This section discusses how registrants can get more information about their obligations.

The CRR Branch works to foster a culture of compliance through outreach and other initiatives. We try to assist registrants in meeting their regulatory requirements in a number of ways.

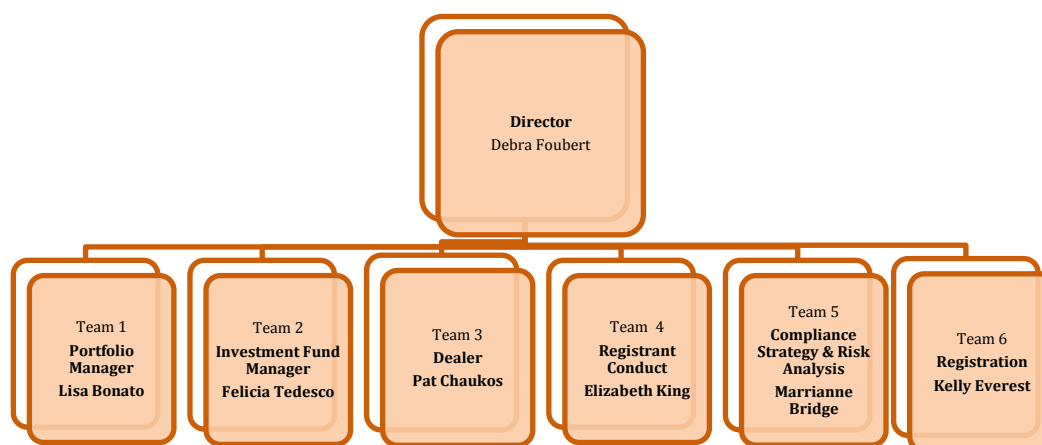
We developed a new outreach program to registrants (see section 2.1 of this report) to help them understand and comply with their obligations. We encourage registrants to visit our [Registrant Outreach web page](#) on the OSC's website.

Also, the [Information for: Dealers, Advisers and IFMs](#) section on the OSC website provides detailed information about the registration process and registrants' ongoing obligations. It includes information about compliance reviews and suggested practices, provides quick links to forms, rules and past reports and e-mail blasts to registrants. It also contains links to previous years' versions of our annual summary reports to registrants.

The [Information for: Investment Funds](#) section on our website also contains useful information for IFMs, including past editions of The Investment Funds Practitioner published by our Investment Funds and Structured Products Branch.

Registrants may also contact us. Please see Appendix A to this report for the CRR Branch's contact information. The CRR Branch's PM, IFM and dealer teams focus on oversight, policy changes, and exemption applications for their respective registration categories. The Registrant Conduct team supports the PM, IFM, dealer, registration and financial analyst teams in cases of potential registrant misconduct. The financial analysts on the Compliance, Strategy and Risk Analysis team review registrant submissions for financial reporting (such as audited annual financial statements, calculations of excess working capital and subordination agreements). The Registration team focuses on registration and registration-related matters for the PM, IFM and dealer registration categories, among others.

Appendix A – Compliance and Registrant Regulation Branch and contact information for Registrants



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The OSC Inquiries & Contact Centre operates from 8:30 a.m. to 5:00 p.m. Eastern Time, Monday to Friday, and can be reached on the Contact Us page of

www.osc.gov.on.ca

If you have questions or comments about this report, please contact:

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