



ONTARIO
SECURITIES
COMMISSION

Annual Summary Report for Dealers, Advisers and Investment Fund Managers

Compliance and Registrant Regulation

OSC Staff Notice 33-746

September 21, 2015

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DIRECTOR'S MESSAGE

Ontario's capital markets are continuously evolving as is the regulatory landscape. The emergence of complex business models and products requires registrants and regulators alike to work together, protecting investors and fostering fair and efficient capital markets.

Registrants have an obligation to deal fairly, honestly and in good faith with clients, which is essential to promoting confidence in Ontario's capital markets. The Ontario Securities Commission's Compliance and Registrant Regulation Branch (CRR) supports registrants in meeting their obligation by focusing on improving how we work together. We continue to develop our oversight and guidance, whether through compliance reviews, the publication of staff notices or the provision of outreach sessions. Our open communication with registrants allows us to enhance existing tools and develop and apply new ones to help registrants achieve effective compliance systems.

We continue to focus on the Registrant Outreach program, by providing sessions on timely topics. In June, we held a session on the elements of an effective compliance system and prior to that we held a session on Phase 2 of the Client Relationship Model (CRM2), given the imminent deadlines that registrants have to meet. We are always looking for new presentation topics and encourage registrants to inform us of any issues that we could address and provide additional guidance on.

As a gatekeeper to Ontario's capital markets, CRR's registration process is essential to assessing the suitability of potential market participants and their interaction with investors in our markets. As part of our review of initial firm registration applications, we established a pre-registration review process that we refer to as "Registration as the First Compliance Review". We are happy to say that this process has been launched and is fully operational. Our objective is to provide guidance to new registrants, answer their questions and assist them in establishing an effective compliance system. The end goal is to help registrants be compliant and meet their regulatory obligations from the start of their operations. We are delighted with the positive feedback we have received regarding the pre-registration interviews completed to date.

We also recently launched the Topical Guide for registrants which organizes relevant information, including rules and guidance, to allow registrants to easily search for guidance. Similarly, work has been done to improve access to CRR's Director's decisions. These tools are located on the Registrant Outreach program [web page](#).

CRR is committed to maintaining open communication with our registrants and to assist them with managing these challenges. We are encouraged by the positive feedback received from our registrant community regarding our efforts to maintain ongoing and open interaction. We look forward to maintaining this important productive relationship.

Debra Foubert
Director, Compliance and Registrant Regulation Branch



INTRODUCTION

Introduction



“Guidance is the equivalent to receiving the answers to an exam before you take the exam.

We are providing you with a roadmap for meeting the regulatory obligations. You may not always agree with the guidance as there may be more than one way to meet [your] regulatory obligations depending on your business model....if you determined another way of meeting the regulatory principles tailored to your firm, then the guidance has served its purpose.”

April 29, 2014 speech by Debra Foubert, Director, CRR Branch to the Strategy Institute

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 Ontario Securities Commission (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			
66,836	1,071 ¹			
		PMs	EMDs	SPDs
		311 ²	262 ³	2 ⁴
				IFMs
				496 ⁵

a) 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 focuses primarily on registered firms and individuals directly overseen by the OSC.

¹This number excludes firms registered solely 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 registered as sole PMs and PMs also registered as EMDs.

³ This number includes firms solely registered as EMDs.

⁴ This number includes firms solely registered as SPDs.

⁵ This number includes sole IFMs and IFMs registered in multiple categories.

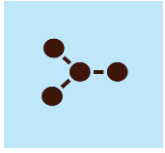
In this annual report, we summarize new and proposed rules and initiatives impacting registrants, current trends in deficiencies from compliance reviews of registrants (including acceptable practices to address them and unacceptable practices to prevent them), and current trends in registration. We provide 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 regulatory obligations, and provide CRR Branch 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,
- our 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.⁶

⁶ 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 Cost disclosure, performance reporting and client statements**
- 1.2 Expanded exempt market review**
- 1.3 Best interest standard**
- 1.4 EMD scope of activities**
- 1.5 Outbound advising and dealing**
- 1.6 Derivatives regulation**
- 1.7 Registrant custody practices**
- 1.8 Independent dispute resolution services for registrants**
- 1.9 Ongoing amendments to registration requirements, exemptions and ongoing registrant obligations**

1 Key policy initiatives impacting registrants



"We will tackle the big issues and important policy work across the regulatory spectrum. We will take a proactive approach through research and risk management which will allow us to respond quickly where appropriate."

June 18, 2015 Message from the OSC Chair in the 2015 – 2017 OSC Strategic Outlook

1.1 Cost disclosure, performance reporting and client statements

On July 15, 2013, the [CRM2](#) amendments to [National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations](#) (NI 31-103) came into effect. They are being phased-in over a three-

year period, ending in 2016. 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 Registration Requirements, Exemptions and Ongoing Registrant Obligations \(Cost Disclosure, Performance Reporting and Client Statements\)](#).

IIROC and MFDA member rules have been harmonized with the Canadian Securities Administrators (CSA) CRM2 requirements and will be implemented on the same schedule. SRO members who comply with equivalent member rules have been exempted from the CRM2 requirements in NI 31-103.

In May, the OSC issued orders in parallel with other CSA members providing interim relief from the new requirements relating to enhanced account statements that came into effect as of July 15, 2015. The orders provide that these requirements may be met starting with statements delivered for the period ending December 31, 2015, instead of the period that includes July 15, 2015. The orders also addressed certain technical issues that had been identified relating to the delivery of information prescribed in the CRM2 requirements. The SROs have made housekeeping amendments to their member rules that have the same effect as the CSA orders. For more information about the orders, see [CSA Staff Notice 31-341 - Omnibus/Blanket Orders Exempting Registrants from Certain CRM2 Provisions of](#)

[National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations.](#)

The last phase of the implementation of CRM2 will begin with the 12-month period that includes July 15, 2016, when requirements for the delivery of annual reports on charges and on investment performance will come into effect. It is our expectation that most firms will plan to report on a calendar year basis, which will mean their first reports will cover the year beginning January 2016 and will be delivered to clients in January 2017.

For additional information, see

- [CSA Staff Notice 31-337 - Cost Disclosure, Performance Reporting and Client Statements – Frequently Asked Questions and Additional Guidance as of February 27, 2014](#), and
- [CRM2 Planning Tips and FAQ](#).

1.2 Expanded exempt market review

EXEMPT MARKET REVIEW ⁷		
\$45 BILLION	90%	27,000
<ul style="list-style-type: none">• ontario capital exemption distributions	<ul style="list-style-type: none">• capital raised through accredited investor exemption	<ul style="list-style-type: none">• purchases made by Ontario residents in exempt distributions

On March 20, 2014, we published for comment four new capital raising prospectus exemptions. The proposed exemptions include the offering memorandum prospectus exemption, a family, friends and business associates prospectus exemption, an existing security holder prospectus exemption, and a crowdfunding prospectus exemption (crowdfunding) along with a registration framework applicable to online crowdfunding portals. These exemptions are intended to facilitate capital raising by businesses at different stages of development, including start-ups and small and medium-sized enterprises (SMEs), while maintaining an appropriate level of investor protection.

⁷ Source: [February 19, 2015 Exempt Market Review Backgrounder](#)



"This is a good news story from a securities regulatory point of view. We are proposing the right rules, applying the right principles and moving forward with the right package to facilitate capital formation while ensuring investor protection."

March 20, 2014 interview with Jim Turner, Vice Chair and executive sponsor on proposed prospectus exemptions

Registrants that will be relying on these prospectus exemptions must comply with the terms of each prospectus exemption. If a registrant plans to distribute securities under any of the new prospectus exemptions, the registrant must establish, maintain and apply internal controls and procedures to monitor

compliance with the new prospectus exemptions and to manage the risks associated with its business in accordance with prudent business practices.

In anticipation of the adoption of the new exemptions, the CRR Branch, along with other OSC branches, are developing compliance programs to oversee the use of the new exemptions. CRR is reviewing current compliance measures with respect to registrants involved in the exempt market to consider how existing compliance oversight may need to be adapted once the new exemptions are in force. This includes a review of resources and consideration of how the new exemptions will impact our risk-based approach to compliance reviews of registered firms.

The [existing security holder prospectus exemption](#) along with the corresponding [changes to the companion policy](#) came into force on February 11, 2015. The [family, friends and business associates prospectus exemption](#) along with the corresponding [changes to the companion policy](#) came into force on May 5, 2015.

On [February 19, 2015](#), we also published amendments to National Instrument 45-106 *Prospectus Exemptions* (NI 45-106) relating to the accredited investor and minimum amount investment prospectus exemptions. Effective May 5, 2015, the following changes came into force:

- the minimum amount exemption is only available for distributions to non-individuals, and
- the accredited investor exemption (the AI exemption) is amended to:
 - require individual accredited investors, other than those who qualify as permitted clients, to complete and sign a new risk acknowledgment form that describes, in plain language, the categories of individual accredited investor and identifies the key risks associated with purchasing securities in the exempt market,

- include family trusts established by an accredited investor for his or her family in the definition of accredited investor, and
- in Ontario, allow fully managed accounts to purchase investment fund securities under the managed account category of the AI exemption, harmonizing with the rest of the CSA.

There are two other initiatives intended to facilitate capital raising by businesses from a broad investor base, the offering memorandum prospectus exemption (OM exemption) and crowdfunding regime. In March 2014, the OSC published for comment an OM exemption, which would allow businesses to raise capital based on a comprehensive disclosure document being made available to investors. The exemption would be available for a wide range of businesses at different stages of development and would provide businesses with access to a broad investor base. At the same time, the OSC published for comment a crowdfunding regime that would enable early stage businesses to raise capital from a large number of investors through a registered online funding portal. The proposed regime included both a crowdfunding prospectus exemption and a registration framework applicable to online crowdfunding portals. The comment period ended in June 2014 and the participating CSA jurisdictions have been working closely in formulating the OM exemption and the crowdfunding regime. The OSC intends to publish the OM exemption and crowdfunding regime in final form and deliver them to the Minister of Finance for decision in the fall of 2015. After taking into account the feedback from stakeholders, our intention is that the final form of these capital raising tools in Ontario will include the following key elements:

OM exemption

- comprehensive disclosure document at point of sale,
- no limit on the amount of capital an issuer can raise,
- investment limits for investors, other than those who would qualify as accredited investors or investors who would qualify to invest under the family, friends and business associates exemption, substantially along the following:
 - in the case of a purchaser that is not an eligible investor, \$10,000 in a 12-month period,
 - in the case of a purchase that is an eligible investor, \$30,000 in a 12-month period, and

- in the case of a purchaser that is an eligible investor and that receives advice from a portfolio manager, investment dealer or EMD that an investment above \$30,000 is suitable, up to \$100,000 in a 12-month period,
- risk acknowledgement form signed by investors, and
- ongoing disclosure made available to investors, including audited annual financial statements, annual notice regarding the use of the money raised and notice of a limited list of significant events.

Crowdfunding regime

- streamlined offering document at point of sale,
- limit of \$1.5 million on amount an issuer group can raise in a 12-month period,
- all investments be made through a funding portal that is registered with securities regulators,
- low investment limits for investors who do not qualify as accredited investors, (\$2,500 in a single investment and \$10,000 under the exemption in a calendar year) with higher investment limits for accredited investors and no investment limits for permitted clients,
- risk acknowledgement form signed by investors, and
- ongoing disclosure made available to investors, including annual financial statements, annual notice regarding the use of the money raised and notice of a limited list of significant events.

1.3 Best interest standard

In order to support the OSC's goal this year of championing investor protection issues by advancing regulatory reforms that put the interests of investors first, we are analyzing various approaches for creating a statutory best interest standard with a view to developing one or more proposals for consideration.

In addition to our work on a statutory best interest standard, we are also:

- finalizing our analysis of adviser compensation practices with a view to publishing our review findings, including expectations for compliance and best practices, and

- developing and evaluating other targeted regulatory reforms and/or guidance under NI 31-103 to improve the adviser/client relationship.

The work streams discussed above aim to improve the alignment of the expectations of investors and the actions of their advisers and to assist investors to more effectively meet the challenging environment they face. This is a regulatory area that requires careful consideration to determine the right solution for Ontario's investors and capital markets while at the same time avoiding unintended consequences.

1.4 EMD scope of activities

In the [recent amendments to NI 31-103](#), the CSA closely considered the activities that EMDs should and should not conduct.

Subsection 7.1(5) of [NI 31-103](#) came into effect on July 11, 2015 and prohibits EMDs from conducting brokerage activities (trading securities listed on an exchange in foreign or Canadian markets). As a general matter, the CSA believes that the appropriate registration category for participating in prospectus offerings is the investment dealer category. IIROC has rules and an oversight infrastructure to supervise these brokerage activities and, as such, only investment dealers who are IIROC members can conduct these activities.

We continue to work with the U.S. broker dealers affected by this prohibition to ensure compliance with this provision.

1.5 Outbound advising and dealing

On June 5, 2015, [OSC Rule 32-505 Conditional Exemption from Registration for United States Broker-Dealers and Advisers Servicing U.S. Clients from Ontario](#) (OSC Rule 32-505) came into force. Its Companion Policy became effective on the same date.

OSC Rule 32-505 provides exemptions from the relevant dealer and adviser registration requirements under the *Securities Act* (Ontario) (the Act), subject to certain conditions, for broker-dealers (U.S. broker-dealers) and advisers (U.S. advisers) that are trading to, with, or on behalf of, clients that are resident in the USA (U.S. clients), or acting as advisers to U.S. clients, but that trigger the requirement to register as a dealer or adviser in Ontario because they have offices or employees in Ontario. The exemptions in OSC Rule 32-505

are not available to U.S. broker-dealers that trade to, with, or on behalf of, persons or companies that are resident in Ontario (Ontario residents), or U.S. advisers that act as advisers to Ontario residents.

OSC Rule 32-505 was made on the basis that, over the last decade, the OSC (and other Canadian regulators) had, subject to certain conditions that are similar to those in OSC Rule 32-505, exempted U.S. broker-dealers and U.S. advisers with offices in Ontario from the requirement to register. On March 26, 2015, members of the CSA, except Ontario, issued parallel orders of general application (the Blanket Orders) granting exemptions from the requirement to register as a dealer or an adviser on conditions that are substantially similar to those in the Rule. As orders of general application are not authorized under Ontario securities law, the OSC made OSC Rule 32-505 in order to coordinate with the action taken by the CSA.

For more information see [OSC Rule 32-505, its Companion Policy and the related notice](#).



“Management of systemic risk in capital markets...has been an implicit consideration in approaching [the OSC’s] mandate to foster an efficient capital market. Systemic risk considerations have traditionally found expression in [the OSC’s] oversight of financial market infrastructure such as clearing systems and exchanges...Promoting financial stability is...about fostering confidence in the integrity and proper functioning of securities markets, a core responsibility of securities regulators.”

**June 17, 2015 speech by OSC Vice-Chair
Monica Kowal to the C.D. Howe Institute**

1.6 Derivatives regulation

In April 2013, the CSA Derivatives Committee published for comment [CSA Consultation Paper 91-407 - Derivatives: Registration](#). Comments have been received and are being reviewed. We continue to work with our colleagues in the OSC Derivatives Branch and the CSA Derivatives Committee to develop 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.

On October 31, 2014, the reporting obligation for reporting counterparties pursuant to [Part 3 of OSC Rule 91-507 - Trade Repositories and Derivatives Data Reporting](#) (the TR Rule) came into effect. The purpose of the TR Rule is to improve transparency in the derivatives market. Derivatives data is essential for effective regulatory oversight of the derivatives market, including the ability to identify and address systemic risk and the risk of market abuse. [OSC Staff Notice 91-704 - Compliance Review Plan for OSC Rule 91-507 Trade](#)

[Repositories and Derivatives Data Reporting](#) (OSC Staff Notice 91-704) was published on June 29, 2015 which provides guidance on how we intend to review compliance with the reporting requirements set out in the TR Rule. We expect to commence on-site TR Rule compliance reviews in the fiscal year 2015-2016. Initial reviews are expected to focus on derivatives dealers that are most active in the market.

1.7 Registrant custody practices

We continue our work with the CSA in reviewing the existing custody requirements in NI 31-103 for non-SRO registrants to assess whether these requirements still adequately protect client assets. As discussed in [OSC Staff Notice 33-742 - 2013 OSC Annual Summary Report for Dealers, Advisers and Investment Fund Managers](#) (OSC Staff Notice 33-742), the existing custody requirements for EMDs, PMs and IFMs in sections 14.6 to 14.9 of NI 31-103 focus primarily on maintaining clients' assets separate and apart from the registrants' assets and do not have specific requirements regarding who can act as a custodian for clients' securities. We have found that most of the non-SRO registrants do not hold clients' assets. However, we are aware of a small number of firms that have custody of their clients' assets, and currently there is no requirement for these firms to hold those assets in each client's name. As a result of the review of custody requirements for non-SRO registrants, the CSA may propose further guidance or enhancements to existing requirements to strengthen investor protection. We will also continue to review custody practices of registered firms as part of our compliance field reviews.

1.8 Independent dispute resolution services for registrants

As we mentioned in last year's report, all registered dealers and advisers operating outside of Quebec are required to join the Ombudsman for Banking Services and Investments (OBSI) as the common service provider for dispute resolution services after August 1, 2014, unless an exemption is available. This requirement is set out in amendments to section 13.16 of NI 31-103, see [CSA Notice of Amendments to NI 31-103 and to 31-103CP \(Dispute Resolution Services\)](#). As well, all dealers and PMs must establish complaint handling policies to ensure that all client complaints are addressed appropriately as required in section 13.15 of NI 31-103.

As part of our follow up procedures on confirming OBSI membership, we sent out two surveys in October 2014 and February 2015 to our registrants.

Publication of OBSI Joint Regulators Committee (JRC) Annual Report

On March 19, 2015, the CSA (other than Quebec), IIROC and the MFDA jointly published the first annual report of the OBSI JRC, see [CSA Staff Notice 31-340 OBSI Joint Regulators Committee Annual Report for 2014](#). The report provides an overview of the JRC and also highlights the major activities conducted by the JRC in 2014. The JRC comprises of representatives from the participating CSA jurisdictions and the SROs.

The mandate of the JRC is to:

- facilitate a holistic approach to information sharing and monitor the dispute resolution process with an overall view to promoting investor protection and confidence in the external dispute resolution system,
- support fairness, accessibility and effectiveness of the dispute resolution process, and
- facilitate regular communication and consultation among JRC members and OBSI.

The JRC meets regularly with OBSI to discuss governance and operational matters and other significant issues that could influence the effectiveness of the dispute resolution system. For more information on the terms of reference for the JRC, see [Memorandum of Understanding concerning oversight of the Ombudsman for Banking Services and Investments \(OBSI\) among the participating members of the Canadian Securities Administrators and OBSI](#).

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

We have continued to monitor [NI 31-103](#) since its implementation in September 2009, and the amendments which came into force in July 2011. Further amendments to NI 31-103 became effective on January 11, 2015. For additional information, refer to [amendments to NI 31-103](#).



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 Topical Guide for registrants**

2 Outreach to registrants



"The OSC was recognized in 2013 and 2014 as one of Toronto's Top Employers, recognizing its workplace programmes and policies that...demonstrate innovative business practices and stakeholder outreach programmes."

2015 – 2017 OSC Strategic Outlook

We continue to interact with our stakeholders through our Registrant Outreach program which was launched in 2013. The objectives of our Registrant Outreach program are to strengthen 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 (since inception)

26

- in-person & webinar seminars provided to June 30, 2015

4100

- individuals that attended outreach sessions to June 30, 2015

Key features

- dedicated web page
- educational seminars
- registrant outreach community
- registrant 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 us about the latest issues impacting our registrants. Since the launch of the program in July 2013, approximately 4,100 individuals have attended registrant outreach sessions, either in-person or via a webinar. The feedback from these participants has been very positive.

The Registrant 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](#) web 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 issues and topics.

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 e-mail 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 12 external members, advises us 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 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 minimum two year term. The initial two year term for the first RAC members expired in December 2014 and a call for new members was made in the

fall of 2014. The new RAC members were officially appointed in January of 2015. You can find a list of [current RAC members](#) on the OSC website.

Topics of discussion with the new RAC members have included:

- outside business activities,
- next steps relating to [CRM2](#),
- the OSC’s proposed whistleblower program introduced by [OSC Staff Consultation Paper 15-401: Proposed Framework for an OSC Whistleblower Program](#), and
- information relating to [OSC Staff Notice 21-708 - OSC Staff Report on the Canadian Fixed Income Market and Next Steps to Enhance Regulation and Transparency of Fixed Income Markets](#).

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 CRR 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 e-mail blast	E-mail blast topic and additional information
July 27, 2015	Monthly Suppression of Terrorism and UN Sanctions Report
July 16, 2015	OSC Staff Notice 11-329 – Withdrawal of Notices and Revocation of Omnibus/Blanket Orders See section 4.1 b) of this report for additional information.
January 14, 2015	OSC Staff Notice 13-705 - Reduced Late Fee for Certain Outside Business Activities Filings See section 4.1 b) of this report for additional information.
October 30, 2014	OSC Capital Markets Participation Fees Calculation
July 17, 2014	Requirement to make OBSI available to clients See section 1.8 of this report for additional information.

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

2.4 Topical Guide for registrants

In October 2014, we published a [Topical Guide for registrants](#) that is designed to assist registrants and other stakeholders to locate topical guidance regarding compliance and registrant regulation matters.



REGISTRATION OF FIRMS AND INDIVIDUALS

- 3.1 Update on registration initiatives**
 - a) Update on pre-registration reviews**
 - b) Registration service commitment**
 - c) Voluntary surrenders of registration**
 - d) Peer-to-peer lending**
- 3.2 Current trends in deficiencies and acceptable practices**
 - a) Common deficiencies in firm registration filings**
 - b) Common deficiencies in individual registration filings**

3 Registration of firms and individuals



"As a gatekeeper to the markets, the OSC vets potential participants to confirm that they are suitable to participate in our markets and interact with investors to raise capital in our markets...Effective registration and compliance oversight regimes, combined with timely enforcement, help deter misconduct and non-compliance by registrants....".

OSC Notice 11-772 - Notice of Statement of Priorities for Financial Year to end March 31, 2016

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 provide an update on current registration initiatives, discuss common deficiencies noted in firm and individual registration filings, highlight the voluntary surrender process, and highlight the potential need for registration related to peer-to-peer lending arrangements.



3.1 Update on registration initiatives

a) Update on pre-registration reviews



"I found the...interview to be the most useful step in the [registration] process. I learned more in the...interview than at any other point in the registration process. I left with a very good sense of what I need to do and am more confident and focused than ever. Hats off to the OSC for creating a dialogue at the beginning of [the relationship]."

Feedback from an external participant of the pre-registration review process

As part of our review of initial firm registration applications and applications where firms are adding categories of registration, we perform pre-registration interviews of key personnel of the firms. This process, which we refer to as "Registration as the First Compliance Review" was described in section 3.1 a) of [OSC Staff Notice 33-745 – 2014 Annual Summary Report for Dealers,](#)

[Advisers and Investment Fund Managers](#) (OSC Staff Notice 33-745).

As of March 31, 2015, we completed twenty-one pre-registration interviews. In most cases, these have been face-to-face interviews with the proposed Ultimate Designated Person (UDP) and the Chief Compliance Officer (CCO) as well as other key personnel (such as the primary dealing or advising representative or the Chief Financial Officer of the applicant firm).

These interviews have helped us to obtain a good understanding of the proposed business activities, compliance system, and proficiency of key individuals of the firms involved. These interviews have also enabled the firms to take action to address potential deficiencies before commencing operations. As part of the pre-registration reviews, we highlight key registration resources such as the Registrant Outreach program, the annual summary report, the [Topical Guide for registrants](#) and the guidance provided in [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). There have been some registration applications where we have recommended denial of registration or taken other regulatory action including registering the firm subject to terms and conditions and referral of the firm to the OSC's Enforcement Branch.

In addition to the guidance provided in [OSC Staff Notice 33-745](#), based on our experience to date we suggest the additional practices set out below.

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

- We expect the proposed CCO to demonstrate a good understanding of the regulatory requirements applicable to the firm and individuals acting on its behalf and of the firm's policies and procedures.
- We expect the firm's business plan to be sufficiently developed so that key personnel can describe with some specificity the business in which the firm intends to engage.
- We expect the description of the business to be consistent with the business plan provided.

Unacceptable practices

Firms and key individuals are discouraged from the following practices:

- Expecting their advisors to respond to questions that should be within the expertise of the key personnel. This may lead to concerns that key firm individuals are not fully

proficient.

- Indicate that they will only become familiar with regulatory requirements applicable to the firm and its individuals and will only familiarize themselves with the firm's policies and procedures after registration.

b) Registration service commitment

We continue to follow the [OSC service commitment](#) published in May 2014 that sets out a framework for standards, conditions and timelines pertaining to registrants and registration-related filings for which the OSC is the principal regulator. Details of the framework can also be found in section 3.1 c) of [OSC Staff Notice 33-745](#). In relation to registration filings, we also continue to consider a file to be dormant and will take steps to close it if we do not receive a response within three weeks of making a request for additional information. Prior to closing the file, we will send another notification informing the filer of the imminent closure unless a response is received within two weeks of the date of the notification. In cases where a re-activation of the file is requested, an additional fee may be required.

c) Voluntary surrenders of registration

We expect a registrant firm to file an application to surrender its registration when it ceases (or intends to cease) conducting registerable activities. When considering a firm's application, we seek to ensure that satisfactory evidence exists that all financial obligations to clients have been discharged and that surrender of the registration is not prejudicial to the public interest. The evidence that we will require a firm to file will depend on the circumstances. However, in most cases we will require the following:

- an officer's certificate,
- a firm's unaudited financial statements, as at a date after the firm ceased registerable activity, and
- an auditor's comfort letter or specified procedures report.

We encourage surrendering firms to contact us at the time of their applications so that we can tailor information requirements to their businesses.

We will not recommend that the Director approve an application to surrender registration if the information that we require is not provided to us. Further, where a firm refuses to

provide the required information, this non-compliance may be considered when assessing future registration applications.



“If you are approaching any Ontario investors to fund peer-to-peer loans or loan portfolios, then you should be talking to the OSC about securities law requirements, including whether you need to be registered or require a prospectus.”

June 19, 2015 – Debra Foubert, Director of CRR in a press release titled “OSC Sets Out Expectations for Businesses Planning to Operate Peer-to-Peer Lending Websites”

d) Peer-to-peer lending

We have identified a number of “peer-to-peer” lending websites (P2P Websites) that are conducting business in Ontario. P2P Websites generally facilitate the matching of borrowers and lenders. The loan agreements entered into on P2P Websites may constitute a “security” as defined in the Act. If you are approaching

Ontario investors to fund peer-to-peer loans or loan portfolios, you must consider whether registration and/or prospectus requirements apply. Additional information on our expectations is available in a [news release](#) issued on June 19, 2015.

3.2 Current trends in deficiencies and acceptable practices

a) Common deficiencies in firm registration filings



(i) New firm registration filings – Form 33-109F6 Firm Registration ([Form 33-109F6](#))

We have received a number of new applications for firm registration that are often submitted without key documents or information necessary for us to assess whether there are issues that impact the suitability of the firm for registration. For example, some firms are submitting applications for the firm’s registered and permitted individuals weeks or months after the filing of Form 33-109F6, which can delay a firm’s registration if the individuals have any proficiency or suitability issues. We pre-screen new firm applications to ensure that they are substantially complete before assigning these applications for a full review.

Acceptable practices to apply for initial registration in Ontario

Applicants must:

- Include all required attachments to the Form 33-109F6 at the time of the application for registration.
- Be prepared to file registration applications on a timely basis for all of the

firm's individuals seeking registration or approval as a permitted individual.

- Provide a business plan covering the firm's anticipated plans for the next upcoming three years.
- Provide the index of the firm's policy and procedures manual (and be prepared to provide the entire document upon request).
- If requested, be prepared to provide:
 - know your client (KYC) forms (for individuals and permitted clients), and
 - relationship disclosure information.

Unacceptable practices

Applicants must not:

- File a completed Form 33-109F6 with incomplete documentation and request the application to be assigned for review.

(ii) Change to firm registration filings – Form 33-109F5 *Change of Registration Information (Form 33-109F5)*

All registered firms with a head office in Ontario, including IIROC and MFDA members, must notify the OSC of changes to their firm registration information by submitting a completed Form 33-109F5 to update any changes to information previously reported on Form 33-109F6, including changes to a firm's business model.

The required changes and deadlines are outlined in Part 3 of National Instrument 33-109 *Registration Information* (NI 33-109). Form 33-109F5 must be filed through the OSC's electronic filing portal. Late filings of Form 33-109F5 are subject to the late fees outlined in [Appendix D](#) of OSC Rule 13-502 *Fees* (OSC Rule 13-502 or the Fee Rule).

Acceptable practices to report changes to firm information

Registrants must:

- Ensure that all changes to Form 33-109F6 are filed by submitting a completed Form 33-109F5 within the time frames set out in [Part 3 of NI 33-109](#).
- Ensure that Form 33-109F5 is filed for updates to both firm information (Form 33-109F5) and individual information (Form 33-109F4) with respect to changes (For example: registration of a new CCO or addition of a new shareholder).

Unacceptable practices

Registrants must not:

- Rely on information provided in notices to the OSC under sections 11.9 or 11.10 of NI 31-103 as a substitute for reporting changes on Form 33-109F5 (For example: transactions that result in a change to a firm's business model, business or ownership structure).
- Rely on filings made to IIROC or the MFDA as a substitute for reporting changes on Form 33-109F5.

b) Common deficiencies in individual registration filings

(i) Suitability issues that require additional review

Three criteria are considered when assessing an individual's suitability for registration: integrity, proficiency and solvency. When we identify integrity or proficiency concerns in a registration filing, a further review and analysis must be completed before a recommendation for a registration decision can be made.

We remind registrants that integrity concerns may arise from activities conducted both inside and outside of the securities industry. Violating statutes, regulations, rules or standards of conduct for example in the banking, insurance or mortgage fields may impact a registration decision. Possible non-securities violations that would impact a registration decision include:

- the falsification of credit card applications,
- misconduct, such as churning or rebating, related to the sale of insurance, and
- promoting mortgage investments to an ineligible client.

Concerns identified with respect to an individual's suitability for registration may result in a recommendation to the Director that the individual be subject to terms and conditions on his or her registration or, in situations involving more serious misconduct, a recommendation that the individual's registration be denied.

Acceptable practices to identify suitability issues with individuals

Registrants are expected to:

- Perform a background check on the individual applicant during the hiring process and prior to submitting a Form 33-109F4, in order to identify any potential issues, such as securities and non-securities related violations.

Unacceptable practices

Registrant firms must not:

- Expect that violations of the law by an individual outside of the securities industry will be excluded as relevant information to the assessment of the individual applicant's suitability for registration.

(ii) Improper use of reinstatement notices – Form 33-109F7 *Reinstatement of Registered Individuals and Permitted Individuals (Form 33-109F7)*

When an individual leaves a sponsoring firm and joins a new registrant firm, they may submit a form 33-109F7 to have their registration or permitted individual status automatically reinstated in one or more of the same categories and jurisdictions as before, subject to all of the conditions set out in subsection 2.3(2) or 2.5(2) of NI 33-109. Only individuals who meet these conditions are permitted to file Form 33-109F7.

Acceptable practices when reinstating an individual's registration status

Registrants must:

- Review the individual's Form 33-109F1 – [*Notice of Termination of Registered Individuals and Permitted Individuals*](#) (Form 33-109F1) carefully and conduct additional due diligence to determine if a reinstatement is appropriate.

Unacceptable practices

Registrants must not:

- File Form 33-109F7 for an individual before the individual is eligible to start performing registrable activities with the new registrant firm (i.e. if the individual is still registered with another registrant).
- Submit a reinstatement notice if, for instance, an individual's Form 33-109F1 describes alleged or acknowledged misconduct in the previous twelve month period. Examples of misconduct include breaches of securities laws, SRO rules, or an employer's code of conduct.

(iii) Reactivation of registrant application – Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals (Form 33-109F4)*

An individual that is applying to reactivate his or her registration with a new sponsoring firm must file Form 33-109F4 (if the individual does not meet the conditions for reinstatement using Form 33-109F7).

We have found that some individuals have not been disclosing all of the details surrounding the individual's resignation, termination or dismissal for cause by the individual's previous employer(s).

Acceptable practices when applying for individual registration reactivation

Registrants must:

- Provide accurate and complete details under item 12 – Resignations and Terminations in Form 33-109F4 for an individual applying for registration with a new sponsoring firm.
- If applicable, list and explain in item 12 of Form 33-109F4 the specific issues noted in the notice of termination (Form 33-109F1) filed by the individual's former sponsoring firm. For example, include details with regards to any resignations, terminations or dismissals for cause by an employer following allegations of:
 - violations from any statutes, regulations, rules or standards of conduct,
 - failure to appropriately supervise compliance with any statutes, regulations, rules or standards of conducts, or
 - committing fraud or the wrongful taking of property, including theft.

(iv) Non-disclosure or late disclosure in Form 33-109F4

A registered individual or permitted individual must notify the OSC of a change to any information previously submitted in respect of the individual's Form 33-109F4.

The required changes and deadlines are outlined in Part 4 of NI 33-109. Updates to Form 33-109F4 are made by completing Form 33-109F5 through the National Registration Database (NRD). Late filings of Form 33-109F5 (to amend Form 33-109F4) are subject to the late fees outlined in Appendix D of OSC Rule 13-502.

We have found that individuals often do not make accurate and timely disclosures of changes to information on Form 33-109F4, particularly with respect to the criminal, civil or financial items. These deficiencies often raise suitability issues, which may lead to a recommendation that regulatory action be imposed, such as supervisory terms and conditions, or denial or suspension of registration.

Acceptable practices to submit changes to an individual's registration information

Registrants must:

- File an update to Form 33-109F4 for each new event occurrence (e.g. next court date involving a criminal or civil case or a copy of the Statement of Defense involving a criminal or civil case).
- Consider whether updates to information are required in multiple sections of Form 33-109F4. Examples include the following disclosures:
 - individuals who obtain an insurance license (required to be disclosed in item 13.3(a) of Form 33-109F4) must also disclose if they start working for or open their own insurance business under Item 10 of Form 33-109F4, and
 - a UDP who holds securities of the registered firm through a personal holding company (required to be disclosed in item 17 of Form 33-109F4) must also disclose that holding company under Item 10 of Form 33-109F4.

Unacceptable practices

Registrants should not:

- Wait and combine multiple changes into one NRD submission. Registrants must notify the regulator of each change by the deadlines outlined in Part 4 of NI 33-109. A separate late fee applies to each change reported on the basis that a separate form was required to be filed in respect of each change.

INFORMATION FOR DEALERS, ADVISERS AND INVESTMENT FUND MANAGERS



- 4.1 All registrants**
 - a) Compliance review process**
 - b) Current trends in deficiencies and acceptable practices**
 - c) Update on initiatives impacting all registrants**

- 4.2 Dealers (EMDs and SPDs)**
 - a) Current trends in deficiencies and acceptable practices**
 - b) Update on initiatives impacting EMDs**

- 4.3 Advisers (PMs)**
 - a) Current trends in deficiencies and acceptable practices**
 - b) Update on initiatives impacting PMs**

- 4.4 Investment fund managers**
 - a) Current trends in deficiencies and acceptable practices**
 - b) Update on initiatives impacting IFMs**

4 Information for dealers, advisers and investment fund managers



“Effective compliance and strong enforcement are the cornerstones of protecting investors and fostering confidence in capital markets. The importance of effective compliance and supervision continues to grow as domestic market structures, processes and products and international guidelines and responsibilities evolve.”

OSC Notice 11-772 – Notice of Statement of Priorities for Financial Year to end March 31, 2016

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 acceptable 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 types of registrants.*

4.1 All registrants

This section discusses our compliance review process, current trends in deficiencies resulting from compliance reviews applicable to all registrants (and acceptable practices to address them) and an update on 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 focus on a specific industry topic or practice we may have concerns with. We conduct compliance reviews on-site at a registrant’s premises, but we 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 or practices requiring review (including risk of harm to investors) and therefore considered to be higher risk, and
- firms that could have a 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 risk assessment questionnaire, their compliance history, complaints or tips from external parties, and intelligence information from another OSC branch, an SRO or another regulator.

(ii) Risk Assessment Questionnaire

In June 2014, firms registered with the OSC in the categories of PM, restricted PM, IFM, EMD and/or restricted dealer were asked to complete a comprehensive risk assessment questionnaire (the [2014 RAQ](#)) consisting of questions covering various business operations related to the different registration categories. The RAQ supports our risk based approach to select firms for on-site compliance reviews or targeted reviews.

The data collected from the 2014 RAQ was analyzed using a risk assessment model. Every registrant response was risk ranked and a risk score was generated. Those firms that were risk ranked as high were recommended for a compliance review. A more detailed discussion of these reviews is included in section 4.1 b), 4.2 a), 4.3 a) and 4.4 a) of this report.

(iii) Sweep reviews

In addition to reviewing firms based on risk ranking, we also conduct sweeps which are compliance reviews on a specific topic. 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 review large or “impact” firms as discussed in (i) above.

We focused the majority of our resources this year on compliance reviews of firms categorized as high risk based on our analysis of the results to the 2014 RAQ. Additional details on the results of these compliance reviews can be found in sections 4.1 b), 4.2 a), 4.3 a) and 4.4 a) of this report.

(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 we identify more serious registrant misconduct.

The outcomes of our compliance reviews in fiscal 2015, with comparables for 2014, are presented in the following table and are listed in their increasing order of seriousness. Firms are shown under the most serious outcome 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 2015	Fiscal 2014
Enhanced compliance	40%	53%
Significantly enhanced compliance	47%	28%
Terms and conditions on registration ⁸	9%	10%
Surrender of registration	0%	3%
Referral to the Enforcement Branch ⁹	3%	5%
Suspension of registration ¹⁰	1%	9%

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).



b) 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 categorized as higher risk based on the response to the 2014 RAQ. These deficiencies were noted as common deficiencies across all three registration categories.

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.***

⁸This percentage includes some registrants reviewed in the prior period.

⁹This percentage includes some registrants reviewed in the prior period.

¹⁰This percentage includes some registrants reviewed in the prior period.

We strongly recommend registrants review the deficiencies and acceptable 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) Inadequate referral arrangements

We continue to be concerned about the practice of some registrants delegating their KYC and suitability obligations to referral agents such as financial planners and mutual fund dealing representatives. We have detailed our concerns with these types of arrangements in previous annual reports (see section 5.2A of [OSC Staff Notice 33-736 – 2011 Annual Summary Report for Dealers, Advisers and Investment Fund Managers](#) (OSC Staff Notice 33-736), section 4.3.1 of OSC Staff Notice 33-742 and section 4.3 a) of OSC Staff Notice 33-745. Despite this, some registrants continued to delegate their KYC and suitability obligations to referral agents. As a result, we focused on the number of referral arrangements and the amount of fees paid to the referring agents, when analyzing the 2014 RAQ responses in order to select the sample of registrants included in the high risk compliance reviews.

We noted the following issues in relation to these types of referral arrangements where deficiencies were identified:

- registrants had a high number of referral arrangements in place with referral agents,
- registrants established a business model that is primarily reliant on third parties, most of whom are not registered under the Act, to refer clients to the registrant,
- the majority of registrant clients were obtained through these referral arrangements,
- registrants were relying on the referral agents to communicate directly with the referred clients for the purpose of completing the KYC process, executing the suitability analysis, and obtaining regular updates to KYC information and therefore improperly delegating their KYC and suitability obligations under NI 31-103,
- clients confirmed that their ongoing relationship was with the referral agent and not the registrant, even after the client money had been invested by the registrant, including calling the referral agent if they had questions about the client statements received from the registrant,
- the referral agreement did not adequately:

- identify the roles and responsibilities of each of the registrant and the referral agent,
- provide that the registrant may terminate the referral agreement if the referral agent engaged in activities that require registration in relation to the registrant's clients,
- identify a non-exhaustive list of activities that the referral agent could engage in,
- did not identify how the registrant would monitor and enforce the referral agent's compliance with the terms of the referral agreement,
- the referral agents name and contact information appeared on the client statement instead of the registrant's contact information,
- registrants did not have enough registered individuals to be able to adequately service the number of referred clients, thus relying on the referral agent to execute registerable activities on their behalf,
- registrants had not created adequate investment management agreements with the referred clients, and
- in some instances, the referral agent received the majority of the management fee as a referral fee charged by the registrant to the referred client based on the client's assets under management.

In the instances where these issues were identified, we responded by taking further regulatory action, including the imposition of terms and conditions on registration. We also are considering additional regulatory action, including recommending a suspension of registration.

Registrants must comply with the referral arrangement requirements in sections 13.8 to 13.10 of NI 31-103 (also, see the guidance in Part 13 of 31-103CP). A client who is referred to a registrant becomes the client of that registrant for the purposes of the services provided under the referral arrangement. The registrant receiving a referral must meet all of its obligations as a registrant towards its referred clients, including KYC and suitability determinations. Registrants may not use a referral arrangement to assign, contract out of or otherwise avoid their regulatory obligations. Registrants that use referral agents should carefully review their practices to ensure that only appropriately registered individuals are performing registerable activities. Registerable activities include

meeting with investors to ascertain their investment needs and objectives, risk tolerance and financial circumstances, discussing and recommending investment opportunities, and performing ongoing portfolio reviews. We also encourage registrants to review the guidance provided in previous annual reports, as referenced above.

(ii) Incomplete and/or inadequate books and records

During our high risk compliance reviews, we noted a number of instances where some firms did not maintain adequate books and records that led to deficiencies in the following areas:

- a lack of or inadequate records to accurately record all business activities, financial affairs and client transactions and to demonstrate compliance with applicable requirements of securities law, and
- firms could not provide OSC Staff with requested books and records, that should have been readily available, supporting a firm's compliance with securities law in a timely manner.

The requirement to maintain adequate books and records is found in section 11.5 of [NI 31-103](#) and in section 19(1) of [the Act](#). Maintaining adequate books and records that can be accessed in a timely manner is a key component of a firm establishing and maintaining an adequate compliance system under section 11.1 of NI 31-103. Additional guidance related to this issue is also found in section 11.1 and 11.5 of [31-103CP](#) and subsection 19(3) of the Act.

Acceptable practices to maintain adequate and complete books and records:

Registrants must:

- Develop and enforce policies and procedures that require adequate books and records to be maintained in relation to all aspects of a registrant's operations.
- Maintain books and records in a manner that is readily available and accessible.
- Have a process in place to review books and records on a regular basis to ensure that adequate and complete books and records are being maintained and that the books and records are up to date (e.g. missing or outdated investment management agreements, outdated insurance riders, incorrect client statements and trade confirmations, missing referral agreements, missing agreements between affiliated entities, incorrect details related to client accounts, etc.).

Unacceptable practices

Registrants must not:

- Engage in registerable activities with missing, incorrect or outdated books and records.

(iii) Repeat common deficiencies

The following includes the deficiencies that we continued to find during the high risk compliance reviews that have been reported on in previous annual reports. The chart highlights the common deficiency and provides information on where guidance related to this deficiency can be found. 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 written policies and procedures	<ul style="list-style-type: none">• Section 4.1 c)(ii) of OSC Staff Notice 33-745
2) Inadequate or no annual compliance report	<ul style="list-style-type: none">• Section 4.1 c)(iv) in OSC Staff Notice 33-745• 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 calculation of excess working capital	<ul style="list-style-type: none">• Section 4.1 c)(iv) in OSC Staff Notice 33-745
4) Inadequate relationship disclosure information	<ul style="list-style-type: none">• Section 4.1 c)(iv) in OSC Staff Notice 33-745• CSA Staff Notice 31-334 – CSA Review of Relationship Disclosure Practices (CSA Staff Notice 31-334)• Section 5.1.2 in OSC Staff Notice 33-738 under the heading <i>Inadequate relationship disclosure information</i>
5) Incomplete client account statements	<ul style="list-style-type: none">• Section 5.2C in OSC Staff Notice 33-736• Section 4.3.3 in OSC Staff Notice 33-742 under the heading <i>PM client account statement practices</i>
6) No notice of or inadequate filing of	<ul style="list-style-type: none">• Section 3.2 in OSC Staff Notice 33-742 under the heading <i>Outside business activities</i>

outside business activities	<ul style="list-style-type: none"> Section 5.2.1 of OSC Staff Notice 33-738 under the heading <i>Not disclosing outside business activities</i>
7) Financial statements not in accordance with International Financial Reporting Standards (IFRS)	<ul style="list-style-type: none"> Section 4.1.2 in OSC Staff Notice 33-742 under the heading <i>Financial statements not prepared in accordance with NI 52-107</i>
8) Inadequate marketing material	<ul style="list-style-type: none"> Section 5.2B of OSC Staff Notice 33-736 CSA Staff Notice 31-325 – Marketing Practices of Portfolio Managers (CSA Staff Notice 31-325)
9) Inadequate marketing practices	<ul style="list-style-type: none"> CSA Staff Notice 31-325



c) Update on initiatives impacting all registrants

(i) Failure to provide notice of ownership changes or asset acquisitions

As reported in section 4.1 b) of [OSC Staff Notice 33-745](#), we continue to have significant concerns with some registrants not filing 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 UDP, CCO, advising representative 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,
- registrants knew, or had reason to believe, that 10% or more of their voting securities were going to be acquired by a non-registrant, including an officer, 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) but did not provide us with the required notice as soon as the registered firm knew, or had reason to believe, that this scenario existed, and
- 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 a section 11.9 or 11.10 notice include:

- the acquisition 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 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. We typically issue a warning letter to a firm regarding the seriousness of their failure to provide notice, however we may in appropriate circumstances object to the transactions and also take other regulatory action. We may also object to the notice of acquisition even though the transaction has been completed. As 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(a) 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), and
- change of manager approval requests under section 5.5 of [National Instrument 81-102 Investment Funds](#) (NI 81-102).

Registrants must 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.

(ii) **Incomplete applications for exemptive relief**

We have noted that applicants and/or their filing counsel (collectively, the filers) do not always follow the required procedures when filing exemptive relief applications. As a consequence, we may be required to spend significant time ensuring that all relevant information has been provided and the application is complete. This additional time can prevent us from processing the application according to the [OSC's service standards](#), or within an expedited time frame, where requested.

We have listed below some of the issues that we encounter when processing exemptive relief applications.

General issues

Some of the general issues noted include:

- applications may not be filed in a timely manner (for example, a filer may request exemptive relief on an expedited basis within a timeframe that is not reasonable to allow for proper review and processing),
- a request to process an application on an expedited basis is made without providing a satisfactory reason to support the request,
- some applications are either not signed by each applicant or do not include a verification statement from each applicant,
- some applications do not follow the required form as set out in the relevant guidance,
- some filers do not make proper use of precedents (for example, some applications are not prepared based on the most up-to-date, relevant precedents or do not cite the relevant precedents), and
- some filers have not completed the applicable legal analysis prior to submission for our review and consideration.

In instances where the applications are deficient, the materials will be returned to the registrant for further review.

Incorrect application filing fees

Some issues relating to filing fees include:

- the filer has not paid the appropriate filing fee for the application, for example:
 - the required additional filing fees have not been paid where the application requests relief from two or more sections of the Act, a Regulation or a Rule, and
 - the required additional filing fees have not been paid where the application requests relief for more than one filer,
- the filers have not paid the additional \$2,000 filing fee to which each of the applicants is subject if an applicant (or its parent company or, if it is a fund, its IFM) is not subject to a participation fee under the Fee Rule or [OSC Rule 13-503 \(Commodity Futures Act\) Fees](#) (the CFA Fee Rule), and
- where the filers may qualify for a fee waiver, the filers have not specified that they are requesting a fee waiver or have not provided reasons for a fee waiver request.

Acceptable practices to ensure exemptive relief applications are ready for submission to the OSC

Filers should ensure that:

- For novel or complex applications, prior to making a formal application for exemptive relief, the filer has considered the submission of a pre-filing to consult with us on a specific issue and how Ontario securities law will be interpreted.
- For local, Ontario-only applications, the filer has consulted [OSC Policy 2.1 Applications to the Ontario Securities Commission](#).
- For applications involving multiple Canadian jurisdictions, the filer has consulted [National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions](#) (NP 11-203).
- The application is signed by each applicant or includes a signed verification statement from each applicant that authorizes the filing of the application and confirms the truth of the facts in the application.
- Inclusion of all applicable ancillary documents, including the precedents that are cited in the application.
- An explanation of how the precedents are relevant to the application is included with the application, along with any material distinctions between the precedents and the application.
- For novel applications, the filer states the application is novel and precedents cannot be identified.

- The draft order conforms as much as reasonable to the most recent and applicable precedents.
- All applicable legal analysis has been executed prior to submitting the application for review.
- The inclusion of a “not in default of securities legislation” representation with respect to the filer (and any other relevant parties) that is consistent with the requirements found in section 5.2 of [NP 11-203](#).
- A thorough review of the relevant Fee Rule or CFA Fee Rule, as applicable, has been conducted to determine the appropriate amount of fees payable for the application.

(iii) **Withdrawal of notices and revocation of omnibus/blanket orders**

On July 16, 2015, the CSA published [CSA Staff Notice 11-329 *Withdrawal of Notices and Revocation of Omnibus/Blanket Orders*](#). This Notice formally withdraws a number of previous, now stale or redundant CSA Staff Notices and confirms the revocation of certain omnibus decisions in Ontario and blanket orders in the other CSA jurisdictions. It also formally announces the withdrawal of Multilateral Policy 34-202 *Registrants Acting as Corporate Directors*.



(iv) **Fees**

a) **Participation fees**

Since 2013 firms have calculated participation fees (see part 3.2 of [OSC Rule 13-502](#)) based on a reference fiscal year. The amendments to the Fee Rule and the CFA Rule, which became effective April 6, 2015, have changed this requirement. Firms will now be required to use their most recent financial year information ending in the calendar year to complete the online [Form 13-502F4 – Capital Market Participation Fee Calculation](#) (Form 13-502F4) (or 13-503F1 for Commodity Futures Act registrants) through the OSC’s website on or before December 1 of each year.

Firms that do not have their year-end financial results before December 1, are required to file the Form 13-502F4 based on a good faith estimate. These firms must then, not later than 90 days after the end of their fiscal year end, determine if they underestimated their participation fee payable. If so, these firms must pay the balance owing and file a completed Form 13-502F4 (13-503F1 for Commodity Futures Act registrants). A firm that

overpaid its participation fee must also file a Form 13-502F4 and [Form 13-502F5 – Adjustment of Fee for Registrant Firms and Unregistered Exempt International Firms](#) and request a refund within 90 days of their fiscal year end. These forms must be filed online.

The calculation and payment of participation fees for unregistered IFMs has now been aligned with that of other registrants and exempt international firms. The Form 13-502F4 for these firms is now due December 1 of each year, regardless of the firm's fiscal year end. These firms are also required to pay participation fees by December 31 of each year. There has been a transition period provided for these firms in section 3.1(5) of [OSC Rule 13-502](#). Unregistered IFMs with a financial year ending between January 1, 2015 and April 5, 2015 that filed a 2015 Form 13-502F4 and paid the required participation fee within 90 days of that financial year end, will not be required to file another Form 13-502F4 by December 1, 2015 or pay another participation fee by December 31, 2015.

A new requirement this year relating to participation fees involves the requirement for a CCO to certify the Form 13-502F4 prior to submission of the form to the OSC. For unregistered capital markets participants without a CCO, an individual acting in a similar capacity to a CCO must provide the certification.

The late filing fee for filing the Form 13-502F4 after the December 1 deadline remains at \$100 per business day the filing is late. A late filing fee of 0.1% of the unpaid portion of the participation fee applies for each business day any portion of the participation fee was due but unpaid.

Firms with bank accounts linked to NRD and who have filed their Form 13-502F4 by the required deadline should expect to have participation fees (along with NRD administrative fees) withdrawn on or after December 31. Firms that do not have bank accounts linked to NRD (such as unregistered capital markets participants) can continue to pay participation fees by cheque or wire transfer.

b) Activity fees and late filing fees

There were changes to the activity fees payable for certain types of registration filings, including fees for proficiency exemptions and filings for new firm applications (see Appendix C, Part E of [OSC Rule 13-502](#) for additional information). Additionally some changes were made with respect to the timing of the assessment of late filing fees. Late

filing fees will now only apply to filings on behalf of firms or individuals for which Ontario is the principal regulator and only for specified sections of the Form 33-109F4 or Form 33-109F6. The late filing fees charged in relation to: (a) amending the Form 33-109F6 with the information of a specified affiliate of the registrant firm has been reduced to a flat fee of \$100 and (b) the late fees cap has increased for firms that reported specified Ontario revenues of \$500 million or more. (See Appendix D of [OSC Rule 13-502](#) for additional information).

c) Outside business activities – late filings and fees

Amendments to NI 31-103 became effective on January 11, 2015. As part of these amendments, section 13.4 of the companion policy to NI 31-103 ([31-103CP](#)) was also amended to add guidance about conflicts of interest in relation to registered and permitted individuals that serve on boards or have outside business activities (OBAs).

We were concerned that some market participants believed the additional guidance in 31-103CP was a new requirement that now required the submission of a completed Form 33-109F5 with respect to previously existing OBAs. The purpose of the amended guidance included in 31-103CP is meant to highlight and explain that there has always been an existing requirement for individuals to report OBA activities.

In order to enable market participants to “catch up” with these filings, OSC Staff issued [OSC Staff Notice 13-705 – Reduced Late Fee for Certain Outside Business Activities Filings](#) (OSC Staff Notice 13-705) on January 14, 2015. OSC Staff Notice 13-705 provided registrant firms and their registered and permitted individuals an opportunity to update item 10 of Form 33-109F4 for any employment, other business activities, officer positions held and directorships, and to apply for a one-time reduced late fee with respect to the activities that were not reported on a timely basis. The eligibility criteria and the late fee relief process were set out in OSC Staff Notice 13-705. The deadline to apply for reduced fee relief was March 27, 2015.

In total, the OSC received applications from approximately 300 registrant firms and over 1,200 individual NRD submissions with updates to item 10 of [Form 33-109F4](#). Firms that were granted relief were issued a late fee of \$100 for each OBA not reported on a timely basis.

As a result of the review process, we have outlined acceptable practices for firms below.

For any required updates, firms must complete Form 33-109F5 via NRD to report each change to item 10 of Form 33-109F4 by the required deadlines (deadlines are outlined in Part 4 of NI 33-109). Late filings are subject to the late fees outlined in OSC Rule 13-502.

Acceptable practices to avoid the payment of fees related to late filings of OBAs

Registrants must:

- Have policies and procedures in place to identify any updates to a registered or permitted individual's employment, other business activities, officer positions held and directorships.
- Have policies and procedures in place to address conflicts of interest with respect to an individual's activities. If a firm has determined that there is no conflict of interest, this does not mean that the activity does not have to be reported on item 10 of Form 33-109F4.

Examples of types of activities that we expect individuals to report include:

Employment: All employment activities with the sponsoring firm and outside of the sponsoring firm.

Officer and director positions: All officer and director positions with the sponsoring firm and outside of the sponsoring firm (regardless of whether the individual is in a position of power or influence). Examples include officer or director positions in the following organizations:

- hospitals
- charities
- cultural and religious organizations
- general partnerships.

Equivalent positions to an officer or director: Equivalent positions to an officer or director include positions where the individual is in a position of power or influence over clients or potential clients. This may include non-leadership roles. For example, some of the activities that we have required to be disclosed include:

- roles handling investments or monies of an organization, such as being on a charity’s investment or finance committee, as these roles are similar to activities performed by registrants,
- acting as a pastor, as this role places the individual in a position of influence over his or her congregation (see section 3.2 of [OSC Staff Notice 33-742](#) for additional information), and
- mentoring youth through an organization (e.g. mentor of a disabled youth where the individual sells the family securities), as it places the individual in a position of influence over potential clients, including family members of the youth.

Outside business activities: OBAs include activities where the individual is in a position of power, position of influence or position that places the individual in contact with clients or potentially vulnerable clients (e.g. seniors). Examples of these type of positions include:

- 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; see section 3.2 g) of [OSC Staff Notice 33-745](#) for additional information).

Having ownership in a holding company is an activity that requires disclosure since owning a holding company allows a person to perform, control or influence a business activity indirectly. However, where the ownership is at a negligible level of 1% or 2%, we generally do not require disclosure (see section 3.2 of [OSC Staff Notice 33-742](#) for additional information). Additional guidance is outlined in section 13.4 of 31-103CP.

4.2 Dealers (EMDs and SPDs)

This section contains information specific to EMDs, including current trends in deficiencies from compliance reviews of EMDs (and acceptable practices to address them) and an update on current initiatives applicable to EMDs.



a) Current trends in deficiencies and acceptable practices

In this section, we summarize key trends in deficiencies from recent compliance reviews of EMDs categorized as higher risk based on the response to the 2014 RAQ.

(i) Failure to complete adequate KYC, know your product and assessment of suitability

We continue to find firms that are not collecting and documenting adequate KYC information for each of their clients (see section 13.2 of NI 31-103). The purpose of KYC is to establish the client's identity, establish the suitability of the proposed transaction and to determine whether the prospectus exemption relied upon is available in the circumstance.

The CSA issued [CSA Staff Notice 31-336](#) in January 2014. KYC, know your product (KYP) and suitability obligations are among the most fundamental obligations owed by registrants to their clients, and are cornerstones of our investor protection regime. We have repeatedly recognized that these requirements are basic obligations of a registrant, and a course of conduct by a registrant involving a failure to comply with them is an extremely serious matter.

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). We have identified concerns with EMDs whose suitability process and practices limit their interaction with investors. Assessing suitability is more than a mechanical fact-finding exercise. An EMD must:

- have a meaningful dialogue with the client to obtain a solid understanding of the client's investment needs and objectives,
- explain to the client the product's features and risks, and
- explain how a proposed investment is suitable for the client.

An EMD's suitability obligation must be discharged regardless of the source of a new client relationship, for example a client's relationship or previous interactions with an issuer does not negate a registrant's suitability obligations.

We encourage EMDs to review [CSA Staff Notice 31-336](#) to improve their understanding of, and compliance with, the fundamental KYC, KYP and suitability obligations and as a self-assessment tool to strengthen their compliance with securities law.

Acceptable practices for interacting with investors

EMDs must establish processes or practices that:

- Promote engagement in meaningful KYC discussions with clients, including, if possible, meeting with clients face to face, or other alternative means such as FaceTime or Skype etc.
- Promote plain language discussion between the dealing representative and the client.
- Ask detailed questions of clients to assist in understanding the clients' investment needs and objectives.
- Collect and document sufficient minimum KYC information including name, age, investment objectives, annual income, net financial assets, net assets, liquidity needs, time horizon, risk tolerance, and portfolio composition.
- Consider a client's *willingness* to accept risk and *ability* to accept risk when assessing a client's risk tolerance.
- Require dealing representatives to retain notes of discussions.

Unacceptable practices

EMDs must not establish a process or practice that:

- Is focused substantially on e-mail correspondence for the distribution and receipt of completed KYC forms and subscription agreements.
- Minimizes the dealing representative and CCO's interaction with clients to confirm the accuracy of the information received.
- Relies on the client to read the information on their own and to determine the investment risks themselves.

(ii) Inappropriate practice of "renting out" a firm's registration

We continue to see that some EMDs are not implementing adequate internal controls to oversee their business operations. We are concerned that some EMDs are sponsoring dealing representatives solely for the purpose of distributing securities of the dealing representatives' employing or affiliated issuers, and are therefore "renting out" their firm's registration. In these instances, the dealing representatives receive a fixed compensation or salary from the issuers, and hold themselves out as acting on behalf of the issuers with

little or no mention of the EMD firm. The dealing representatives' independent operations within the EMD firm suggest that the issuers themselves should be registered in the appropriate category. A dealing representative should not be acting as a stand-alone operation within a firm and they should not sell only the products of their employer or affiliated issuers. A person or company engaged in the business of trading must be registered as a dealer. To comply with the dealer registration requirement, section 25(1)(b) of the Act requires that individuals not only be registered as dealing representatives of a registered firm, but that they be acting on behalf of that registered firm. A dealing representative who engages in, or holds themselves out as engaging in, the business of trading on behalf of an unregistered entity (such as their employing issuer) is therefore not complying with the dealer registration requirement. Furthermore, to meet their suitability obligations to clients, dealing representatives should know and consider other products of their EMD firm when recommending investments to clients.

Section 11.1 of NI 31-103 requires a firm to establish, maintain and apply policies and procedures which establish a system of controls and supervision sufficient to:

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

Acceptable practices to avoid the improper use of a firm's registration

EMDs must ensure that:

- Dealing representatives act on behalf of the EMD firm.
- Dealing representatives are compensated by the EMD firm for its registration activities.
- There is an adequate KYP process to conduct product due diligence and to train dealing representatives on all the products approved by the sponsoring firm.
- There are adequate controls and supervision by the firm to oversee the activities of its dealing representatives.

Unacceptable practices

EMDs must not allow a practice of:

- Dealing representatives to operate "their own business" within the operations of the EMD firm's registration.

- Dealing representatives to sell only his/her own shelf of products. The products approved by the firm should be available to be sold by all registered dealing representatives acting for the firm.
- Minimizing the compliance and supervision of dealing representatives.

(iii) Inadequate supervision of dealing representatives

As a result of inadequate supervision of dealing representatives, we have found that EMDs:

- did not collect complete KYC information for the purpose of establishing client identity and assessing the suitability of a proposed transaction,
- distributed securities in reliance on a prospectus exemption that was not available because the dealing representative did not have an adequate understanding of the requirements of the prospectus exemption,
- failed to ensure that dealing representatives had knowledge of the products they were recommending or trading in,
- did not effectively review trades which led to the approval of unsuitable trades,
- were not aware of outside business relationships that dealing representatives had which raised potential conflicts of interest,
- were not aware of the social media marketing activities of their dealing representatives,
- were not aware of the outside employment and business activities of their dealing representatives, and had failed to report these to the OSC, and
- failed to supervise the personal trading activities of their dealing representatives.

We remind EMDs of their obligation to have adequate policies and processes in place, which:

- monitor the firm's operations for non-compliance with securities laws, and provide for self-reporting to the Commission, if necessary,
- identify weaknesses in the internal controls to report to management or another individual who has authority to take supervisory action to correct them, and
- demonstrate that the firm can take supervisory action to correct any identified non-compliance.

Subsection 32(2) of [the Act](#) requires registrants to establish and maintain systems of control and supervision for controlling their activities and supervising their representatives. Also, section 11.1 of [31-103CP](#), under the heading "Day-to-day monitoring and

supervision” states that anyone who supervises registered individuals has a responsibility on behalf of the firm to take all reasonable measures to provide assurance that the firm and individuals acting on its behalf:

- deal fairly, honestly and in good faith with their clients,
- comply with securities legislation,
- comply with the firm’s policies and procedures, and
- maintain an appropriate level of proficiency.

Section 3.4 of [NI 31-103](#) requires that a registered individual 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, including understanding the structure, features and risks of each security the individual recommends.

Acceptable processes for supervision of dealing representatives

EMDs must establish, maintain and apply policies and procedures to supervise the activities of the firm, including those activities undertaken by registered individuals, that:

- Clearly articulates the activities to be supervised and by whom.
- Provides a process regarding the frequency of the supervision.
- Provides a process on how the supervision will be evidenced and enforced by the firm.

EMDs must provide ongoing training for dealing representatives that provides:

- Awareness of the securities law requirements impacting their activities.
- An understanding of how to comply with their firm’s policies and procedures.
- An in-depth understanding of the products they recommend to clients.
- Information regarding any changes to the above on a timely basis.

A best industry practice may include conducting a formal review of the dealing representatives, on an annual basis, to assess their proficiency, their knowledge of compliance, and identifying areas for improvement through possible further training. Conducting a risk ranking of dealing representatives may also assist to focus supervision resources to those registered individuals that display a higher risk of non-compliance. In addition, EMDs should consider what supervisory resources are required to oversee dealing representatives and clients who communicate only in French or another language.

Unacceptable practices

EMDs must not allow dealing representatives to:

- Trade in securities not approved by the firm.
- Complete trades without reviewing to ensure compliance with the available prospectus exemption relied on.
- Use and send documentation to clients on anything but the firm's letterhead.
- Engage in verbal referral arrangements.
- Conduct OBA without the knowledge and approval of the firm.
- Engage in social media activities or other marketing activities without the knowledge and approval of the firm.

(iv) Failure to provide adequate disclosure of underwriting conflicts

During our compliance reviews, we identified that certain EMDs are not providing adequate consideration to the requirements of [NI 33-105 Underwriting Conflicts](#) (NI 33-105). If an EMD is trading in securities of a "related issuer" or "connected issuer", then NI 33-105 applies.

The disclosure requirements apply to distributions under a prospectus and most types of prospectus-exempt distributions including distributions made in reliance on the AI exemption. Further, an EMD that is acting as an intermediary, whether as a principal or an agent, is considered to be an underwriter and must comply with the disclosure requirements.

It is important that investors purchase securities at a price determined through a process unaffected by conflicts of interest, and that investors receive full, true and plain disclosure of all material facts regarding the issuer and the securities offered. NI 33-105 seeks to protect the integrity of the underwriting process in circumstances where there is a direct or indirect relationship between the issuer and the underwriter which might give a perception that they are not independent of the distribution.

There are two requirements:

- full disclosure of the relationships, giving rise to the potential conflicts of interest, must be given to investors, and

- an independent underwriter is required in certain circumstances to participate in the transaction.

An EMD, selling a “related issuer” or a “connected issuer” in a private placement to an accredited investor made in reliance on the AI exemption, is required to ensure that the distribution is made on the basis of a document (e.g. an offering memorandum) that contains the disclosure required by Appendix C to [NI 33-105](#). The disclosure includes, among other things:

- certain information to be included on the front page of the prospectus or other document, including a bold statement that the issuer is a connected issuer or a related issuer of the registrant, the basis for the relationship and a cross-reference for further information, and
- certain information to be included in the body of the prospectus or other document, including if the issuer is a connected issuer because of indebtedness, then information about that indebtedness.

We encourage you to review and complete a self-assessment using the illustrations provided in Appendix A to [NI 33-105](#) to determine whether this instrument applies to your distribution and to review the guidance in the companion policy to NI 33-105.

(v) Failure to provide adequate relationship information

The CSA issued guidance on relationship disclosure practices in July 2013 through [CSA Staff Notice 31-334](#). We continue to find EMDs are not delivering to clients all information that a reasonable investor would consider important about the client’s relationship with the registrant, including a description of conflicts of interest and types of risks.

Subsection 14.2(2) of [NI 31-103](#) requires EMDs to deliver specific relationship disclosure information. We noted that EMDs have failed to provide clients with:

- information about the nature or type of account that the client has with the firm (paragraph 14.2(2)(a)),
- information that identifies the products or services the firm offers to its clients (paragraph 14.2(2)(b)),
- a description of the types of risks that a client should consider when making an investment decision (paragraph 14.2(2)(c)),

- a description of the risks of using borrowed money to finance a purchase of a security (paragraph 14.2(2)(d)),
- a description of the conflicts of interest that the firm is required to disclose under securities law (paragraph 14.2(2)(e)),
- a description of all of the costs that the client will incur to operate an account, and all costs they will incur when making, holding and selling an investment (paragraph 14.2(2)(f) and 14.2(2)(g)), and
- a statement that the firm has an obligation to assess whether a purchase or sale of a security is suitable for the client prior to executing the transaction or at any other time (paragraph 14.2(2)(k)).

EMDs may provide this information in a single document, or in separate documents, which together give the client the prescribed information. We encourage you to review [CSA Staff Notice 31-334](#) to improve your understanding of, and compliance with, relationship information obligations and as a self-assessment tool to strengthen your compliance with securities law.

Acceptable processes for delivering relationship information

EMDs must:

- Provide relationship information which is clear and meaningful to the client, so that the client is able to understand the information presented.
- Ensure that their dealing representatives spend sufficient time with clients as part of an in-person or telephone meeting, or other method that is consistent with their operations, to adequately explain the information that is delivered to them.
- Have policies and procedures in place which will require its registered individuals to be able to demonstrate to the firm that they met with the client to discuss relationship information and the client has an adequate understanding.
- Be able to demonstrate delivery of relationship information at account opening, prior to trading and at any other times when a significant change in the relationship information has occurred.

Unacceptable practices

EMDs must not deliver relationship information which:

- Is full of technical terms and acronyms.
- Simply provides a link or a reference to another document, such as an offering

document, for the client to obtain information on the risks of the product, and the registrant does not provide the client with that actual document.

- Assumes the client will just read the relationship disclosure information at another time.



b) Update on initiatives impacting EMDs

(i) Online portals

In recent years we have registered firms who operate accredited investor online portals. These EMDs can facilitate distributions of securities in reliance on prospectus exemptions provided they comply with all of the normal requirements applicable to their EMD registration. Our initial review of these business models has identified concerns that these registrants are not applying the principles of NI 31-103 to their operations, including:

- establishing, maintaining and applying an adequate compliance system (see Part 11 of [NI 31-103](#)),
- meeting KYC and suitability obligations, conflict of interest and referral obligations (see Part 13 of NI 31-103),
- providing adequate disclosure to clients (see Part 14 of NI 31-103), and
- meeting financial condition requirements and delivering financial information to the OSC (see Part 12 of NI 31-103).

We have identified concerns with online portals performing an inadequate assessment of the issuers/products they are distributing. For an investment to be posted on an online portal website, the firm must have completed an adequate product assessment (KYP), in order to meet its suitability obligations. Further, the investment opportunities should not be marketed in any form prior to all KYP obligations being fully discharged – this includes posting security offerings on websites and social media, which could be construed as a recommendation. It is unacceptable to conduct product due diligence only if a client expresses interest in the product.

(ii) Registrants who sell related party products

We continue to have concerns with firms registered solely in the EMD category who trade solely or primarily in a limited number of related or connected issuers (referred to in this section as "captive dealers"). The basis of this concern is that EMDs who trade solely or primarily in the securities of related or connected issuers or who are financially dependent

on these issuers have created a business model that has significant inherent conflicts of interest.

During our compliance reviews, we continued to identify significant deficiencies that include concealment of the poor financial condition of related and/or connected issuers, sale of unsuitable, high-risk investments to investors, high investment concentration in related party products and in some rare cases, the misappropriation of investor funds. Material conflicts of interest arise with these relationships, in large part due to the lack of separation between the mind and management of the captive dealer and the issuer. We expect EMDs to avoid conflicts of interest that are not able to be mitigated with controls and/or disclosure.

We remind EMDs that when soliciting investors to invest in a related and/or connected issuers, those investors are clients of the EMD. We have identified captive dealers who did not recognize that investors were their clients, instead treating them as clients of their related and/or connected issuers. An EMD's client is the investor purchasing the securities, not the issuer. Captive dealers are required to comply with all registrant obligations, including those relating to KYC, KYP and suitability (refer to section 4.2 a) (i) in this report for a discussion of registrants' KYC, KYP and suitability obligations).

For those captive dealers that are able to manage these material conflicts of interest through internal controls and/or disclosure, we expect meaningful disclosure to be provided to investors in plain language. For example, disclosure in a simplified document, similar to a mutual fund fact sheet, which includes a useful and readable summary of the key facts, risks, conflicts of interest, up-front and on-going related party compensation and a breakdown of the use of proceeds is helpful to investors.

Our compliance reviews of captive dealers will continue to focus on how conflicts of interest are addressed. Captive dealers with business models where conflicts of interest have not been properly addressed will be subject to regulatory action where appropriate. For applicants who propose to have this business model, we will focus our pre-registration review on conflicts of interest identification, evaluation and controls. We may also recommend refusal of registration to firms that propose to have a captive dealer business model that does not adequately address the conflicts of interest.

We remind dealers that changes in business models must be filed with us. If an EMD’s business model changes from distributing third-party products to distributing products of related or connected issuers, the EMD is required to file Form 33-109F5.

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 an update on current initiatives applicable to PMs.



a) Current trends in deficiencies and acceptable practices

In this section, we summarize key trends in deficiencies from recent compliance reviews of PMs categorized as higher risk based on the response to the 2014 RAQ.

(i) Repeat common deficiencies

The following includes the deficiencies that we continued 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 or unregistered employees</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 • CSA Staff Notice 31-336: see unacceptable practices under the heading ‘<i>How should registrants collect and document KYC information?</i>’

2) Inadequate investment management agreements	<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
3) Inadequate personal trading policies	<ul style="list-style-type: none"> • Section 4.3.1 of OSC Staff Notice 33-742 under the heading <i>Inadequate personal trading policies</i> • Section 32(2) and 119 of the Act • Section 11.1 of NI 31-103
4) Account statement practices	<ul style="list-style-type: none"> • Section 4.3.3 of OSC Staff Notice 33-742 under the heading <i>PM client account statement practices</i> • Sections 14.14 and 14.14.1 of NI 31-103 and 31-103CP

(ii) Inadequate written policies and procedures on portfolio management

We noted that a majority of the PMs reviewed did not maintain adequate written policies and procedures on how they manage portfolios for clients, and how they place trades with dealers. These PMs’ policies and procedures did not cover the following areas:

- portfolio management processes or trading practices,
- the PM’s actual practices relating to portfolio management processes, and trading practices.

Section 11.1 of [NI 31-103](#) requires PMs to establish, maintain and apply policies and procedures that establish a system of controls and supervision to provide reasonable assurance that the firm and individuals acting on its behalf comply with securities legislation and manage the risks associated with their business in accordance with prudent business practices. To comply, PMs must establish, maintain and apply detailed policies and procedures on their portfolio management processes and trading practices that are tailored to their business operations and reflect their actual practices. We also expect PMs to have a process in place to ensure that written policies and procedures are regularly updated (at least annually) for changes in the firm’s business operations (including clients,

personnel, administrators or any material changes in business arrangements), industry practices and securities law. PMs should also consider if any compliance matters that arose in the past year indicate a need to revise the written policies and procedures.

Acceptable practices to ensure adequate written policies and procedures
PMs must ensure the policies and procedures manual addresses the following topics:

- In relation to portfolio management practices, cover:
 - collection, documentation and timely updating of KYC information for clients,
 - suitability of investments and trades for each client,
 - compliance with clients' specified investment restrictions or other instructions,
 - compliance with regulatory requirements (e.g. Part 2 of NI 81-102 if managing investment funds),
 - the requirement for sufficient research to support investment decisions, which includes understanding attributes and risks of investments (KYP),
 - restrictions on risky investment strategies, such as short-selling and the use of derivatives or leverage,
 - regular re-balancing of client portfolios,
 - supervision of advising representatives, including associate advising representatives and sub-advisers,
 - ensuring that proxies are voted in accordance with any client instructions, and
 - guidance on proxy voting, including such issues as executive compensation (e.g. stock options), take-over protection (poison pills), and acquisitions.

- In relation to trading practices, cover the following:
 - ensure trades are executed in accordance with the advising representatives' instructions,
 - identify and resolve failed trades and trading errors, including how trading losses are allocated,
 - guidelines on the selection of dealers,
 - fairness in allocating investment opportunities amongst clients, including block trades, initial public offerings and other new issues,
 - obtain best execution for clients and executing trades in a timely manner,
 - ensure trades are settled on a timely basis in the correct client accounts, at the correct quantity and amount,

- procedures governing any client directed brokerage arrangements,
- guidelines on use of client brokerage commissions (i.e. soft dollar arrangements),
- guidelines on cross trades, including their review and approval, pricing, execution cost, requirement to execute through a dealer, and restrictions on certain managed account transactions, and
- ensure institutional trades are matched on a timely basis, monitoring of trade matching percentages, and reporting trade matching exceptions.

Unacceptable practices

PMs 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.
- Rely on a policies and procedures manual of an affiliated firm as a substitute for its own policies and procedures.

(iii) Inadequate update of clients' KYC and suitability information

A majority of the PMs reviewed did not have current KYC and suitability information on file for all of their managed account clients. This indicates that these PMs had an inadequate process for updating their client's KYC and suitability information. For example, these PMs:

- did not have a discussion with each of their clients in the past twelve months to ascertain if there had been any changes in their KYC information,
- only sent an e-mail or letter to each of their clients requesting that they inform them if there had been any changes in their KYC information, but did not follow-up with clients if there was no response, or
- did not always document the results of their KYC update discussion with the client, especially when there had been no changes in the client's circumstances.

Since PMs have an ongoing suitability obligation for managed accounts, these PMs may not have sufficiently up-to-date KYC and suitability information to perform adequate suitability assessments.

Section 13.2(4) of [NI 31-103](#) requires PMs to take reasonable steps to keep their client's KYC and suitability information current. Section 13.2 of [31-103CP](#) states that we

consider information to be current if it is sufficiently up-to-date to support a suitability determination. For example, a PM with discretionary authority should update its clients' KYC information frequently. Further section 11.5(2)(l) of NI 31-103 requires PMs to maintain records that demonstrate compliance with the KYC and suitability obligations in section 13.2 of NI 31-103. For more information, see [CSA Staff Notice 31-336](#).

When there is a change in a client's KYC information, PMs must document the change and assess if the client's investment strategy and investment portfolio remains suitable or should be adjusted.

Acceptable practices to adequately update KYC information:

An advising representative must:

- Be proactive in ensuring client's KYC information is kept up-to-date.
- Create and implement a process to update each client's KYC information at least annually and more often if there is a material change in the client's circumstances (for example, due to trigger events such as marriage, divorce, birth of a child, loss or change in employment, serious health issue), or when there is a significant change in market conditions.
- Update KYC information through a meaningful discussion with each client, such as at a scheduled meeting to discuss the client's portfolio, returns and progress in meeting their investment goals.
- Create and use a KYC update form, check-list or standard list of questions to ask (which uses the above trigger events) to facilitate the discussion and to document the results.
- When applicable, document in the client's file that there has been no change in a client's KYC information or circumstances as evidence that a KYC update was performed and when it was performed.
- Where a letter or e-mail is sent to clients to update their KYC information:
 - obtain positive confirmation from the client when there is no change in their circumstances by requesting a reply by a specific date and follow-up with the client if no reply is received (i.e. don't assume no changes if the client doesn't respond),
 - provide a copy of the client's latest KYC information on file, and ask them to confirm if it is accurate and current, or to notify you of the changes (and how to do so), and

- provide examples of changes that the client should inform you of (such as the above trigger events, an increase or decrease in income or net worth, etc.).
- Document the steps taken to contact clients for KYC updates, especially when the client is non-responsive.
- If a client remains non-responsive to updating their KYC information over a prolonged period, inform them of your obligation to keep their KYC information current and that continued non-cooperation may result in the closure of their account with you.

Further, any changes in KYC information should be signed, dated and reviewed by the advising representative and the client, and the client should receive a signed copy of the revised KYC form for their records.

Unacceptable practices

An advising representative must not:

- Use outdated KYC information to assess suitability of investments.
- Wait for clients to inform them of a change in KYC information if the advising representative becomes aware of client information that suggests a change in KYC information.
- Rely on a referral agent or unregistered employee to update the client's KYC information.

(iv) No collection of client's insider status

We have concerns that some of the PMs reviewed did not ascertain if all of their clients are an insider of a public company, including positions as an officer or director, or being a significant owner. These PMs did not, for all of their clients, collect and document this information as part of their account opening process or when they updated clients' KYC information. Ascertaining this information is important for compliance with the insider trading rules in Part XXI of the Act.

Section 13.2(2)(b) of [NI 31-103](#) requires PMs to establish whether the client is an insider of a reporting issuer or any other issuer whose securities are publicly traded. Further, section 11.5(2)(l) of [NI 31-103](#) requires PMs to maintain records that demonstrate compliance with the KYC and suitability obligations in section 13.2.

An insider is defined in [section 1\(1\) of the Act](#) and includes a director or officer of a reporting issuer or a person or company that beneficially owns, controls or directs more than 10% of the voting securities of a reporting issuer. Section 13.2(1) of [NI 31-103](#) states that for the purposes of section 13.2(2)(b) of [NI 31-103](#), the definition of insider is to include reporting issuer and any other issuer whose securities are publicly traded. Publicly traded includes trades on any public market, including domestic, foreign, exchange-listed and over-the-counter markets.

PMs must collect and document each client's insider status at the time of opening the client account and when updating client KYC information.

Acceptable practices for PMs to establish a client's insider status:

Advising representatives must:

- When asking the client if they are an insider, explain what an insider is and what it means for securities to be publicly traded.
- For clients that are insiders, assess if there are any restrictions in managing the client's portfolio (i.e. restrictions on trading in securities of the issuer, or taking any instructions from the client).
- For clients that are insiders, discuss with the client and document (e.g. in investment management agreement) who is responsible for insider trading reporting obligations.
- When updating clients' insider status as part of the KYC information updating process, give extra attention to clients that are existing insiders.

Unacceptable practices

Advising representatives must not:

- Wait for clients to inform them of their insider status if the PM becomes aware of information that suggests the client is an insider.
- Assume the client knows what an insider is or what publicly traded means.
- Assume the client will be responsible for filing any insider trading reports.



b) Update on initiatives impacting PMs

(i) Accredited investor exemption for investment funds

As part of the OSC's broader exempt market initiative, the AI exemption has been amended to permit fully managed accounts, where the adviser has a fiduciary

relationship with the investor, to purchase any securities on an exempt basis, including investment fund securities. For additional information, refer to section 4.4 b) (ii) a) in this report for additional information.

(ii) PM-IIROC member dealer service arrangements

The CSA and IIROC staff continue to review service arrangements between CSA-regulated PMs and investment dealers that are members of IIROC to assess if rule amendments and/or guidance are needed. Review topics include:

- whether there is a way for clients to receive a single account statement instead of two statements, and
- principle related to a written services agreement between the PM and IIROC member dealer outlining roles and responsibilities.

(iii) Registration of online advisory business

Some PMs have recently begun operating as “online advisers”. They include new registrants as well as PMs that were already registered and have changed their operating model to provide advice using an online platform. These firms provide discretionary investment management services to retail investors through an interactive website.

There is no “online advice” exemption from the normal conditions of registration for a PM. The rules are the same whether the PM operates under the traditional model of interacting with clients face-to-face or on an online platform.

The online advice platforms registered to date are hybrid services that utilize an online platform for efficiency, while registered advising representatives remain actively involved in (and responsible for) the “on-boarding” of new clients and decisions about their investment portfolios. Clients’ managed accounts are invested in relatively simple investment products, including un-leveraged exchange traded funds (ETFs), low cost mutual funds or other redeemable investment funds, or cash and cash equivalents.

Prior to implementing an online advice operating model, a PM or an applicant for registration as a PM will be asked to file substantial documentation, including their proposed online KYC questionnaire and information about the processes relating to its use. For new applicants, this is part of the normal process to provide information about

proposed business activities and plans. For existing registrants, this is part of the obligation to inform us of plans to change any of a firm's primary business activities, target market, or the products and services it intends to provide to clients.

To date, we have not imposed terms and conditions on online advisers who contact each prospective client during the on-boarding process. If a firm is planning to operate as an online adviser and does not intend to have an advising representative contact every prospective client, we will:

- ask the firm to demonstrate to us that it has a satisfactory system for identifying circumstances when an advising representative *will* initiate contact with a prospective client, and
- recommend that the firm be registered as a restricted PM with terms and conditions imposed limiting the firm to using the relatively simple investment products described above.

We will also consider whether terms and conditions are appropriate for different online operating models as they develop over time. The due diligence review conducted by CSA Staff in no way diminishes any registrant's ongoing responsibilities under applicable securities laws.

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) and an update on current initiatives applicable to IFMs.



a) Current trends in deficiencies and acceptable practices

In this section, we summarize key trends in deficiencies from recent compliance reviews of IFMs categorized as higher risk based on the response to the 2014 RAQ.

(i) Repeat common deficiencies

The following includes the deficiencies that we continued to find in reviews of our IFMs 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) Inappropriate expenses charged to investment funds	<ul style="list-style-type: none"> • Section 4.4 (a)(i) of OSC Staff Notice 33-745 • Part II of OSC Staff Notice 33-743
2) Inadequate oversight of outsourced functions and service providers	<ul style="list-style-type: none"> • Section 4.4 (a)(i) of OSC Staff Notice 33-745 • 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> • Section 11.1 of NI 31-103 and 11.1 of 31-103CP
3) Non-delivery of net asset value adjustments to the OSC	<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 (a)(i) and 4.4 (d)(i) in OSC Staff Notice 33-745 • Paragraph 12.14 c) of NI 31-103 and Form 31-103F4 Net Asset Value Adjustments • Paragraph 12.14 of 31-103CP

(ii) Commingling of client assets

We noted issues with IFMs, managing private investment funds that were not adhering to the requirement to separate assets of the investment funds they manage from their own property in separately designated trust accounts. A registered firm that holds client assets must ensure that those client assets are dealt with in the following manner:

- are held separate and apart from the registrants own property,
- are held in trust for the registrant’s clients,
- cash must be held in a designated trust account at a Canadian financial institution, a Schedule III bank, or a member of IIROC.

We noted the following circumstances in instances where IFMs were holding assets but not adhering to these requirements:

- the registrant was accepting subscription proceeds via a cheque payable to the registrant and depositing the cheque in the registrant's operating bank account,
- the registrant was directing redemption proceeds to be deposited in the registrant's operating bank account and then issuing a cheque for the amount of the redemption proceeds to investors from the registrant's operating bank account.

Section 14.6 of NI 31-103 provides specific requirements that a registrant must adhere to when holding client assets in relation to an investment in an investment fund managed by the IFM. An IFM must ensure that these requirements are adhered to when holding client assets.

Acceptable practices to prevent the commingling of assets of an investment fund

IFMs must:

- Determine if they are holding client assets. Examples of holding assets include the following:
 - client cheques for subscriptions in an investment fund are made payable to the IFM,
 - the IFM accepts cash for investment in one of their investment funds.
- If the IFM concludes that they are holding assets, set up a designated trust account at a Canadian financial institution, a Schedule III bank, or a member of IIROC and use this account for unitholder subscription and redemption proceeds.
- Open a separate operating account in the name of the registrant to handle transactions relating to the IFMs operations and ensure that these transactions do not flow through the trust account related to the investment funds managed by the IFM.
- Develop internal policies and procedures regarding the use of the designated trust account taking into consideration the following:
 - which transactions can and cannot flow through the trust account,
 - which transactions will flow through the IFMs operating account,
 - prepare a reconciliation of activity in the trust account, and
 - ensure the timely preparation, review and approval of the trust account reconciliation.

Unacceptable practices

IFMs must not:

- Commingle the assets of the investment fund and its unitholders with the assets of the IFM.
- Use one bank account for the transactions of the IFM and the transactions of the investment funds managed.
- Use a bank account that is not designated as a trust account to handle client cash.
- Accept client assets without having clearly documented policies and procedures regarding the handling of client assets.

(iii) Prohibited inter-fund trading

We noted issues with IFMs that manage multiple private investment funds that are also registered as PMs, directing trades of securities between their investment funds.

In the cases that we reviewed, the registrant traded a security between two private investment funds both managed and advised by the registrant, at the closing market price without executing the trade through a registered dealer.

The inter-fund trading was the result of a rebalancing of the portfolio securities held by both investment funds. The securities were in line with the investment objectives and investment restrictions of the investment fund and were held by the investment fund prior to the occurrence of the inter-fund trades. The investment funds and ultimately the underlying unitholders were not negatively affected. However, the inter-fund trades were offside securities law.

Section 13.5(2)(b) of [NI 31-103](#) strictly prohibits inter-fund trading between two investment funds that have the same adviser. An inter-fund trade occurs when an adviser for an investment fund knowingly directs a trade in portfolio securities to another investment fund that it acts for or instructs the dealer to execute the trade with the other investment fund. Although there currently is an exemption from this prohibition that exists for inter-fund trades by public investment funds in section 6.1 of [National Instrument 81-107 Independent Review Committee for Investment Funds](#), the exemption does not apply to private investment funds. Section 13.5(2)(b) of NI 31-103 is not intended to prohibit a responsible person from purchasing units in the investment fund itself, nor is it intended to

prohibit one investment fund from purchasing units of another investment fund in situations where they have the same adviser.

Acceptable practices to avoid inter-fund trading in private investment funds

IFMs must:

- As part of their conflict of interest policies and procedures, develop and implement a process to ensure that inter-fund trading does not occur, including a process to oversee adviser activity.
- Discuss the inter-fund prohibition with the adviser of the investment funds and ensure the adviser has a process in place to avoid the occurrence of inter-fund trading through their own conflict of interest policies and procedures and through their own process to monitor the trading activities of the adviser in relation to the investment fund.

Unacceptable practices

IFMs must not:

- Rely solely on the advisers of their investment funds to ensure that the inter-fund prohibition is followed.



b) Update on initiatives impacting IFMs

(i) Changes to the Act

Part XXI of the Act, Insider Trading and Self-Dealing, contains conflict of interest investment restrictions which, until July 24, 2014, only applied to mutual funds. This was reported on in section 4.4(d)(ii) of [OSC Staff Notice 33-745](#). The conflict of interest investment restrictions now apply to all investment funds, including non-redeemable investment funds. After the Act was amended on July 24, 2014, some questions arose about the application of Part XXI to non-redeemable investment funds, and about the impact of the amendments on the existing requirements for mutual funds. Staff of the Investment Funds and Structured Products Branch (IFSP) responded to these questions by setting out its views in [OSC Staff Notice 81-725 - Recent Amendments to Part XXI Insider Trading and Self-Dealing of the Securities Act \(Ontario\) – Transition Issues](#) on August 7, 2014. In particular, IFSP Branch Staff provided guidance on the interaction between Part XXI of the Act and the Modernization amendments to NI 81-102 that came into force in September 2014 (see paragraph 4.4 (ii) c) below in this section of the report for additional information).

(ii) Investment Funds and Structured Products Branch

Our IFSP 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(d)(iii) of OSC Staff Notice 33-745. A summary of some of this work and the relevant information sources can be found in the chart and brief write-ups below.

Project	Information source
1) Mutual fund fees	<ul style="list-style-type: none"> Section 1.1 of 2014 – Summary Report for Investment Fund and Structured Product Issuers published on February 18, 2015. 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 which provides additional information on this initiative.
2) Mutual fund risk classification	<ul style="list-style-type: none"> Section 1.2 (i) of 2014 – Summary Report for Investment Fund and Structured Product Issuers published on February 18, 2015. On January 29, 2015 the CSA published CSA Staff Notice 81-325 Status Report on Consultation under CSA Notice 81-324 and Request for Comment on Proposed CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts which provides additional information on this initiative.
3) Point of sale disclosure	<ul style="list-style-type: none"> Section 1.2 of 2014 – Summary Report for Investment Fund and Structured Product Issuers published on February 18, 2015. On December 11, 2014 the CSA published final amendments to National Instrument 81-101 <i>Mutual Fund Prospectus Disclosure</i> and to Companion Policy 81-101CP to National Instrument 81-101 <i>Mutual Fund Prospectus Disclosure</i> to implement pre-sale delivery of Fund Facts for mutual funds. This amendment becomes effective on May 30, 2016.
4) Review of portfolio liquidity	<ul style="list-style-type: none"> Our IFSP Branch recently conducted a targeted review of mutual funds that invest in asset classes that may be

	<p>susceptible to liquidity issues, in particular, funds with exposure to high yield fixed income, small cap equity funds, and emerging market issuers. OSC Staff Notice 81-727 – Report on Staff’s Continuous Disclosure Review of Mutual Fund Practices Relating to Portfolio Liquidity summarizes the findings and provides guidance to address the findings.</p>
IFM Resources	Information source
1) Annual Summary Report	<ul style="list-style-type: none"> The IFSP Branch publishes an annual summary report for Investment Fund Issuers. The fifth annual summary report 2014 – Summary Report for Investment Fund and Structured Product Issuers was published on February 18, 2015.
2) Investment Funds Practitioner	<ul style="list-style-type: none"> The Practitioner is an ongoing publication that provides an overview of operational issues arising from applications for discretionary relief, prospectuses, and continuous disclosure documents that are filed with the OSC.

a) Accredited Investor exemption for investment funds

As part of the OSC’s broader exempt market initiative, the AI exemption has been amended to permit fully managed accounts, where the adviser has a fiduciary relationship with the investor, to purchase any securities on an exempt basis, including investment fund securities. The OSC has removed the carve out of the managed account category of the AI exemption for investment funds to harmonize the managed account category in all Canadian jurisdictions. This amendment became effective May 5, 2015. See section 1.2 of this report for additional information.

b) Development of a summary disclosure document for exchange traded mutual funds

On June 18, 2015, the CSA published for comment proposed amendments mandating the form of a summary disclosure document for ETFs (called “ETF Facts”) and requiring its delivery within two days of purchase. The ETF Facts is based on the Fund Facts, with modifications to reflect the specific attributes of ETFs. For additional information, refer to [CSA Notice and Request for Comment Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and Its Delivery – Proposed Amendments to NI 41-101 General Prospectus Requirements and to Companion Policy 41-101CP to National](#)

[Instrument 41-101 *General Prospectus Requirements and Related Consequential Amendments*](#).

c) Recent Amendments to NI 81-102 – Closed-End Funds

Phase 2 of Modernization of Investment Fund Product Regulation came into effect on September 22, 2014. These recent amendments introduce investment restrictions and fundamental operational requirements for non-redeemable investment funds. For additional information, refer to [Amendments to NI 81-102 *Mutual Funds*](#) and [Changes to Companion Policy 81-102CP *Mutual Funds*](#).



ACTING ON REGISTRANT MISCONDUCT

- a) Regulatory action during April 1, 2014 to March 31, 2015**
- b) CSA Disciplined Persons List**
- c) Cases of interest**
- d) Contested OTBH decisions and settlements by topic**

5 Acting on registrant misconduct

We are alert to signs of potential registrant misconduct which may come to our attention through compliance reviews, applications for registration, disclosures on NRD and by other means such as complaints, inquiries or tips. We respond by taking appropriate, timely and effective regulatory action. Regulatory actions applicable to both firms and individuals may include the imposition of terms and conditions on registration, suspension of registration, or referrals to our Enforcement Branch.

HIGHLIGHTS OF MISCONDUCT CASES

"In my opinion, there are no other effective options [other than firm suspension] available to address the breaches of securities law and address the integrity issues identified in this matter. Considering that registration is a privilege, not a right..."¹¹

"There are many registrants in Ontario that are considered small.....A registrant is required to have sufficient resources in place to discharge their regulatory obligations regardless of the number of persons who are employed by the firm."¹²

Prior to a Director of the OSC imposing terms and conditions on a registration, or refusing an application for registration or reinstatement of registration, or suspending or amending a registration, a registrant has the right under section 31 of the Act to request an Opportunity to be Heard (OTBH) before the Director.

Director's decisions on OTBH proceedings are published in the OSC Bulletin and on the OSC website. Director's decisions are now presented by topic on the OSC website, in addition to being presented by year. The topical headings used on this page represent some of the significant issues that arise in these [Director's decisions](#).

Director's decisions are an important resource for registrants and their advisers, as they highlight matters of concern to the OSC as well as the regulatory action that may be

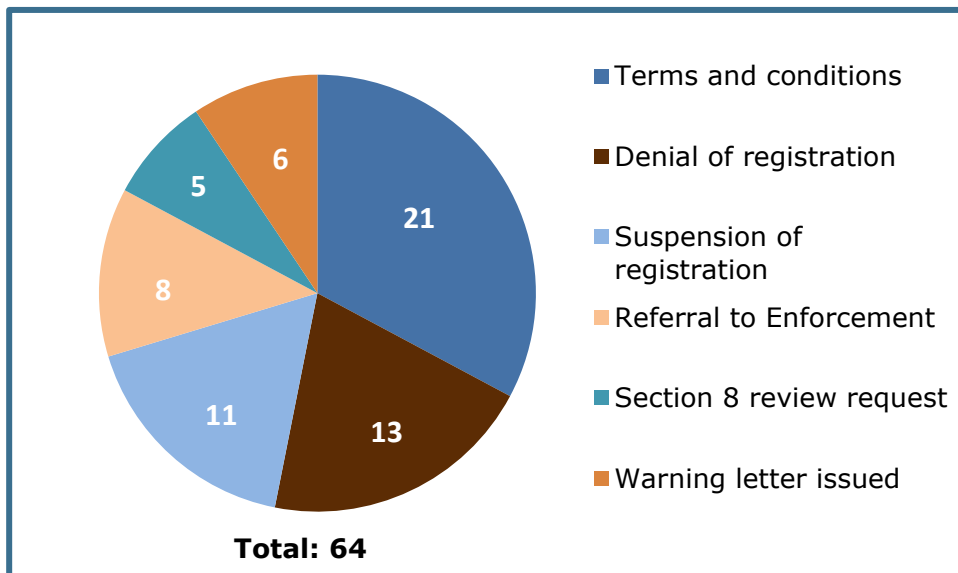
¹¹Director's Decision – June 13, 2014 – Wealth Stewards Portfolio Management Inc.

¹²Director's Decision – August 6, 2014 – Acasta Capital Inc.

taken as a result of misconduct. Directors' decisions approving settlements of OTBH proceedings are also published on the website. Publication of Directors' decisions increases transparency by communicating important information regarding registrant conduct to the public in a timely manner.

a) Regulatory action during April 1, 2014 to March 31, 2015

For the period of this report, the following chart summarizes the regulatory actions taken by CRR staff against firms or individuals engaged in registrant misconduct or serious non-compliance with Ontario securities law.



The chart demonstrates our actions during the year along what we call the compliance – enforcement continuum; we take appropriate and effective regulatory action in the context of the magnitude of the non-compliance or breach in a given situation. In some situations, we use the tools available within our Branch to address serious non-compliance. These include terms and conditions, denials of registration, suspensions of registration or warning letters. In other cases, for example, where the appropriate tools are powers that only the Commission can exercise, we make prompt and effective referrals to the Enforcement Branch (eight matters during the year). In some cases, a registrant may request a hearing and review by the Commission of a Director's Decision under Section 8 of the *Securities Act* (Ontario) (five matters during the year). In some cases, a suspension or a term and

condition was applied while a referral to the Enforcement Branch is also made in order to deal appropriately with the serious non-compliance and limit investor harm.

During the year, three opportunities to be heard were conducted; two of these were the subject of a hearing and review to the Commission under section 8 of the Act. One of these reviews was ultimately withdrawn.

b) CSA Disciplined Persons List

We have publicly prioritized enhanced transparency to the public in respect of disciplined registrants, and to reflect this priority, the CSA Disciplined Persons List (DPL) has been expanded to include individual registrants subject to discipline through the CRR Branch. This will assist retail investors by reducing the number of sources they must check in order to perform thorough research on the background of registrants with whom they wish to do business.

When an individual registrant faces regulatory action such as a suspension, refusal or strict supervision based on concerns with the individual's integrity, the individual's name will generally be added to the DPL. The DPL is available on the [CSA website](#).

c) Cases of interest

(i) Criminal charges

Registered and permitted individuals are required by NI 33-109 to notify the individual's principal regulator of changes to information previously submitted in respect of the individual's Form 33-109F4. This includes changes to Item 14, which requires disclosure of, among other things, any outstanding criminal charges.

Where charges are brought against a registrant pursuant to the *Criminal Code*, and where the allegations, if proven, would bear directly on an individual's suitability for registration, we will take immediate measures to protect investors (such as imposing supervisory terms and conditions on the individual's registration) pending the outcome of the criminal proceedings. Examples of such charges include theft, fraud, perjury, smuggling, identity theft, and obtaining by false pretenses. In such situations, we reserve the right to investigate independently or take further action as the case advances. This year strict supervision was imposed in three such cases.

(ii) Failure to comply with terms and conditions

Non-compliance with terms and conditions may result in further regulatory action, including suspension of registration. In a recent case reviewed by us, terms and conditions were imposed on an individual’s registration as a mutual fund dealing representative for failure to disclose a bankruptcy on NRD until after the bankruptcy was discharged. The terms and conditions required that the registrant successfully complete the Conduct and Practices Handbook (CPH) course within six months.

After we agreed to extend this deadline in light of extenuating circumstances, and after three failed attempts at the examination, the individual did not successfully complete the CPH. In our view, by failing to disclose the bankruptcy and failing to complete the CPH, the individual did not meet the proficiency requirements of a registrant. Further, the breach of the terms and conditions constituted a breach of Ontario securities law and made the individual’s registration objectionable, both grounds for suspension under section 28 of the Act. As a result, we recommended that the individual’s registration be suspended. The individual then resigned. Since the matter did not proceed to an OTBH, no Director’s decision was made or published.

d) Contested OTBH decisions and settlements by topic

The following matters came before the Director this year. The full [Director’s decisions](#) on these matters are available on the OSC website under the following topical headings.

(i) False client documentation

Registrant and date of Director’s decision	Description
Christopher Reaney January 6, 2015	Christopher Reaney was registered as a mutual fund dealing representative. An internal compliance audit by his sponsor firm found that he had signed the signatures of some of his clients to investment documents, and that he had also obtained pre-signed forms from some of them. In the exercise of its jurisdiction over the ongoing registration of mutual fund dealing representatives, we conducted a review of the matter and recommended to the Director that Mr. Reaney’s registration be suspended. Following an OTBH, the Director suspended Mr. Reaney’s registration for a period of six

	<p>months. The Director’s decision to suspend Mr. Reaney was stayed pending a hearing and review by a panel of the Commission under section 8 of the Act. The hearing and review was held on March 31, 2015. On July 13, 2015, the Commission dismissed Mr. Reaney’s application and released its reasons for the decision. In its reasons, the Commission considered the problem of using pre-signed forms as a corner-cutting tactic (not as a means to defraud the client) and affirmed the principle that forgeries and pre-signed forms are always bad, regardless of the motivation. It goes on to identify various factors which may aggravate or mitigate the conduct. The Commission emphasized that a high standard of conduct is necessary for meeting the requirements for registration. In the result, the Commission suspended Mr. Reaney’s registration for six months.</p>
<p>Kevin Duffy October 16, 2014</p>	<p>Kevin Duffy is a mutual fund dealing representative, whose employment with his sponsoring firm was terminated for a number of reasons, including his continued use of pre-signed forms. Mr. Duffy applied for a reactivation of registration, and during our assessment of the application, we learned that in the course of compliance audits conducted in 2008, 2010, and 2013, Mr. Duffy’s sponsor firm found him in possession of pre-signed forms. We further learned that after each compliance review, Mr. Duffy signed a document for his sponsoring firm stating that he would not obtain pre-signed forms again. We notified Mr. Duffy that there were grounds upon which we could recommend to the Director that his application for a reactivation of registration be refused, which would trigger his right to an OTBH. This matter was resolved on the basis that Mr. Duffy would withdraw his application for a period of time that effectively resulted in a nine-month suspension of registration, and that in the event of his registration in the future, terms and conditions would be imposed such that he would be subject to strict supervision, and that he would be required to submit original copies of all trade documentation to his sponsoring firm in a timely manner to allow the firm to check for the recurrence of pre-signed forms. Prior to applying for reinstatement of his registration, Mr. Duffy would be required to complete the CPH.</p>
<p>Wealth Stewards</p>	<p>Wealth Stewards Portfolio Management Inc. was a registered PM.</p>

<p>Portfolio Management Inc. and Sushila Lucas June 13, 2014*</p>	<p>Sushila Lucas was the sole registered advising representative and the firm's UDP and CCO. However, Bruce Deck, an unregistered individual, handled KYC, suitability and advising responsibilities while maintaining the client facing relationships for most of the firm's clients. Mr. Deck maintained a financial planning business and was a 50% owner of the firm, although he had not filed the appropriate notice to acquire his position in the firm; he was in default of a settlement agreement with the predecessor IIROC, which required him to pay a fine and costs as a result of disciplinary proceedings. In addition to improperly delegating KYC, suitability and advising responsibilities to Mr. Deck, Ms. Lucas also falsely signed documents indicating that she had verified client identity and attesting that she had met with clients to discuss their managed accounts, when in fact Mr. Deck handled these duties. The firm also asked clients to sign a waiver that falsely claimed that Mr. Deck had not provided any investment advice. Following an OTBH, the Director suspended the firm's registration indefinitely. The Director also suspended Ms. Lucas as UDP and CCO for three years, and as advising representative for six months. The Director further mandated that Ms. Lucas complete specified additional educational requirements tailored to the specific category (or categories) for which she would seek reactivation of registration.</p>
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* The Director's decision in Wealth Stewards Portfolio Management Inc. and Sushila Lucas can also be found in the [Director's Decisions](#) section of the OSC website under the categories of 'KYC, KYP and Suitability' and 'Trading or Advising Without Appropriate Registration'.

(ii) **KYC, KYP and suitability**

Registrant	Description
Gold Investment Management Ltd. October 23, 2014	Gold Investment Management Ltd. (Gold) is a PM that established a business model whereby it accepted referrals from unregistered financial planners. Initially, Gold relied on these financial planners to meet with Gold's clients for the purpose of collecting KYC information, and as a result many of the firm's 1000-plus client households had never spoken with any of Gold's registered advising representatives. In May 2013, Gold consented to terms and conditions on its registration that required it to retain a compliance consultant to assist the firm in strengthening its compliance system by the end of the year. In mid-December 2013, it became apparent that Gold was not going to meet its end-of-year deadline, and as a result we recommended to the Director that additional terms and conditions be imposed on Gold's registration that would prohibit the firm from accepting new clients. The firm requested an OTBH in respect of these proposed terms and conditions, but eventually agreed to them on an interim basis. In October 2014, the Director approved of a settlement agreement in which the interim terms and conditions were removed and new terms and conditions were imposed that required the ongoing retention of the compliance consultant, reporting on KYC testing and new account opening, annual compliance reviews by the consultant for a period of three years, and amendments to Gold's referral agreements to enhance the firm's oversight of its referral agents.
Sloane Capital Corp. and Freedman July 14, 2014	During a compliance review of Sloane Capital Corp. (Sloane) an EMD, we found that Sloane had numerous significant deficiencies, many of which were repeat issues from another compliance review conducted approximately one year earlier. Among the serious issues we discovered were a failure by Sloane to comply with its KYC and suitability obligations. In particular, we found that Stephen Freedman, Sloane's UDP, CCO and one of its registered dealing representatives had agreed to distribute numerous issuers, and he had limited knowledge about some of these issuers. We also found that a representative of Sloane did not always meet with a client to obtain KYC information before a trade was made, instead relying on representatives of the issuer to carry out

this function, a type of misconduct known as being a “dealer after the fact” that the Commission has found to be unacceptable in *Re Sterling Grace and Co. Ltd.* (September 2014).

The Director approved of a settlement agreement to resolve the OTBH requested by Sloane and Stephen Freedman. Among other things, the settlement agreement provides that Sloane is to be suspended indefinitely, and Mr. Freedman is to be suspended as a UDP and CCO for a period of 5 years, and as a dealing representative for 10 months. In the settlement agreement, the Director also provides a non-objection to the acquisition of Sloane’s assets (namely its sales force and back office software) to another EMD.

(iii) Trading or advising without appropriate registration

Registrant	Description
Arkady Burdo August 21, 2014	Arkady Burdo was registered as a SPD representative. Despite only being registered in the category of SPD, Mr. Burdo acted in furtherance of trades in an “investment program” that purported to relate to a real estate development in the Caribbean. Mr. Burdo introduced clients to the investment program, explained the nature of the business of the investment program, and provided clients with copies of the program’s “revenue capital agreement” for signature. Mr. Burdo’s clients suffered total or partial losses of their investment, and Mr. Burdo suffered a total loss of the principal of his own investment. Although Mr. Burdo knew as a result of his own investment that the investment program became unable to honour redemption requests, he did not disclose the collapse of the investment program to one of his clients for months. This client had expressed a low risk tolerance when agreeing to invest in the investment program. Mr. Burdo admitted to trading outside his category of registration and failing to discharge his obligations as a registered dealing representative. In a settlement agreement, Mr. Burdo agreed to an 18 month suspension and a requirement to complete the CPH Handbook course before reapplying for registration.

(iv) Late delivery of financial statements

Registrant	Description
Acasta Capital Inc. August 6, 2014	Acasta Capital Inc. (Acasta) is an EMD. Acasta did not submit its annual financial statements to CRR within the time required by NI 31-103. Acasta stated that its failure to meet the delivery requirement was the result of resource constraints, travel commitments caused by an expanding client base, and the unexpected departure of their CCO. Following an OTBH, the Director imposed terms and conditions on Acasta's registration requiring monthly financial reporting to CRR, and a review by the firm of its procedures for compliance with Ontario securities law.



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.

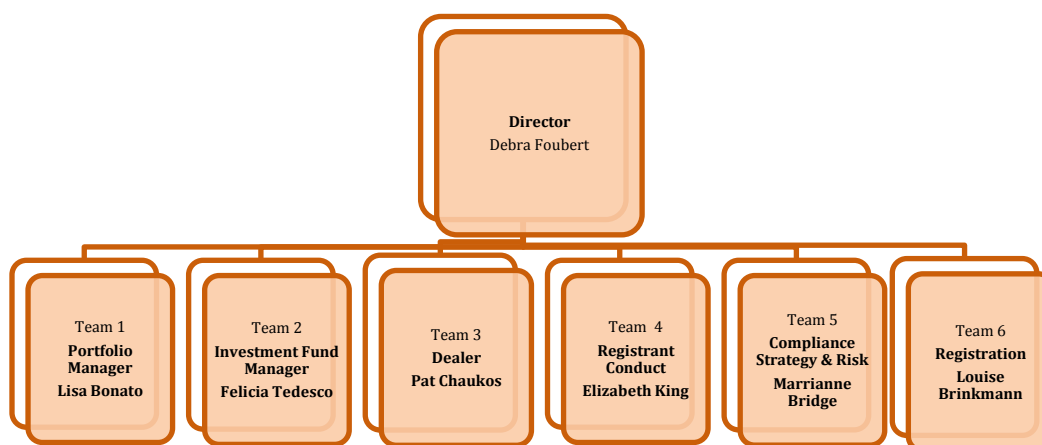
We continue to develop new discussion topics and update the Registrant Outreach program to registrants (see section 2.1 of this report) to help them understand and comply with their obligations. We encourage registrants to visit our [Registrant Outreach web page](#) on the OSC's website.

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

Registrants may also contact us. Refer to Appendix A of 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 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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