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2014 OSC Annual Summary Report and Know-your-client and Suitability Obligations

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Agenda

- High level overview of the 2014 Annual Summary Report – OSC Staff Notice 33-745
 - Key issues and common deficiencies re advisers and investment fund managers (IFMs) and associated regulatory concerns

2014 Annual Summary Report

- Sixth publication of the annual summary report
- Purpose of the Annual Summary Report – communication tool with our registrants to:
 - Summarize new and proposed rules and initiatives
 - Current trends in deficiencies
 - Guidance to address and prevent deficiencies
 - Current trends in registration
 - Registrant Outreach Program
 - Highlight key misconduct cases

2014 Annual Summary Report

- Tool for registrants to enhance their understanding of:
 - initial and ongoing registration and compliance requirements
 - OSC Staff expectations of registrants and our interpretation of regulatory requirements, and
 - new and proposed rules and other regulatory initiatives

2014 Annual Summary Report

- Registrant outreach program
 - Amendments to NI 31-103 – February 4, 2015
 - Implementation of Client Relationship Model 2 – April 2015
 - Elements of an effective compliance system – June 2015
- Registrant Advisory Committee
 - 2nd term
 - Adviser representation through individuals representing registered advisers and through PMAC membership

2014 Annual Summary Report

- Key findings involving all registrants:
 - Failure to provide notice of ownership changes or asset acquisitions:
 - Registrants acquire 10% or more of another firm or their sponsoring firm
 - Non-registrant is acquiring 10% or more of a registrant's voting securities
 - Registrants acquired all or a substantial part of the assets of another registrant

2014 Annual Summary Report

- Current trends in deficiencies and acceptable practices
 - Written policies and procedures are not tailored to a registrant's operations
 - Use template written policies and procedures provided by another firm or a consultant
 - Inadequate insurance coverage
 - FIB covers insurance for the benefit plan of the firm's employees under same insurance rider maintained by the firm to meet its obligations under section 12.6 of NI 31-103

2014 Annual Summary Report

- Current trends in PM specific deficiencies and acceptable practices
 - Repeat deficiencies:
 - Delegating KYC and suitability obligations to referral agents (Carlin)
 - Inadequate supervision of ARs and research analysts
 - Inadequate investment management agreements

2014 Annual Summary Report

- Current trends in IFM specific deficiencies and acceptable practices
 - Repeat deficiencies
 - Sweep of large IFMs – main findings included:
 - Inadequate sales practices under NI 81-105
 - Inappropriate expenses charged to investment funds:
 - Charging the cost of research materials to investment funds
 - Published OSC Staff Notice 33-743 *Guidance on sales practices, expense allocation and other relevant areas*
 - Inadequate oversight of outsourced functions and service providers

KYC and suitability obligations

- National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103)
- Principal KYC, KYP and suitability obligations
 - Section 3.4 – Proficiency (KYP)
 - Part 13, Division 1 – KYC & suitability

KYC and suitability obligations

- Suitability is a fundamental obligation owed by registrants to their clients and a cornerstone of our investor protection regime
- Staff expect firms to comply with both the letter and the spirit of these requirements
- This requires a meaningful suitability assessment,
 - Not just a mechanical fact-finding or “tick the box” exercise
 - Requires a meaningful dialogue with the client to obtain a solid understanding of the client’s investment needs and objectives, and to explain how a proposed investment is suitable for the client in light of the client’s investment needs and objectives
- Appropriate documentation is essential

Suitability Notice

- Published a CSA staff notice on suitability guidance (CSA Staff Notice 31-336 - January, 2014)
- Provide staff interpretation of the regulatory requirements on KYC, KYP and suitability obligations
- Set out staff's expectation of registrants on how to comply with the requirements
- Provide examples of suggested practices and unacceptable practices

Delegating KYC and suitability obligations to referral agents

What we found:

- Referral agreement exists between financial planners/relationship managers and portfolio managers
- Financial planners/relationship managers could be registered or unregistered individuals

Delegating KYC and suitability obligations to referral agents

- Financial planners/relationship managers conducted the following activities:
 - meet with client to collect KYC info (e.g. investment objectives, risk tolerance)
 - discuss investment objectives and strategies
 - explain investment policy statement and how the account will be managed
 - discuss account performance and portfolio holdings

Delegating KYC and suitability obligations to referral agents (cont'd)

- Responsible for updating KYC information
- Clients thought that the financial planners/relationship managers were the portfolio managers

Conducting registerable activities without registration

- Registered advising activity is broader than advising in securities; it also includes KYC collection, documentation and updating.
- Financial planners/relationship managers do not have the proficiency to perform these activities for a managed account

Suggested practices

PM firms should:

- Review the referral agreements to ensure that only registered individuals are performing registerable activities
 - Clearly define the roles and responsibilities of referral agents and ensure they understand what they can do and can't do
 - Review policies and procedures to ensure that registered individuals are responsible for collecting KYC info, engaging in a meaningful discussion with the client and maintaining an ongoing relationship with the clients (e.g. discuss investments, account performance and update KYC)
 - Maintain adequate documentation to demonstrate compliance (e.g. documentation of clients' meetings)
 - Monitor the procedures to ensure compliance
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Next step

- Continue to focus on suitability issues in our compliance reviews
- Take appropriate regulatory actions (T&Cs, suspension of registration or referring the matter to Enforcement) to ensure compliance

Questions?

