

ASC Exempt Market Dealer Sweep



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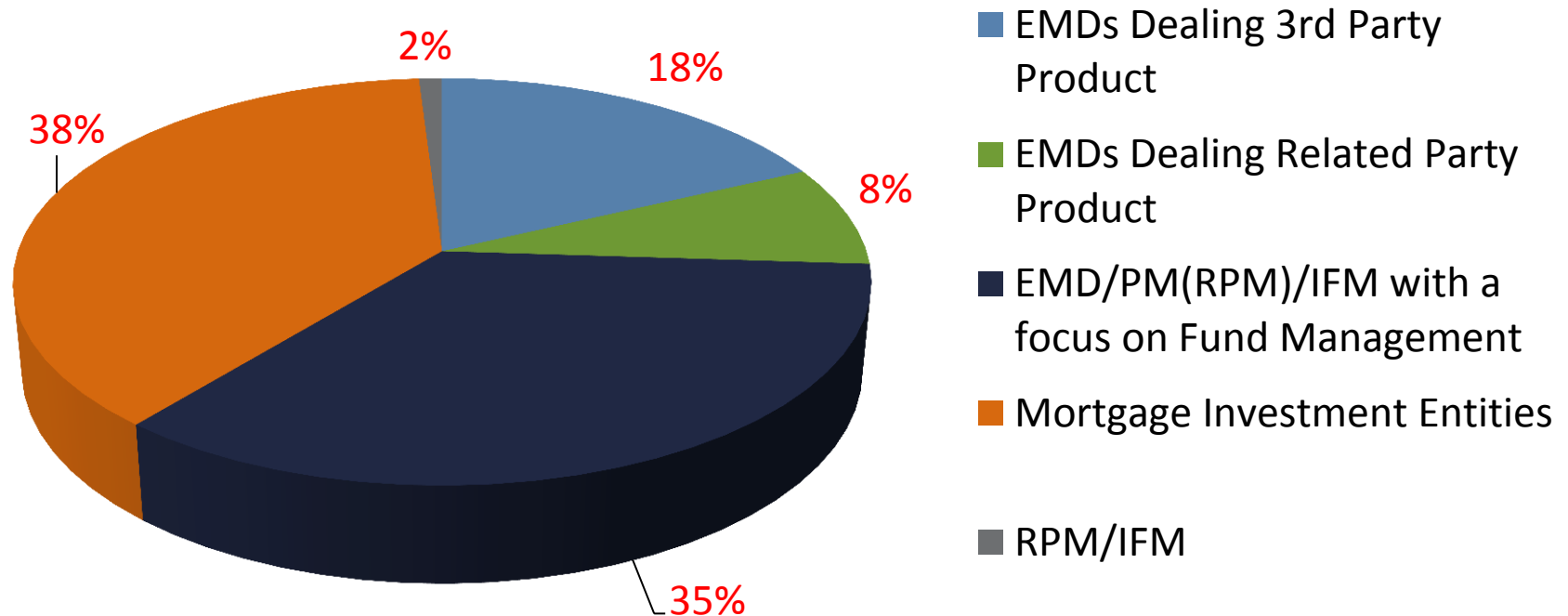
- The ASC conducted focused compliance reviews in 2011/2012
- The ASC began the EMD Sweep in fiscal 2015 and it has carried through until April 2017
- For many Firms, the EMD Sweep represented the first complete ASC examination
- Staff completed reviews of 66 registered firms in the EMD Sweep

- Sole EMD vs. EMD plus Additional Categories of Registration
 - Portfolio Managers and Restricted Portfolio Managers
 - Investment Fund Managers
 - Mutual Fund Dealers

- Dealing 3rd Party Products vs. Dealing Related or Connected Party Products (or a combination of both)

- The size of Alberta's sole EMD firms range from a single registered individual to over a hundred registered individuals

Registration Categories and Product Focus



- Rectify any deficiencies
- Written response detailing how deficiencies will be rectified
- Regulatory Actions and Other Outcomes
 - Termination/Suspension
 - Referrals to Enforcement and Corporate Finance
 - Voluntary Cessation of Operations
 - Terms and Conditions
 - Undertakings
 - Warning Letters
 - Enhanced Informal Compliance

- EMD Sweep Review Program
 - Compliance System
 - Know Your Client (KYC)
 - Know Your Product (KYP)
 - Suitability
 - Sales Practices and Marketing
 - Conflicts of Interest
 - Relationship Disclosure Information (RDI)
 - Reporting to Clients

Requirement – Maintain and apply policies and procedures that establish a system of controls and supervision to provide reasonable assurance of compliance with securities law requirements and to manage risks

Findings

- Inadequate policies and procedures manual
- Inadequate performance of the Chief Compliance Officer
- Inadequate training or oversight of dealing representatives and business locations
- Inadequate books and records
- Inadequate complaint handling

Requirement – Take reasonable steps to establish the identity of a client and collect sufficient information to meet the suitability obligation, including the client’s investment needs and objectives, financial circumstances and risk tolerance

Findings

- Inadequate collection and documentation of KYC information
- Inadequate KYC forms
- Prospectus exemption qualification

Requirement – Understand the structure, features and risks of each security recommended. The KYP obligation is an essential element of the suitability obligation

Findings

- Inadequate analysis of exempt market products
 - Relied on a related or connected issuer's KYP information
 - Relied on third party reports
 - Inadequate review of product risks

Requirement – Take reasonable steps to ensure that recommended trades are suitable for the clients

Findings

- Risk tolerances of clients not consistent with the risk of the product
- Investments objectives of clients not consistent with the nature of the product
- Client time horizon not consistent with product time horizon
- Elderly clients
- Other vulnerable clients
- Failure to identify use of leverage
- Inadequate assessment of client account concentration levels

- Diversification is an important factor in assessing suitability
- Lack of diversification may expose clients to significant investment risks
- Exempt market products are generally illiquid and high risk
- Concentration in exempt market products should therefore be considered as part of the diversification analysis

- Overconcentration – high percentages noted without any suitability analysis
- Information collection
 - No information on products purchased outside the firm
 - Financial information collected in unhelpful ranges
- Illiquid assets in NFA concentration calculation
- Policies and procedures

Requirement – Deal fairly, honestly and in good faith with clients and not make false or misleading statements

Findings

- Unsubstantiated claims, unbalanced or misleading information, and inadequate disclosure in marketing materials
- Inadequate marketing policies and procedures
- Inadequate oversight of marketing materials
- Inadequate supervision of referral arrangements

Requirement – Take reasonable steps to identify and respond to existing and potential material conflicts between the firm, including each individual acting on the firm’s behalf, and clients

Findings

- Inadequate identification and response to conflicts of interest
- Inadequate conflicts of interest controls including policies and procedures

Major Findings - Relationship Disclosure Information (RDI)

Requirement – Deliver to a client all information that a reasonable investor would consider important about the client’s relationship with the registrant

Findings

- Failure to deliver an RDI document
- Inadequate RDI documents
 - Was not updated to comply with regulatory amendments
 - Did not adequately disclose conflicts of interest
 - Did not disclose all elements required under 14.2(2) of NI 31-103
 - Did not provide clear and meaningful disclosure of compensation paid to the EMD by the issuer
- Inadequate RDI policies and procedures

- ASC staff also found deficiencies in other areas
 - Client reporting
 - Inadequate supervision of outside business activities
 - Inadequate reporting and updating of registration information on National Registration Database
 - Non-registrants performing registerable activities
 - Issues related to the allocation of investment opportunities among clients
 - Inadequate performance of portfolio management activities
 - Inadequate internal controls concerning the calculation and disclosure of net asset value and management / performance fees
 - Restricted transactions in investment funds

- Suggested Practices
 - Promote documentation
 - Update P&PM in sections and provide training
 - Consider outside advice from lawyers, consultants, etc.
 - Keep training records
 - Risk-based reviews
 - Regular documented DR audits and business location oversight
 - Review handling of books and records
 - Ensure complaint files are comprehensive and include evidence of follow-up actions

- Unacceptable Practices
 - Use of template P&PMs
 - Failing to update P&PMs
 - Relying on issuer training
 - Lack of oversight over books and records
 - Failing to adequately investigate, respond and document complaints
 - Lack of documentation of compliance activity

- **KYC Collection**
 - Review information with the client
 - Date, sign and provide a copy to the client
 - Online searches
 - Quality assurance calls by compliance department

- **Prospectus Exemption Practices**
 - Refer to information collected
 - Policies and procedures
 - Exempt market holdings
 - Meaningful ranges

- **KYC Collection**
 - Permitted client status
 - Outdated information
 - Financial information ranges
- **Misleading Terminology in KYC Forms**
 - Predetermining responses
 - Inappropriate disclaimers
- **Prospectus Exemption Practices**
 - Rely solely on client representations
 - Non-individual clients

- Suggested Practices
 - Policies and procedures
 - Document KYP analysis
 - Independent review
 - Background checks
 - Offering summaries
 - Independent sources
 - Monitor changes

- Unacceptable Practices
 - Risk comparison
 - Exempt market product risks
 - Not providing an overall risk assessment
 - Lack of ongoing KYP
 - Over-reliance on third party information
 - Selling prior to KYP review

- Document suitability
- Second level review
 - Red flags
- Elderly clients
- Other vulnerable clients
- Investment concentration considerations
 - Holdings purchased through the firm
 - Holdings outside of the firm
 - Diversification considerations

- Inadequate review
 - Processing trades for clients with financial circumstances or objectives that differ from the product
- Sophisticated clients
 - Reliance on a client's sophistication or opinion to determine suitability
- Disclosure only
 - Reliance on disclosure to clients of risk and material information to satisfy the suitability obligation
- Timing of suitability assessment
 - Determining suitability after the trade has been settled and cannot be reversed

- Oversight of marketing materials
 - Monitoring social media
 - Electronic records

- Marketing policies and procedures
 - CSA Staff Notice 31-325

- Reviewing marketing materials
 - Evidence review and approval

- Referral agents
 - Standardization
 - Background checks

- Claims made in marketing materials
 - Misleading statements
 - Opinions stated as fact
 - Unclear claims

- Marketing policies and procedures
 - Issuer marketing materials
 - Calculating and presenting performance data

- Reviewing marketing materials
 - Lack of oversight over DR marketing

- Conflicts identification and response
 - Product specific disclosure
 - Ongoing review of conflicts
 - Disclosure acknowledgment

- Conflicts policies and procedures
 - Log conflicts
 - Update disclosure to clients
 - Independent review
 - Compliance personnel contact with clients

- Conflicts identification and response
 - High-level only disclosure
 - Lack of documentation
 - Reliance on issuer disclosure
 - Disclosure only on demand

- Conflicts policies and procedures
 - Lack of policies and procedures
 - Over-reliance on documentation

- Providing RDI
 - Have client acknowledge receipt
 - Ensure client reads and understands
 - Disclosure of fees
 - Providing RDI in a single document
 - Quality assurance calls
 - Plain language

- RDI policies and procedures
 - Ongoing review of RDI
 - Timely delivery

Relationship Disclosure - Unacceptable Practices

- Failing to provide adequate RDI
 - Permitted client exception
 - RDI updates
 - Misleading comments
 - Non-standard RDI
 - Unclear RDI
 - Risks and conflicts
 - Inappropriate disclaimers

- No RDI policies and procedures

Thank you.

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