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ARTICLE

OSC's Regulatory Burden Reduction Proposals – Potential Benefits to Investment Funds and Registrants

On November 19, 2019, the Ontario Securities Commission released *Reducing Regulatory Burden in Ontario's Capital Markets* (the Report). The Report responds to the feedback provided to the OSC from stakeholders (including BLG's feedback), and outlines the specific ways in which the OSC plans to reduce unnecessary burden on capital markets participants operating in Ontario. Of the 107 decisions and recommendations outlined in the Report, close to 70 of them will directly affect investment funds and securities registrants. Certain projects have already been proposed and implementation of the applicable rule changes are well underway (see BLG's Investment Management bulletins from October 2019 and July 2019 for further information).

Investment funds and securities registrants will benefit, over time, from the specified proposals, although many of the proposals require changes to national rules and policies, which means the support of the other members of the Canadian Securities Administrators will be critical to the success of the OSC's initiative. Other proposals can be implemented by the OSC through changes in staff's administrative procedures and practices. For all, however, reading the "fine print" will be crucial in determining just how much of a regulatory burden reduction will be achieved. The burden reduction initiative does not purport to be a comprehensive review of the myriad rules, policies and staff guidance that apply in Ontario; for the most part, the recommendations are quick fixes and responses to stakeholder feedback, rather than decisions proposing substantially different ways to regulate Ontario's capital markets. Not all feedback has been acted upon – some of our suggestions were not taken up (for example, the OSC did not respond to our comment about joining the CSA Passport System), while others were only partially reflected in the Report.

However, one must never look a gift horse in the mouth. Where there are unnecessary regulatory burdens, it is likely that the costs associated with those burdens are being passed (directly or indirectly) onwards to investors. Therefore, a project that is characterized as reducing burdens (and costs) on industry participants is really about reducing costs and improving outcomes for investors. In our view, reducing regulatory burden is a win for all concerned – the industry, investors and the regulators.

Clearly, the OSC has embarked on an ambitious project. The OSC explains that it will take swift action to address as many concerns as possible, and will be accountable for following through. The OSC also plans to "embed burden reduction" into its operations and commit to a process of continuous improvement.

Some of the more substantive recommendations of the 70 that will affect investment funds and registrants are summarized below. The work on most of these proposals is stated to be underway (since the summer) and will take anywhere from 12 to 24 months to complete. Ten of the 70 recommendations are noted as being already completed.

- The OSC will be granted powers to make so-called "blanket orders" (to be described as "class order exemptions"), which are exemptions from applicable rules that will apply to multiple market participants, through amendments to the *Securities Act* (Ontario). The amendment to the *Securities Act* provided for in Bill 138 (first reading November 6, 2019) suggests that these exemptions will operate only for 18 months and the Commission must take a positive step to extend the exemption for further periods through a rule.
- The OSC plans to hold consultations with market participants to discuss how staff issues "guidance" which is intended to supplement rules and policy, and how staff uses that guidance in compliance and regulatory reviews. BLG was one of many stakeholders who expressed a concern that staff guidance is being applied as if it were "law". We are not aware of the specific forum for this consultation, but consider this to be a very important consultation, particularly given the sheer volume of guidance that has been issued over the past few years and how that guidance has been applied by staff during compliance reviews and otherwise.
- The deadlines for filing exempt trade reports under National Instrument 45-106 *Prospectus Exemptions* will be reconsidered by the OSC, along with the rest of the CSA. The OSC is also considering reducing its fees levied on the filing of these reports. Any relief will be welcome – based on our experience over the past few years, we consider the annual filing deadline for investment funds (30 days after calendar year end) to be unnecessarily tight. Disappointingly, no other changes to the exempt market prospectus exemption regime are being considered (we provided feedback on recommendations for changes, in particular, changes to the type and amount of information requested in the exempt trade reports). We note, however, that the replacement for SEDAR (now named SEDAR+ and scheduled to be operational by 2021) is expected to address the regulatory burdens associated with having to file the exempt trade reports using three different filing systems.
- The OSC will publish a consultation paper (presumably with the rest of the CSA) on how to reduce the frequency of investment fund prospectus filings and plans to implement changes to reduce the frequency of these filings. This is very welcome news and we will look forward to reviewing the consultation paper.
- With the rest of the CSA, the OSC plans to relook at investment fund continuous disclosure, with six recommendations for streamlining or developing alternative disclosure models, as well as allowing for electronic delivery of documents. The recommendations in some respects do not go far enough, since we believe posting to a public website ("access equals delivery") to be the optimal approach to take with these documents, particularly given the very low take-up of the documents and their presumably equally low readership.
- An exemption "precedent" has already been developed, which will allow managers to apply for an exemption giving investment funds the ability to appoint more than one custodian. The OSC also says it will finalize another exemption "precedent" which will allow alternative mutual funds to apply for more flexibility in their use of leverage. Notably these are not rule changes, but rather exemptions that must be individually applied for. Staff is also working on articulating the proficiency requirements for distributors of alternative mutual funds.
- OSC staff in the Investment Funds and Structured Products Branch indicate that they have adopted internal processes for using "sunset clauses" in decisions granting exemptions "only where appropriate". We are advocates for the cessation of the use of "sunset clauses" for all OSC and Director-level decisions and suggest that all OSC Branches implement the same internal process.
- OSC staff in the Investment Funds and Structured Products Branch will be looking at ways to improve its engagement with stakeholders and service standards, including on prospectus reviews and processing applications for exemptions.
- The OSC, with its CSA colleagues, will be reviewing National Instrument 33-109 *Registration Information*, with specific attention paid to reassessing disclosure of "outside business activities" and modernizing the registration information required to be filed with the regulators under that instrument.
- Nine specific process improvements are recommended for OSC staff in carrying out compliance reviews of registrants, two of which are stated to be have been completed. All are improvements for staff administrative practices, which although welcome, will not substantively change the ways in which compliance reviews are carried out.
- Four process improvements are recommended in connection with the "risk assessment questionnaire" required to be completed by registrants every two years. The OSC has rejected the feedback, including from BLG, that the RAQ should be required only once every three years.
- The OSC will be developing a process to permit the registration of "client relationship managers" as advising representatives or associate advising representatives. This has long been an issue with the OSC and the CSA and we welcome this initiative to be moved forward as quickly as possible.
- Three changes to the rules and practices regarding chief compliance officers for registrants are proposed, although the "devil will certainly be in the details" in this area:
  - Allow multiple CCOs to be registered for a single firm.
  - Fintech firms will be permitted to register a person as CCO where that person has relevant broader business experience, but not necessarily the specific required CCO proficiency required by National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.
  - Permit Ontario registrants "in appropriate circumstances" to have a CCO who is a CCO for other "unaffiliated" registrants; presumably this will be a boon to compliance consultants, as well as ease the burdens on smaller firms.

- Streamline registration and acquisition notices required to be filed with one of the SROs and also with the OSC under NI 31-103.
- Evaluate changes to the percentage thresholds that trigger a notice under sections 11.9 or 11.10 of NI 31-103 and improve the processing of these notices. Work on both of these recommendations will commence in January 2020 and, we look forward to the results of this review.
- The OSC has informed IIROC of the stakeholder feedback that the definition of "permitted client" in NI 31-103 and the definition of "institutional client" in the IIROC rules be harmonized, to permit consistent application of waivers of KYC and suitability assessments.
- Eliminate the reporting requirements for investment dealers and advisers under NI 24-101 *Institutional Trade Matching and Settlement* if the specified thresholds are not met. We are in complete support of this change.
- Various specified changes to the derivatives rules (including those not yet in force) are being considered, including the elimination of duplicative obligations for dealers and advisers that are already registered. The OSC explains that it will do more to align Canadian derivatives rules with corresponding non-Canadian rules. In our view, additional international harmonization could be achieved and is critical, particularly with respect to the proposed business conduct rule, given the relatively small size of the Canadian derivatives market and the prominence of non-Canadian firms operating in Canada.
- Certain international registrants and exempt firms will be exempted from the *Commodity Futures Act*.

We will watch for the developments that can be expected to flow from the Report and will provide periodic updates and analysis.

Please contact any of the authors of this Bulletin or your BLG lawyer if you have questions about any of the matters outlined in this Bulletin or in the Report.

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