



Outreach session for Portfolio Managers

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May 22, 2014 (in-person meeting)

Agenda

Part 1

- Overview of CRR Branch and Portfolio Manager (PM) team
- Update on new and proposed rules and other initiatives impacting PMs

Part 2

- PM compliance review findings/suggested practices

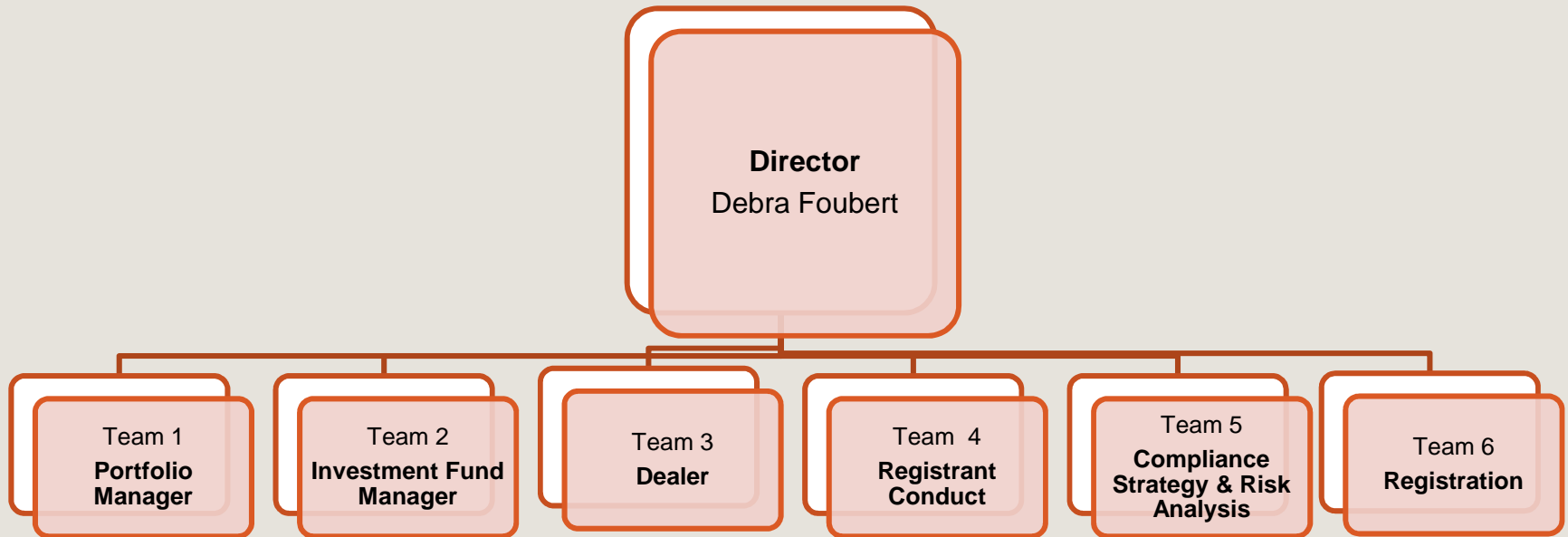
Part 3

- Guidance on KYC/suitability obligations for PMs

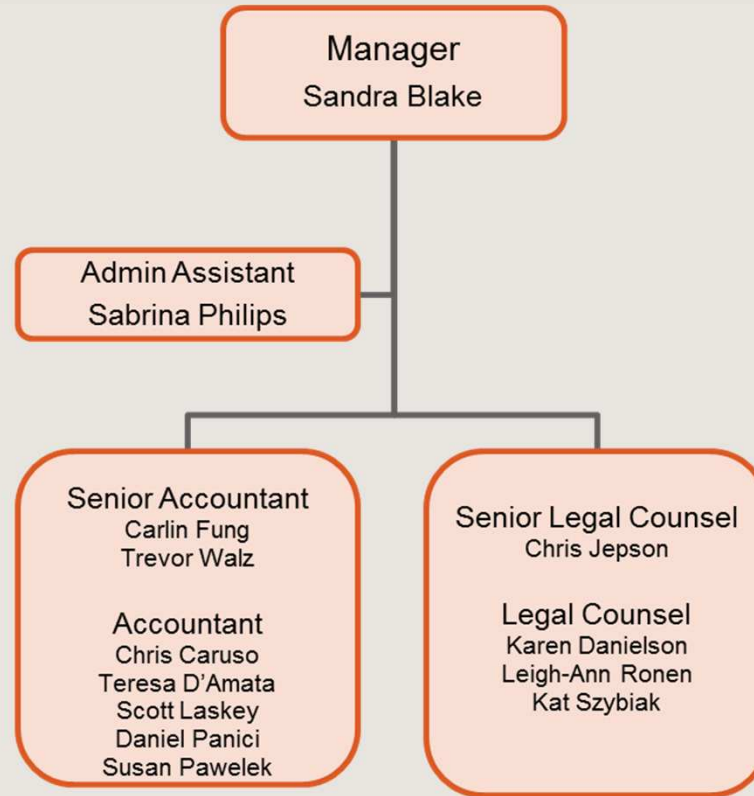
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Overview of CRR Branch



Overview of portfolio manager team



PM registration stats (April 2014)

- 857 PM firms are registered in Canada (includes 46 restricted PMs)
- 711 PM firms are registered in Ontario (includes 9 restricted PMs) (83% of Canadian PMs)
- 538 PM firms have OSC as principal regulator (includes 6 restricted PMs) (63% of Canadian PMs)

Individuals registered in Ontario:

- 3206 advising representatives (AR)
- 464 associate advising representatives (AAR)



Update on new and proposed rules and other initiatives impacting PMs

Electronic delivery of documents to OSC –final rule

- Since February, electronic filing of many documents (such as financial statements) to OSC is mandatory
- Filings must be done through Electronic Filing Portal on OSC website

For more information:

- click on [Electronic Filing Portal tab on OSC website](#)
- see [OSC Rule 11-501](#)

Cost disclosure, performance reporting and client statements (CRM2) – final rule change

Key upcoming requirements:

- new account statement/additional statement requirements start July 15, 2015
- annual report to clients on charges/compensation starts July 15, 2016
- annual investment performance report to clients starts July 15, 2016

For more information, see:

- CRM2 FAQ in [CSA Staff Notice 31-337](#)
 - OSC implementation [planning tips](#) on our website
 - slides from November 2013 [CRM2 outreach session](#)
 - [final amendments to NI 31-103](#) dated March 28, 2013
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Independent dispute resolution for client complaints – final rule change

- In December, amendments to NI 31-103 made the Ombudsman for Banking Services and Investments (OBSI) the common, independent dispute resolution service provider for the securities industry (except in Québec)
- August 1, 2014 deadline for most firms

For more information:

- see guidance on providing disclosure to clients in [CSA Staff Notice 31-338](#)
- visit OBSI's website (www.obsi.ca)
- see [amendments to NI 31-103](#) dated December 19, 2013

Prospectus exemption that impacts PMs (proposed rule change)

Key proposal impacting PMs:

- amend the definition of accredited investor (AI) in Ontario to allow fully managed accounts to purchase investment fund securities using the managed account category of the AI exemption

For more information, see:

- [proposed changes to NI 45-106](#) published February 27, 2014 (out for comment until May 28, 2014)
- [Exempt Market Dealers outreach slides](#) from April 2014

Ongoing amendments to NI 31-103 and related rules (proposed rule change)

Some proposed items of interest to PMs:

- additional guidance on outside business activities of registered individuals that must be disclosed to OSC/CSA
- incorporated guidance for what we may consider to be “relevant investment management experience” for registering an AR or AAR

For more information, see:

- [proposed changes to NI 31-103 and related rules](#) published December 5, 2013
- [CSA Staff Notice 31-332](#)

Review of custody requirements (potential policy initiative)

- CSA plans to review the custody requirements that apply to registered firms, other than SRO members, to assess if enhancements are needed to improve protection of client assets
- Existing rules in sections 14.6 to 14.9 of NI 31-103 focus mostly on segregating client assets from the firm's assets and do not establish a detailed custodial regime

For more information, see:

- section 4.1.3 of [OSC Staff Notice 33-742](#)

PM – IIROC dealer service arrangements (potential policy initiative)

- CSA and IIROC are reviewing service arrangements between PMs and IIROC dealers to assess if rules and/or guidance are needed
- Under these arrangements, a dealer typically provides custody and trading services to a PM and its clients, but may also provide recordkeeping and margin services

For more information:

- See section 4.3.3 of [OSC Staff Notice 33-742](#), including for OSC expectations and interim guidance on PM client account statement delivery practices

Best interest standard (consultation)

- CSA continues to assess the need for statutory requirement for PMs and dealers to act in the best interests of their clients

For more information, see:

- [CSA Consultation Paper 33-403](#) from October 2012
- CSA status report from December 2013 ([CSA Staff Notice 33-316](#))

Regulation of OTC derivatives advisers (consultation)

- In April 2013, CSA publishes consultation paper on the registration and regulation of derivatives market participants, including derivatives advisers

For more information, see:

- [CSA Consultation Paper 91-401](#) on proposed framework for regulation of OTC derivatives in Canada
- [CSA Consultation Paper 91-407](#) on Derivatives: Registration
- [OSC Rule 91-506 Derivatives: Product Determination](#) (for trade reporting purposes only)



PM compliance review findings and suggested practices

Compliance reviews of PMs

- New risk assessment questionnaire
- Focus on higher-risk activities (e.g. portfolio management, trading) rather than all activities
- More integrated reviews for firms registered in multiple categories
- Reviews of large/impact firms and newly registered firms

For more information, see:

- section 4.1.1 of [OSC Staff Notice 33-742](#)
- [Start to finish: Getting through an OSC compliance review outreach slides](#) from October 2013

PM compliance review findings

Inadequate or no CCO annual compliance report to board of directors (BOD)

- The CCO of a PM must submit an annual compliance report to its BOD or equivalent

We expect the compliance report to:

- be in writing
- be submitted more frequently than annually if appropriate
- detail steps taken to perform assessment, results of assessment and what has been done to address non-compliance identified

PM compliance review findings

Inadequate supervision of advising representatives (ARs) and research analysts

- PMs must have firm-wide supervisory controls, policies and procedures that apply to all ARs and research analysts
- ARs must fully understand structure, features and risk of each trade that they authorize for clients
- ARs must pre-approve the advice of associate advising representatives they are responsible for

PM compliance review findings

Insufficient working capital or inaccurate calculations of working capital

- A registrant's excess working capital must not be less than zero for 2 consecutive days
- Registrants should be aware of their working capital position at all times
- Registrants are required to notify their principal regulator as soon as possible of any capital deficiency

PM compliance review findings

Inadequate investment management agreements (IMA)

- An IMA with each client should:
 - set out the services to be provided,
 - discuss the roles and responsibilities of each party, and
 - address all aspects of the investment advisory process
- IMA should be reviewed, signed and dated by senior management of PM and the client
- Provide copy of IMA to client

PM compliance review findings

Inadequate personal trading policies

We expect:

- PMs to develop and enforce written policies and procedures on personal trading for access persons
- Pre-clear personal trades
- Regular review of access persons' personal trading records

For more information on compliance review findings, see:

- [OSC Staff Notice 33-742](#)
- [prior years' annual reports for Dealers, Advisers and Investment Fund Managers](#)



Guidance on KYC and suitability obligations for PMs

Guidance on KYC and suitability obligations for PMs' managed account clients

- May 2013: OSC summarizes results of its 2012 sweep of KYC and suitability practices of 87 PMs and EMDs ([OSC Staff Notice 33-740](#))
- December 2013: OSC staff hold seminars on KYC and suitability obligations for PMs and EMDs (see [slides on registrant outreach section](#) of our website)
- January 2014: CSA provides guidance for PMs/EMDs on KYC, KYP and suitability obligations ([CSA Staff Notice 31-336](#))
- Today's focus: Guidance for PMs with managed accounts

Guidance on KYC/suitability obligations

Engage in meaningful KYC discussion with each client

- Preferably face-to-face meeting
- Discussion should focus on client's investment needs and objectives, risk tolerance, investment time horizon, investment knowledge, financial circumstances
- Explain the PM's proposed investment strategy to the client in light of their KYC information
- Document client's KYC information on a standard form: AR and client to sign and date, give client copy

Guidance on KYC/suitability obligations

Develop an investment policy statement (IPS) for each client

- What should an IPS cover?
 - investment objectives, risk tolerance
 - planned asset allocation, investment instructions
 - income needs, liquidity requirements, return goals
 - permitted/non-permitted investments, concentration thresholds
 - the investment strategy the PM will use to meet the client's objectives, and
 - any regulatory/legal considerations
- AR and client to sign and date IPS, give client copy

Guidance on KYC/suitability obligations

Consider a client's willingness and ability to accept risk when assessing their risk tolerance

- A client may be willing to accept risk; however, this does not necessarily mean that a client has the ability to financially withstand a downturn in the market or either partial or total loss of their investment
- Alternatively, a client may have the financial means to absorb losses, but may not be willing to do so
- A risk questionnaire facilitates understanding a client's willingness to accept risk

Guidance on KYC/suitability obligations

Consider and document reasonable investment concentration thresholds

- Diversification is important factor to consider when assessing suitability of investments
- Investments in securities of a single issuer or group of related issuers that represent more than 10% of the investor's net financial assets potentially raise suitability concerns due to concentration

Guidance on KYC/suitability obligations

When should suitability assessment be made?

- Required under s. 13.3 of NI 31-103 at time of each purchase or sale of a security for a managed account
- Expectations for suitability assessment:
 - on a regular basis (such as each quarter)
 - major market event occurs
 - material change in client's KYC information
 - change in AR
 - transfer-in of new securities to account

Guidance on KYC/suitability obligations

How often should KYC information be updated?

- Requirement in section 13.2 of NI 31-103: an AR must take reasonable steps to keep client's KYC information current
- Expectation: update KYC information
 - at least annually,
 - when there is a material change in a client's investment needs or objectives, risk tolerance or financial situation, and
 - when the client has a "trigger event" (for example: marriage, divorce, birth of a child, loss of/change in employment, etc.)
- Document steps taken to update KYC info and results

Online advice

- Proposals to collect KYC and suitability information online and/or provide computer-generated investment recommendations to clients
- Online advice proposals must establish to us that they'll meet their regulatory obligations, including the KYC and suitability requirements

For more information, see:

- section 5.2D of [OSC Staff Notice 33-736](#)
- section 2.3 of [OSC Staff Notice 33-738](#)
- section 3.3 of [OSC Staff Notice 33-742](#)

Delegating KYC and suitability obligations to referral agents

- PMs may not delegate these obligations to others, such as financial planners and mutual fund dealing representatives
- We expect a registered advising representative at the PM firm to:
 - have a meaningful discussion with the referred client to ascertain their KYC and suitability information, and select an investment mandate, and
 - maintain an ongoing relationship with the referred client to discuss their investments and update their KYC and suitability information
- Registered advising activity is broader than advising in securities; it also includes KYC collection, documentation and updating

Dealing with senior investors

Seniors as a vulnerable group

- Becoming a larger part of the population
- Rely on investments for financial security in retirement
- Reduced investment time horizon to recover from financial loss
- Possible diminished mental capacity and physical illness
- Susceptible to financial abuse

Dealing with senior investors

Some key areas to consider:

- Communicate effectively with senior investors
- Identify senior-specific issues (e.g. signs of diminished capacity and financial abuse, etc.)
 - train advising representatives to identify the issues
 - establish policies and procedures for dealing with these issues
- Ensure suitability of investments
- Incorporate additional review and supervisory procedures for senior investor accounts



Questions



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