

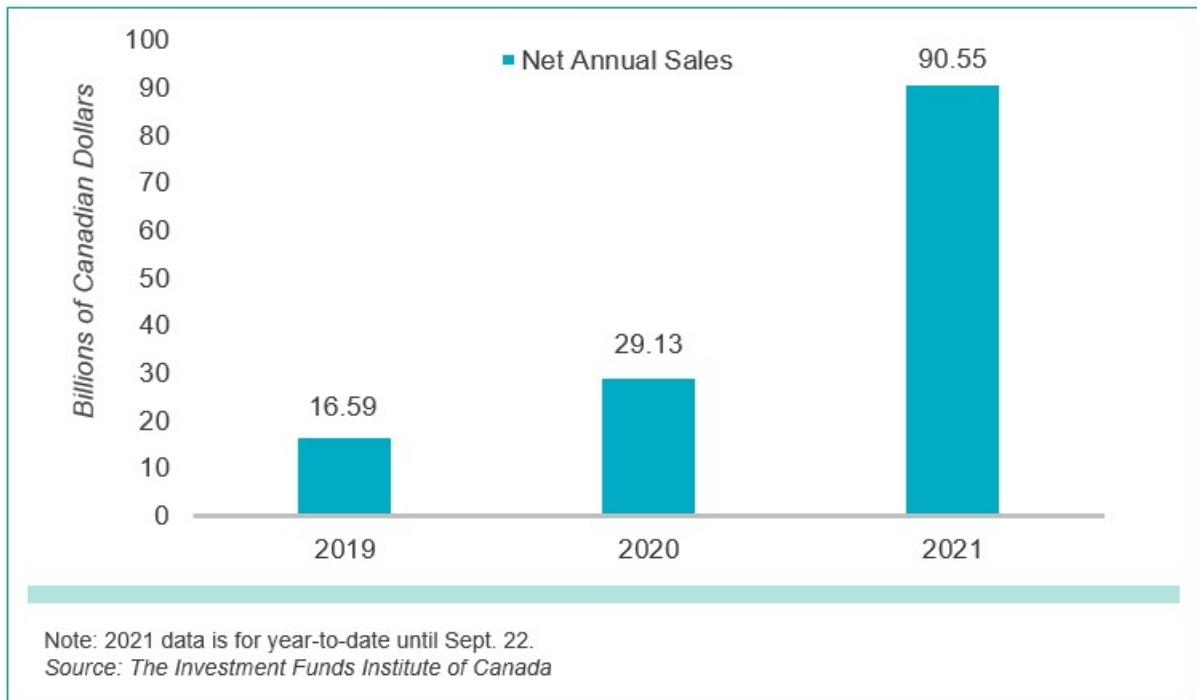
Canada's Investment Funds Prepare for a Hybrid World

As pandemic restrictions are starting to ease in Canada, investment fund managers (IFMs) are getting ready for a post-pandemic marketplace, and they are aware that the future will not look like the pre-pandemic past, especially when it comes to sales practices. Just as many firms are preparing for a hybrid office working environment, Canadian IFMs realize post-pandemic sales activities will incorporate some form of hybrid model, mixing virtual activities with in-person events.

Canadian IFMs rapidly pivoted to virtual activities during the pandemic and became increasingly savvy and innovative in engaging their distribution networks these past 18 months. They even benefited from virtual events, as they could eliminate the travel and location costs while being able to connect with advisers across the country in shorter time spans and more often than they ever could in a physical world of branch visits, road shows and other sales practices. Advisers adapted similarly, leveraging virtual meetings and client visits to reach more existing and prospective clients.

While they had to adapt their sales practices quickly to fit the constraints of a locked-down world, IFMs may not have had time to stop and fully reflect on the application of relevant securities regulation and guidance to virtual events and all implications to compliance risk. Regulators do expect IFMs to review and enhance compliance and operational processes in response to external and internal changes. After 18 months, it's time to revisit and update the well established internal guidelines, policies and internal controls of IFMs, adapting previous regulatory guidance and enforcement actions to apply to virtual and hybrid practices.

Canadian Mutual Fund Sales Didn't Slow Down During Pandemic



New regulatory guidance is likely to come from the Ontario Securities Commission (OSC) following its industry sweeps, 2021 reviews and focus on conflicts of interest matters arising from the 2021 activities related to Client Focused Reforms, a long-running effort to bring brokers closer to fiduciary standards. With a large number of Ontario-headquartered IFMs representing substantial assets under management, the OSC's guidance often sets the tone for IFMs across Canada. We explain the rules and provide IFMs nationwide with some suggestions to consider as they prepare for a hybrid sales-practices future and apply the spirit of the rules to virtual, in-person and hybrid sales practices.

What the rules say

Applicable Canadian securities regulations are prescriptive in so far as identifying for what an IFM can pay, with whom it can have direct interactions, what types of interactions are permitted and several other elements of sales behaviour. And yet the rules also require judgement, leaving room for interpretation.

National Instrument 81-105: Mutual Fund Sales Practices (NI 81-105) and its Companion Policy (NI 81-105CP) were adopted to discourage sales practices and compensation arrangements that could be perceived as inducing dealers and their representatives to sell mutual funds on the basis of incentives they receive rather than on the basis of what was suitable for and in the best

interests of their clients.¹ NI 81-105 states that, in the context of mutual fund sales, IFMs cannot make payments, provide non-monetary benefits, or reimburse expenses to a dealer or dealer representative, except under specific permitted conditions.² A dealer cannot solicit or accept such payments, benefits or reimbursements either, except for what the rule allows.³

Permitted sales practices under the rule include:

- (1) Payment of a dealer's direct costs incurred relating to a sales communication, conference or seminar for investors, or non-investors, prepared or presented by the dealer, provided certain conditions described in the regulations are met, such as the cap on the percentage of costs that can be covered.⁴
- (2) Provision of a non-monetary benefit to a dealer representative by allowing him or her to attend a conference or seminar organized by the IFM if certain conditions are met, such as the primary purpose of the event being educational and the dealer deciding which representative attends.⁵ Reasonable costs associated with such an event that can be covered include food and beverages, conference materials and registration fees. Reasonable costs would *not* include gifts or entertainment unless they are permitted by section 5.6 described in (3) below.⁶
- (3) The non-monetary benefits of a *promotional nature* and of *minimal value* are allowed if:
 - a. The benefit and the activity are neither so extensive nor so frequent as to cause a reasonable person to question whether their provision would influence the advice given by the representative to clients.
 - b. The payment of travel, accommodation or personal incidental expenses of the attending representative are not paid by the IFM.⁷

Examples of such non-monetary benefits include pens, T-shirts and other paraphernalia with the IFM's logo. Reasonable business promotional activities include *occasional* meals or drinks, and tickets to sporting events or concerts.⁸ To be considered promotional, an IFM and a dealer representative must attend the activity for the entire duration of the event.⁹

¹ NI 81-105CP.

² NI 81-105, section 2.1.

³ NI 81-105, section 2.2.

⁴ NI 81-105, sections 5.1, and 5.5.

⁵ NI 81-105, section 5.2.

⁶ NI 81-105CP, section 7.3.

⁷ NI 81-105, section 5.6.

⁸ NI 81-105CP, section 7.6.

⁹ See, for example, OSC Staff Notice 33-750.

Several guidance notes have been issued to help dealers and IFMs interpret the rules.¹⁰ However, there is still a lot of room for interpretation, and the industry has not always gotten it right in the eyes of the regulators, with several players having faced enforcement actions in the past.¹¹

In Staff Notice 33-749, the OSC suggested applying a qualitative analysis, and suggested considering the following factors when assessing whether a cost or item is reasonable:

- Does the item comply with the spirit of the rule?
- Does the activity fit within the IFM's internal policies?
- How would an independent third party react to the provision of the item or activity?
- Would that independent third party consider it to be extravagant?
- What would be the reputational impact to the IFM if the non-monetary benefit was made public, for example, in a news article?

Applying the rules and the guidance to virtual or hybrid activities, one must consider whether they could be perceived as inducing dealer representatives to sell certain mutual funds on the basis of incentives rather than client suitability and best interests¹². NI 81-105 applies to all sales activities, whether they are held in person or virtually. Legal and compliance professionals need to consider all costs associated with the hosting of virtual sessions, including recording and distribution of the recording, the frequency of providing the events and the perception of offering complimentary events. Where guidance doesn't specifically address a situation and interpretation of the rules is required, IFMs are encouraged to document their rationale in supporting their decisions.

What IFMs should do to prepare for the post-pandemic future

IFMs that have invested in technology for virtual events need to ensure their legal and compliance staff are able to analyze attendance and subsequent viewing data of distributed recordings. They need to make sure adequate records exist and are readily accessible to monitor compliance with frequency expectations. In the case of investor seminars, technology can

¹⁰ For example, OSC Staff Notice 33-743: *Guidance on Sales Practices, Expense Allocation and Other Relevant Areas Developed from the Results of the Targeted Review of Large Investment Fund Managers* (2014); OSC Staff Notice 33-749: *Compliance and Registrant Regulation: Annual Summary Report for Dealers, Advisers and Investment Fund Managers* (2018); and OSC Staff Notice 33-750: *Compliance and Registrant Regulation – Summary Report for Dealers, Advisers, and Investment Fund Managers* (2019).

¹¹ For example, see sales practices settlement agreements dated March 31, 2017, April 4, 2018 and April 19, 2018.

¹² OSC Staff Notice 33-750.

provide legal and compliance professionals with evidence to monitor whether a dealer representative is present for the duration of the event and appropriate branding is visible to support the cooperative requirements of section 5.1 of NI 81-105.

The requirement to maintain complete, accurate and relevant records associated with all sales practices remains unchanged. Compliance professionals need to consider which records associated with the virtual event should be kept, how and by whom. Further, they need to ensure the event recording and/or transcripts are appropriately labelled and retained, along with any materials presented on screen for prompt retrieval for internal monitoring and also in case of a regulatory review.

Virtual sales practices are here to stay. They are cost effective and facilitate the delivery of content quickly to wide audiences in many jurisdictions. Recordings facilitate easy distribution of content in an engaging format. After 18 months of remote work, professionals around the world are too used to virtual formats to give them up for good. While in-person meetings and conferences and branch visits will return, virtual activities will continue to be part of our lives and Canadian mutual fund sales practices.

Use of virtual formats introduces risk to an organization. IFM compliance departments can consider the list below, as a starting point to mitigate risk and ideally avoid potential challenges arising from a regulatory review:

- i. Update all policies and procedures to reflect the firm's use of virtual sales practices, identifying permissible and acceptable activities, expectations about how virtual activities are to be conducted, and requirements for prior approval and requirements surrounding the form, nature and content of records to be captured and retained, including assigning accountability for maintaining such records.
- ii. Consider rules and protocols around who can attend virtual events, where participants reside, and how to limit and control distribution of recordings to ensure the firm is not seen to be engaging in distribution activities in jurisdictions where it is not appropriately registered.
- iii. Update all policies and procedures to reflect how and when marketing content can be used within virtual sales events, including how to clearly communicate appropriate disclaimers and disclosures when data is being shown and/or discussed to ensure the audience has the opportunity to read or hear them.

- iv. Consider the nature of information, particularly financial information, presented in a virtual event, including the form in which it is presented (oral or visual) to ensure that regulatory expectations continue to be met.
- v. Consider how or whether to reference titles or roles of presenters (orally or visually), particularly where the possibility of confusion around the nature of the presenters' duties exists.
- vi. Update policies and procedures to reflect how digital recordings of virtual sales practices can be used, when their use is inappropriate, when and if they expire and are ineligible for ongoing use, and whether and how records are to be maintained surrounding their distribution.
- vii. Consider privacy legislation when collecting, using and storing personal information of participants for the delivery of meals, beverages and other items as part of the virtual event.
- viii. Consider the applicability of any local requirements (for example, the *Accessibility for Ontarians with Disabilities Act*) when hosting, recording and distributing recordings of a virtual event.
- ix. Consider whether the risks associated with the distribution of recordings can be adequately managed to ensure that content remains in the hands of intended audiences only and the ability to remove from circulation any stale or dated information can be achieved cost effectively.
- x. Update the risk assessment to reflect current risks associated with the firm's use of virtual sales practices and the risk appetite associated with it.
- xi. Update compliance procedures to reflect regulatory positions taken in relation to the frequency, invitation approach, delivery methods, content, records and retention practices associated with all virtual sales activities.
- xii. Review technology provider service agreements regarding data archival, access and retrieval capabilities.
- xiii. Document, report and escalate unintended or unforeseen exceptions to internal sales practices policy, procedures and controls.

- xiv. Update and deliver ongoing training to employees involved in the preparation, review, administration, distribution, and retention of records associated with permitted virtual sales practices of the firm.

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