



British Columbia  
Securities Commission

# **2017 Annual Compliance Report Card**

## British Columbia Securities Commission

June 2017



# BCSC 2017 ANNUAL COMPLIANCE REPORT CARD

This compliance report card summarizes the findings that our compliance teams made in the course of their reviews of the compliance programs of BC-based portfolio managers (PMs), investment fund managers (IFMs), and exempt market dealers (EMDs) from April 1, 2016 to March 31, 2017.

We provide this report card to chief compliance officers (CCOs) and compliance professionals to help them improve their compliance programs. The report card highlights problem areas we saw and explains our approach to compliance examinations.

## **Our firms**

At March 31, 2017, the British Columbia Securities Commission (BCSC) had 116 directly registered firms (excluding IIROC and MFDA firms). Based on the nature of each firm's business, our directly registered firms consisted of:

- 88 Adviser/IFM firms
- 28 Dealer firms

In addition to our registered firms, we also continued to review the compliance of unregistered market participants that we thought might be required to register. These market participants include both issuers and finders that appeared to be in the business of trading in securities under registration and prospectus exemptions in BC.

## **Our approach to regulation – risk and outcomes based**

Our goal is to foster a culture of compliance among market participants. Where we find serious compliance failures or dishonest conduct, we will take decisive action. This past year, we found significant failures of compliance that resulted in the BCSC placing terms and conditions on the registrations of some firms.

We help our registered firms foster a culture of compliance by assigning dedicated relationship managers (RMs) to each firm. Our RMs maintain communications with the firms assigned to them. They understand each firm's business and compliance program. We encourage firms to contact their RMs to discuss compliance-related issues or to report changes in their business or personnel. Please contact us if you do not know your RM (see contact details at the end of this report card).

# COMPLIANCE REVIEW FINDINGS

The BCSC continues to use its predictive risk model to assess the risks for BC-based registered firms. We take data from the answers firms provide every two years to our risk questionnaire and the firm's examination results. The data from our risk model, together with information gathered from observation, helps us predict the likelihood of compliance failures through significant and repeat deficiencies. In addition to reviewing firms due for review based on the time elapsed since their last review, we choose firms with the highest likelihood of compliance failures for our compliance examinations. Once we choose a firm to review, we use the information we know about that firm to tailor our compliance review program to test any compliance concerns we may have.

If we receive information or complaints that indicate any market participant is seriously noncompliant or dishonest, we conduct a "for cause" review.

## Compliance Review Findings

We saw compliance strengths and weaknesses in the firms we reviewed this year, which we discuss below under "positive findings" and "top five deficiencies".

### *Registered firms – positive findings*

We found these positive practices among firms with good cultures of compliance:

- They review guidance from CSA Staff Notices to take timely proactive corrective actions, instead of waiting for Commission staff to identify compliance issues.
- They consult with their RM and their professional service providers to resolve issues before they become compliance deficiencies in a compliance examination.
- They provide a meaningful annual CCO's report to the firm's board, detailing a fulsome self-assessment of their compliance systems and operations, and changes made to address weaknesses.
- They consider how changes to their business, staff, or revenue may affect their compliance program, and update their policies and procedures manuals (PPMs) appropriately, instead of simply doing a cursory annual review.

## COMPLIANCE REVIEW FINDINGS

### *Registered firms – top five deficiencies*

In our compliance reviews, we tested 49 deficiency categories covering 9 operational areas of registrants.

This year, we conducted 26 compliance reviews and found 171 compliance deficiencies in total, averaging 6.58 deficiencies per review. The top five deficiencies represent approximately 59% of all of the compliance deficiencies we found.

The top five deficiencies (the last two share fifth position) were:

Deficiency Type	Number of Deficiencies	% of all Deficiencies
Client statements and reporting	23	13%
Registration administration	21	12%
Know-your-client and suitability	19	11%
Policies and procedures	18	11%
Disclosures	10	6%
Advertising, marketing, holding out	10	6%
<b>Total</b>	<b>101 / 171</b>	<b>59%</b>

### *Divergent results between Adviser/IFM and Dealer businesses*

This past year, unlike previous years, we saw a divergence in the top five deficiencies by type between the two business categories:

Deficiency Type	Adviser / IFM		Dealer	
	Rank	Number of Deficiencies	Rank	Number of Deficiencies
Client statements and reporting	4	9	1	14
Registration administration	1	20	n/a	1
Know-your-client and suitability	2	13	2	6
Policies and procedures	2	13	3	5
Disclosures	3	10	n/a	n/a
Advertising, marketing and holding out	n/a	4	2	6
Records	5	7	n/a	2
Conflicts of interest and personal trading	n/a	5	2	6

## COMPLIANCE REVIEW FINDINGS

Examples of the compliance deficiencies we found in the various deficiency categories include:

### **Client statements and reporting**

Our reviews tested if registrants deliver and present in their client reporting, including trade confirmations and client statements, accurate information in a clear, meaningful, and timely manner, in compliance with Part 14 of National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103).

From dealer reviews, we saw failures to deliver:

- written trade confirmations of transactions setting out all the information required in section 14.12(1)(a) to (h) of NI 31-103
- account statements that included all the information referred to in subsections 14.14 (4) and (5) of NI 31-103

As part of our client statements review, we also tested compliance with the Client Relationship Model (CRM2). CRM2's second phase requirements came into effect this past year. From adviser/IFM reviews, we found that many firms fail to:

- disclose whether the position cost information is based on book cost or original cost
- provide a description of the chosen cost method

In addition to the CRM2-related issues, our reviews indicated that some adviser/IFM firms failed to understand and meet the obligation of having their own adequate client records in order to ensure that clients receive accurate account statements. We saw failures to keep client records independent of the custodian and to review and reconcile the custodian's statements with the firm's books and records. We remind firms that they have the obligation to maintain books and records that demonstrate compliance with section 11.5 of NI 31-103.

# COMPLIANCE REVIEW FINDINGS

## Registration administration

We review whether firms meet their compliance requirements to update information about the firm and its registered individuals on the National Registration Database (NRD). Current and correct information on NRD is critical because NRD serves as a national record of all registration activity. Compliance failures in this area often indicate more substantial compliance issues. We saw failures that included the following:

- Failure to identify, evaluate, and disclose outside business activities (OBAs) by individual registrants, including changes to, or the addition of, OBAs. Firms need to make reasonable efforts to ensure that individual registrants report their OBAs on NRD for truth and completeness. In addition, we expect firms to have procedures in place to identify, review, and assess their employees' OBAs for potential conflicts of interest. OBA issues are some of the most prevalent findings in adviser/IFM reviews.
- Failure to notify regulators in other provinces of the use of the mobility exemption, when clients move away from BC. Additionally, firms also failed to provide the required mobility exemption disclosure to clients moving away from BC.
- Failure to supervise associate advising representatives by preapproving their advice before they provide that advice to clients, as required by section 4.2 of NI 31-103.
- Paying unregistered personal corporations of registered individuals for their registrable activities. We understand that this is tax efficient, but it is not allowed.

## Know-your-client and suitability

Know-your-client (KYC) and suitability form the cornerstone of a registrant's obligation to its clients. Accurate and current client records are critical for a firm to be able to assess the suitability of a trade for a client. Failures of KYC and suitability often result in client complaints to the BCSC. We found the following failures:

- incomplete KYC forms with data fields left blank
- outdated KYC information, at times, several years old
- gaps between, or no evidence of, KYC updates, despite significant life changes for clients
- inadequate KYC information for the firm to conduct a proper suitability assessment of the client's trade
- registered individuals not following the firm's PPM requirements on collection, documentation, and retention of KYC information
- KYC collection and suitability assessment done on a household basis, rather than for the individual clients within the household
- collecting and assessing KYC information of the trustee or power of attorney of an account instead of the beneficiary of the account
- lack of records to demonstrate compliance with the firm's KYC and suitability process

# COMPLIANCE REVIEW FINDINGS

## Policies and procedures

Registered firms must maintain policies and procedures that establish a system of controls to provide reasonable assurance that the firm and individuals acting for it comply with securities legislation and appropriately manage the risks associated with its business. Compliance failures in this area often indicate that firms did not consider the risks associated with their business.

We saw failures including:

- not following the firm's policies and procedures, indicating a lax culture of compliance set by the firm's leadership
- outdated policies and procedures and/or references to repealed securities legislation, indicating that their PPM is infrequently updated and the CCO is not keeping current with securities legislation
- missing or inadequate policies for the CCO's supervision and review of personal trading by the firm's employees

## Disclosures

Registrants are required to provide relationship disclosure information (RDI) on areas such as referral arrangements and conflicts of interest, as well as any specific information that a reasonable investor would consider important to know. Firms should provide clear, meaningful, and timely RDI to clients and ensure that clients can readily understand the information presented. These requirements are consistent with the obligation to deal honestly, fairly, and in good faith with clients.

This past year, we emphasized reviewing RDI as part of our follow-on work to the national RDI sweep in 2013 and the small firm sweep in 2016 in this area. We identified a large number of disclosure-related deficiencies, which suggests that CCOs need to focus more on this area of disclosure.

From dealer reviews, we saw failures to:

- ensure accuracy of the information presented in the RDI
- present all information in the RDI that a reasonable client would consider important about the client's relationship with the registrant and, at a minimum, all the information required in section 14.2(2) of NI 31-103
- deliver the RDI before the registrant first purchases or sells a security for clients or advises the client to purchase, sell, or hold a security and, in those cases, to ensure that the client received the RDI
- provide clients with sufficient information to enable the client to understand the type of accounts they hold, how the accounts operate, and the services associated with their accounts



## COMPLIANCE REVIEW FINDINGS

From adviser/IFM reviews, we found:

- no disclosures to clients that the firm uses foreign cloud storage service providers, which may result in privacy risks
- no disclosure of conflicts of interest between the firm and its clients
- unacceptable boilerplate disclosures in client statements, performance calculations, and marketing presentations that disclaim the firm's responsibilities from any errors or omissions

### How we treat non-compliance

When we see non-compliance, we can:

- require a firm to rectify its compliance program
- recommend imposing registration terms and conditions to reduce the risk of non-compliance
- recommend suspending registration
- take enforcement action

The CCO must ensure that every aspect of the firm's business complies with securities legislation. Where we find instances of non-compliance with regulatory requirements, we expect the CCO to take immediate action to resolve these deficiencies.

In the past year, we identified a number of firms that had significantly higher than average deficiencies. As a result, we took compliance actions against these firms and imposed registration conditions on firms more frequently than we have in previous years. In some cases, we are working on enforcement actions.

This past year, the Executive Director imposed registration conditions on seven firms. Examples of the registration conditions the Executive Director imposed include:

- requiring firms to hire a compliance monitor to work with them to remedy compliance deficiencies including reviewing and reporting on their KYC documentation and rewriting their PPMs
- preventing a firm from trading in client accounts until it meets its compliance obligations
- preventing a firm from hiring additional representatives
- preventing a firm from conducting trades for clients until it updates its KYC information
- requiring the UDP or CCO to pass specified courses

Any conditions placed on the registration of a firm are public and reported on NRD and the public National Registration Search service.

We also charge costs for our compliance reviews where we see significant compliance failures, repeat deficiencies, or conduct that indicates the firm is not adequately managing its compliance program or the risks associated with its business. This year, we imposed costs on a number of firms.

## EXAMINATION FOCUS 2017 - 2018

During the year ahead, we will continue to focus our compliance reviews of registered firms on the top five deficiencies. We will continue to select firms for review based on changes of business, revenue, and size. When we review firms, we will continue to focus on PPMs, KYC and suitability, and compliance with CRM2 requirements.

### **Guidance**

When facing reviews, CCOs should consider the practices mentioned in this report card and the numerous guidance notices that the CSA has published. In particular, we remind firms that the CSA has provided useful guidance in:

- *Multilateral Policy 31-202 Registration Requirement for Investment Fund Managers*
- *CSA Staff Notice 31-325 Marketing Practices of Portfolio Managers*
- *CSA Staff Notice 31-334 CSA Review of Relationship Disclosure Practices*
- *CSA Staff Notice 31-336 Guidance for Portfolio Managers, Exempt Market Dealers and Other Registrants on the Know-Your-Client, Know-Your-Product and Suitability Obligations*
- *CSA Staff Notice 31-347 Guidance for Portfolio Managers for Service Arrangements with IIROC Dealer Members*
- *CSA Staff Notice 31-350 Guidance on Small Firms Compliance and Regulatory Obligations*

We remind you to subscribe to the *Weekly Report*, so that you can get early information about legislative changes on the horizon.

If you have questions about your compliance program, please contact the BCSC relationship manager for your firm, or any member of the BCSC compliance team.

## CONNECTING WITH THE BCSC

If you have questions or concerns, please contact your relationship manager, the Compliance Managers, or the Director.

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