

1.1.2 The Investment Funds Practitioner

September, 2008

THE INVESTMENT FUNDS PRACTITIONER

From the Investment Funds Branch, Ontario Securities Commission

What is the Investment Funds Practitioner

The Practitioner is an overview of recent issues that have arisen in connection with applications for discretionary relief, prospectuses, and continuous disclosure documents that investment funds file with the OSC. We, the staff of the Investment Funds Branch, have written the Practitioner primarily for investment fund managers and their staff or advisors who regularly prepare public disclosure documents and applications for exemptive relief on behalf of investment funds.

The purpose of the Practitioner is to make you more broadly aware of some of the issues we have raised in connection with our reviews of documents filed with us and how we have resolved them. We hope that fund managers and their advisors will find this information useful and that the Practitioner can serve as a useful resource when preparing applications and disclosure documents.

Please note, however, that the information contained in the Practitioner is based upon particular factual circumstances and that outcomes may change as facts change or as regulatory approaches evolve. We will continue to assess each particular case on its own merits. Please also note that staff of the Investment Funds Branch prepared the Practitioner and the views it expresses do not necessarily reflect those of the Commission or the Canadian Securities Administrators.

Request for Feedback

This is the third edition of the Practitioner. The two previous editions are available on our website www.osc.gov.on.ca. We welcome your feedback and any suggestions for topics that you would like us to cover in future editions. Please forward your comments by email to investmentfunds@osc.gov.on.ca, or feel free to contact us.

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Who we are

Currently, our group is:

Shaill Bahuguna	Administrative Support Clerk
Stacey Barker	Senior Accountant
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Oriole Burton	Review Officer & Administrative Assistant
Leslie Byberg	Director
Raymond Chan	Senior Accountant
Joan DeLeon	Review Officer
Lisa Duncan	Administrative Assistant
Daniela Follegot	Legal Counsel
Patricia Fuller	Administrative Assistant
Robert Gates	Legal Counsel
Rhonda Goldberg	Manager
Pei-Ching Huang	Legal Counsel
Meenu Joshi	Accountant
Ian Kearsey	Legal Counsel
Irene Lee	Legal Counsel
Tracey Leonardo	Administrative Assistant
Chantal Mainville	Senior Legal Counsel
Darren McCall	Assistant Manager
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Viraf Nania	Senior Accountant
Vera Nunes	Assistant Manager

Sarah Oseni	Senior Legal Counsel
Stephen Paglia	Legal Counsel
Violet Persaud	Review Officer
Melissa Schofield	Senior Legal Counsel
Susan Thomas	Legal Counsel
Doug Welsh	Senior Legal Counsel
Sovener Yu	Accountant

Applications for Relief

Process

We remind filers that NP 12-201 – *Mutual Reliance Review System for Exemptive Relief Applications* has been replaced by National Policy 11-203 – *Process for Exemptive Relief Applications in Multiple Jurisdictions*. Filers and their advisors should review NP 11-203 prior to filing any applications.

We would also like to remind filers that:

- It is their responsibility to provide us with a draft decision that complies with the form required by NP 11-203 at the time they file the application. Failure to do so can cause delays in processing the application.
- Commission duty panels generally meet on Tuesdays and Fridays to consider applications for exemptive relief. Generally, we must submit final materials for consideration by a duty panel the day before the duty panel convenes. We recommend that filers factor in the Commission's duty panel schedule when planning any transactions that require relief from the Commission.
- Applications for novel relief generally take more time to process. They often require, amongst other steps, significant discussions with our colleagues in the CSA. It assists our review of novel applications if the application also explains the business purpose of a particular novel structure, feature, or product.
- It is a good idea to indicate in bold on the first page of the application the date by which the filer requires the relief if it is seeking expedited treatment and the reasons why the filer is requesting expedited treatment. Filers may wish to review s. 6.2(5) of NP 11-203 regarding requests for expedited treatment.

NI 81-107 and the Conflicts Provisions

As reported in the last edition, the Commission and the Director have granted a number of decisions reissuing relief that they previously granted, but that terminated with the coming into force of NI 81-107 – *Independent Review Committee for Investment Funds*.

We continue to also see a number of novel applications for relief from the various conflicts provisions under the Act, the Regulation, and NI 81-102 – *Mutual Funds* based on IRC approval. We remind filers that the CSA deliberately chose to maintain the various conflicts provisions in the legislation and codify only limited exemptions from them in NI 81-107 rather than replace them wholesale with a fund governance agency. We encourage filers to carefully consider the basis for any novel relief from the conflicts provisions before filing an application.

The following are some requests for relief from the conflicts provisions that have been considered since the last edition.

Relief to Permit Purchases of Related Party Debt on the Secondary Market

Several filers applied for and received relief from s. 111 and s. 118(2)(a) of the Act and s. 4.1(2) of NI 81-102 to permit their mutual funds to purchase debt securities of related entities on the secondary market.¹ These filers were unable to rely upon the relief from s.118(2)(a) codified in section 6.2(2) of NI 81-107 as that exemption requires the trade to occur on an exchange. Most debt securities do not trade on an exchange. The relief was granted based on IRC approval and conditions designed to impose pricing discipline and transparency in a manner similar to trades that occur on an exchange.

Some of the filers were also dealer managed funds. Consequently, they also applied for and received relief from s. 4.1(2) of NI 81-102 for both purchases of related party debt in the secondary market and purchases of equity on an exchange.

¹ See *Altamira Investment Services Inc. et al* dated May 15, 2008 for the NI 81-102 relief and May 22, 2008 for the s. 111 and 118 relief.

Inter-fund Trades at Last Sale Price

One filer applied for and received relief to conduct inter-fund trades using the last sale price, as defined under UMIR, as opposed to current market price, as defined under NI 81-107.² We suggest that any future requests for this relief be drafted as an exemption from the relevant prohibitions in the Act as opposed to an exemption from the conditions of the exemption codified in NI 81-107.

Relief to Permit Inter-fund Trades with Pooled Funds and Managed Accounts

Some filers applied for and received relief to facilitate inter-fund trading with and between pooled funds and managed accounts.³ The inter-fund trading exemption codified under s. 6.1(4) only applies to inter-fund trades between investment funds that are subject to NI 81-107. Pooled funds that are not reporting issuers and managed accounts are not subject to NI 81-107. The relief was granted subject to similar conditions as those in s. 6.1(2) of NI 81-107.

Consistent with the exemptions codified under NI 81-107 and NI 81-102, the filers requested relief from section 118(2)(b) of the Act, section 115(6) of the Regulation, and section 4.2 of NI 81-102.

The conditions of relief include that the pooled funds must appoint an IRC and that the managed accounts must obtain the consent of the account holder.

The filers requested relief from section 4.2 of NI 81-102 for inter-fund trades in debt securities because the filers could not rely upon the exemption codified in s. 4.3(2) of NI 81-102. As with the exemption from s. 118(2)(b) and s. 115(6) codified under s. 6.1(4) of NI 81-107, the exemption under s. 4.3(2) of NI 81-102 requires the funds on both side of the trade to be subject to NI 81-107. The exemption codified under s. 4.3(1) of NI 81-102, however, remains available for inter-fund trades with pooled funds and managed accounts.

We recognize that an inter-fund trade in a non-debt security that is not exchange traded could comply with the conditions in s. 6.1(2) of NI 81-107, but not technically be able to comply with the conditions in s. 4.3(1) of NI 81-102. We will attempt to rectify this discrepancy through consequential amendments at the next available opportunity.

Relief to Permit Non-Redeemable Investment Fund to Purchase Mortgages from a Related Party

This filer applied for and received relief from s. 118(2)(b) of the Act and s. 115(6) of the Regulation.⁴ The filer requested the relief to facilitate a mortgage fund's purchase of mortgages from a related party that was pooling mortgages for the purpose of transferring them to the filer. Historically, the Commission has only granted such relief to conventional mutual funds that will be complying with National Policy 29 – *Mutual Funds Investing in Mortgages*. The relief was granted based on IRC approval and the filer satisfying staff regarding the manner in which it would value the mortgages.

Inter-fund Trades and Reorganizations

One filer applied for relief from section 118(2)(b) of the Act and section 115(6) of the Regulation in connection with a merger that was subject to NI 81-102 and IRC review. The filer applied out of concern that the trades in portfolio securities necessary to complete the merger may be inter-fund trades and the filer was not able to comply with all of the conditions of the exemption codified under s. 6.1(2) of NI 81-107. The filer also applied for the Director's approval under section 5.5 of NI 81-102.

Trades in portfolio securities effected in connection with mergers can be inter-fund trades, but we remind filers of the exemption from the mutual fund conflict of interest investment restrictions codified under section 5.9 of NI 81-102. This exemption remains available in connection with inter-fund trades effected as part of a merger or reorganization transaction that either complies with section 5.6 of NI 81-102 or that has been approved by the Director. The filer subsequently withdrew the request for relief from section 118(2)(b) and section 115(6) after realizing it could avail itself of this exemption.

Prospectuses

Process

Increasingly, filers have been adding more issuers (from 2 to 100 or more), different types of units and shares, and jurisdictions to their combined preliminary and pro forma prospectuses. This may cause delays in the processing of preliminary receipts.

² See *RBC Asset Management Inc.* dated January 18, 2008.

³ See *UBS Global Asset Management (Canada) Co.* dated April 1, 2008 and *CIBC Asset Management Inc.* dated July 8, 2008 for relief granted under the Act and *CIBC Asset Management Inc.* dated July 22, 2008 for relief granted under NI 81-102.

⁴ See *C.A.B. Realty Finance L.P.* dated February 19, 2008.

To make the filing process as smooth, efficient and accurate as possible, we suggest that filers detail in their covering letters the following:

- the issuers and their securities that need to be issued a preliminary receipt;
- the new jurisdiction(s) the filing is being added to; and
- the current names of all funds to be on the document with future or former names noted as well.

Long-term Warrant Offerings – Non Redeemable Investment Funds

A couple of filers recently filed short-form prospectuses for long-term warrant offerings. These offerings were structured as rights offerings. The warrants were not sweetener warrants offered as part of a unit offering. The warrants were issued on a stand-alone basis to existing unitholders at no charge. In each case, the warrants were exercisable for a price into underlying units for up to two years. A distinguishing feature of these offerings is the term of the warrants relative to a conventional rights offering that normally has a much more limited exercise period and closes in a relatively short period of time.

We remind filers of the requirement contained in s. 4.2(a) of NI 45-101 – *Rights Offerings*. This provision requires that the prospectus qualify the underlying securities that the warrants can be exercised into in addition to the warrants themselves. One of the policy reasons for this requirement is to ensure that investors receive the appropriate statutory rights in connection with the securities underlying the warrants.

Practically, this requirement will generally result in the filer having to keep their prospectus live for the duration of the exercise period of the long-term warrants and provide a second delivery of the prospectus at the time the long-term warrant is exercised. Filers contemplating long-term warrant offerings may wish to review the disclosure provided in the short-form prospectus filed by First Capital Realty Inc. dated March 8, 2002 under Sedar Project No. 424349. Filers may also wish to review the discussion of long-term warrants contained in paragraph 5 of OSC Staff Notice 51-706 – *Corporate Finance Report* for the year 2004.

National Instrument 81-105 – Payment of Trailing Commissions

We have periodically seen filers disclose that dealers will be paid a trailing commission based on a percentage of the performance fee received by the portfolio manager. We have consistently raised comments expressing concern whether a trailing commission calculated in this manner complies with section 3.2(1)(d)(ii) of National Instrument 81-105 – *Sales Practices*. Filers have generally responded by removing the feature from their prospectus filings.

Form 41-101F2 – Forms Compliance Reviews

National Instrument 41-101 – *General Prospectus Requirements* came into force March 17, 2008. This rule includes a new form for investment funds that must file a long-form prospectus. We have been raising comments on long-form prospectuses where it appears that the disclosure does not comply with the new form requirements. We encourage filers to review the new form requirements before filing their preliminary long-form prospectuses.

Part 14 of NI 41-101 – Custodian Requirements

We have raised comments in several instances regarding Part 14 of NI 41-101. Part 14 requires investment funds that use Form 41-101F2 to have a qualified custodian. Prior to the coming into force of NI 41-101, investment fund issuers that were not subject to NI 81-102 were not required to have a custodian. We remind all long form investment fund issuers that Part 14 of NI 41-101 imposes a new custodian requirement.

Continuous Disclosure

Publication of Recent Amendments

As a follow-up to previous editions that reported on the exemption the Director granted under NI 81-106 in connection with section 3855 of the CICA Handbook, the amendments to National Instrument 81-106 – *Investment Fund Continuous Disclosure* were published in the OSC Bulletin on June 20, 2008. These amendments came into force on September 8, 2008.

Publication of CSA Staff Notice 52-320

The CSA issued CSA Staff Notice 52-320 – *Disclosure of Expected Changes in Accounting Policies Relating to Changeover to International Financial Reporting Standards* on May 9, 2008, which was published in the May 9, 2008 OSC Bulletin. This was in response to the Canadian Accounting Standards Board confirmation that January 1, 2011 will be the date on which International

Financial Reporting Standards (IFRS) will replace current Canadian standards and interpretations as Canadian Generally Accepted Accounting Principles (Canadian GAAP).

The Notice discusses the disclosure of relevant information about the changeover to IFRS, including, but not limited to, the key elements and timing of the changeover plan in the annual and interim filings three, two, and one year(s) before the changeover. Filers may wish to review the Notice when preparing their MRFP or notes to their financial statements for as early as the interim period to June 30, 2008.

Public Inquiries

NI 81-107 – Inter-fund Trades – Market Integrity Requirements for Non-Exchange Traded Securities

Sub-paragraph 6.1(1)(b)(iii) of NI 81-107 defines market integrity requirements in that context as: "...the purchase or sale is through a dealer, *if* the purchase or sale is required to be reported by a registered dealer under applicable securities legislation". We have received several inquiries regarding the applicability of the market integrity requirement to inter-fund trades in debt or other securities that do not trade on an exchange. The inquiries have generally focused on what applicable securities legislation is sub-paragraph 6.1(1)(b)(iii) referring to and how should that provision be read together with the exemptions codified in subsections 6.1(3) and 6.1(5).

Sub-paragraph 6.1(1)(b)(iii) is intended to refer to the dealer reporting obligations for non-exchange traded securities found in s. 154 of the Regulation in Ontario and Part 8 of National Instrument 21-101 – *Marketplace Operation*.

The overall intent of the requirement in this context is for these inter-fund trades to be reported in the same manner that a dealer would be required to report them if a dealer were conducting the trade. If a dealer would not be required under applicable securities legislation to report the trade, there is no reporting requirement in connection with the inter-fund trade.