

1.1.2 The Investment Funds Practitioner – November 2013

OSC

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 arising from applications for discretionary relief, prospectuses, and continuous disclosure documents that investment funds file with the OSC. It is intended to assist 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 Practitioner is also intended 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.

The information contained in the Practitioner is based on particular factual circumstances. Outcomes may differ as facts change or as regulatory approaches evolve. We will continue to assess each case on its own merits.

The Practitioner has been prepared by staff of the Investment Funds Branch and the views it expresses do not necessarily reflect the views of the Commission or the Canadian Securities Administrators.

Request for Feedback

This is the tenth edition of the Practitioner. Previous editions of the Practitioner are available on the OSC website www.osc.gov.on.ca under Investment Funds – Related Information.¹ 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.

Prospectuses

Prospectus Review Priorities

For full reviews of prospectus filings, staff are currently focusing on three topic areas:

- fees and expenses;
- investment objectives and strategies; and
- conflicts of interest.

Staff's focus on disclosure concerning fees and expenses, investment objectives and strategies, and conflicts of interest in prospectus reviews is intended to achieve the following objectives:

- encourage more consistent disclosure by investment funds to enhance comparability of the three noted themes;
- promote the disclosure of all relevant information to investors in a clear, understandable and accurate manner and challenge "boiler plate disclosure"; and
- provide more focused comments to filers on issues of particular importance to investors to assist them in making more informed investment decisions.

Staff will consider, among other things, the scope of the following disclosure in the prospectus:

Fees and Expenses:

- a summary of all applicable fees and expenses;

¹ At http://www.osc.gov.on.ca/en/About_if_index.htm or http://www.osc.gov.on.ca/en/InvestmentFunds_index.htm

- explanations of fees and expenses that are in plain language and clear so that investors can understand what each fee is for and what services or activities the fee covers; and
- sufficient clarity for investors and staff to determine that there is no duplication of fees and expenses and whether the overall cost of the fund is comparable to similar investment funds and not contrary to the public interest.

Investment Objectives and Strategies:

- investment objectives and strategies of the fund that provide meaningful information to investors, namely, a clear and accurate picture of the fund and the asset classes the fund will invest in;
- identification of all material risks associated with the fund's objectives and strategies; and
- sufficient differentiation in the disclosure to assist investors in distinguishing between multiple funds within a prospectus or fund family and understanding the difference between funds that appear similar in name and/or investment strategies.

Conflicts of Interest:

- identification of all related parties associated with the operation of the fund;
- information regarding the fund manager's controls, policies and procedures, to address and mitigate all conflicts of interest; and
- confirmation that applicable conflicts of interest will be referred to the fund's Independent Review Committee (IRC).

We remind investment fund issuers and their advisers that staff's increased focus on these areas in our prospectus reviews does not take away from the issuer's responsibility to comply with all applicable securities legislation, policies and practices. Staff will continue to raise general comments in the course of a prospectus review as appropriate.

Use of the Term "Guarantee"

Although not common, there are some investment funds that offer a form of "guarantee" if the securities are held for a particular period of time. We remind filers that if a fund offers a guarantee, the disclosure in the prospectus and in the Fund Facts should enable investors to fully understand the unique characteristics of the fund, the fund's investment objectives, the fund's suitability for investors and, in particular, the nature of the "guarantee" and the consequences of an investor redeeming units early or an early termination of the fund. Specifically, Item 6(4) of Part B of Form 81-101F1 *Contents of Simplified Prospectus* sets out the required prospectus disclosure for funds offering a form of a guarantee, which includes identifying the person or company providing the guarantee. If the guarantee relates to distributions, and such distributions may consist primarily of returns of the investor's capital, then the distributions should not be described as "yield", "income" or "returns" of the fund. If early termination of the guarantee is a possibility, staff expect IRC approval and securityholder approval to be obtained prior to termination.

Principal Holders of Securities

Item 11.1 of Form 81-101F2 *Contents of Annual Information Form* (Form 81-101F2) requires specific disclosure on ownership interests in a mutual fund or its manager by principal securityholders.

We have recently seen simplified prospectuses where issuers have identified in the annual information form companies that are principal holders of the fund as "Investor A", "Investor B", etc. We note that staff's position to allow principal holders of the mutual funds in a prospectus to be referred to as Investor A, B or C, was historically restricted to the identification of individuals, not companies. This was also due to filer concerns about the privacy of the names of such individuals.

To date, staff have not accepted that the privacy concerns raised with respect to individuals apply equally to companies. Accordingly, we remind investment fund issuers and their counsel that, absent exemptive relief, the names of companies that are principal holders of a fund must be disclosed in the annual information form of the simplified prospectus in order to comply with the requirements of Item 11.1 of Form 81-101F2. Staff's view is that identifiers, such as Investor A, B, or C, used to identify securityholders across funds in the same prospectus should be used to reference individuals only.

Further, information on principal holders should be included in the prospectus prior to staff clearing the prospectus for final, not on the filing of the final version of the prospectus.

Marketing Materials for Scholarship Plans

Staff are aware that scholarship plan providers typically prepare advertising brochures and other marketing materials to promote their plans to investors. These materials are often used by scholarship plan sales representatives in their interactions with existing or potential subscribers to a plan.

We recently reviewed an advertising document used by a scholarship plan provider which summarized key information about the scholarship plans. Staff's concern, however, was that the presentation of the document resembled the Fund Facts document used by conventional mutual funds and included similar content, such as a risk rating and information on fees, to summarize key facts about the scholarship plans. We reminded the plan provider that the scholarship plan prospectus, comprised of the Plan Summary document and the Detailed Plan Disclosure, is intended to be the primary source of information for investors regarding a scholarship plan. Specifically, we highlighted that the Plan Summary is intended to summarize the key benefits, risks and costs associated with investing in a scholarship plan.

Staff's view is that scholarship plan providers should ensure that their sales representatives become familiar with all aspects of the new prospectus form for scholarship plans, Form 41-101F3 *Information Required in a Scholarship Plan Prospectus* (Form 41-101F3), which came into force on May 31, 2013. Form 41-101F3 includes both the Plan Summary and the Detailed Plan Disclosure which collectively comprise the prospectus.

Advertising and marketing materials intended to promote the scholarship plan or for use by sales representatives should not contain information about a scholarship plan that is not otherwise provided in a publicly filed document, such as the prospectus or any continuous disclosure document. Staff will continue to review advertising and marketing materials in the context of prospectus reviews concerning scholarship plans.

Recirculation Agreements

In our reviews of closed-end fund prospectuses, staff have begun to examine disclosure regarding recirculation agreements. Generally, this disclosure states that the fund may, or will, enter into a recirculation agreement with a recirculation agent whereby the recirculation agent will agree to use commercially reasonable efforts to find purchasers for any securities tendered for redemption (the Tendered Securities) during a specified period. The tendering securityholder then receives payment for his or her Tendered Securities from the proceeds of the sale of those securities by the recirculation agent.

Where the proceeds of the sale of the Tendered Securities by the recirculation agent are less than the amount that would have been payable to the securityholder if his or her securities had been redeemed (the Redemption Amount), the fund may cover the shortfall by paying to such securityholder an amount equal to the difference between the Redemption Amount and the proceeds from the sale of the Tendered Securities by the recirculation agent.

Staff are concerned that in the situation described, the fund's remaining securityholders suffer dilution of the value of their securities. In one recent prospectus filing, staff's concerns were addressed by the inclusion of a requirement that the proceeds of the sale of Tendered Securities by the recirculation agent must be equal to or exceed the Redemption Amount.²

Issuers and their counsel are encouraged to contact staff should questions arise regarding recirculation agreements.

Continuous Disclosure

Risk Ratings Review of Fund Facts

Staff recently conducted targeted continuous disclosure reviews of risk ratings of mutual funds disclosed in the Fund Facts. Staff have conducted similar reviews in the past and continue to monitor the risk ratings of mutual funds.

As part of the review, staff focused on mutual funds in the same fund family that had both a currency hedged fund and an unhedged fund that provided exposure to the same underlying fund or portfolio. Staff noted that fund managers tend to rate both the currency hedged fund and the unhedged fund with the same risk rating, even though volatility of past returns varied significantly between the two funds.

It is staff's view that the risk ratings for currency hedged funds should be determined separate and apart from their unhedged counterparts, with due consideration given to the fund's own volatility rather than the volatility of the corresponding unhedged fund.

² See the prospectus of *Canso Select Opportunities Fund* dated September 25, 2013.

We remind filers that we would generally consider any changes to a mutual fund's risk level to be a material change under securities legislation, since it may be an important factor in an investor's determination whether to purchase or continue holding securities of a mutual fund.

International Financial Reporting Standards

The Canadian Securities Administrators (CSA) completed the final step in the transition to International Financial Reporting Standards (IFRS) for investment funds with the publication of final amendments to National Instrument 81-106 *Investment Fund Continuous Disclosure*, its Companion Policy and related amendments on October 3, 2013. Investment funds must apply the changes for financial years beginning on or after January 1, 2014.

The final amendments reflect comments received on the 2009 proposal, additional stakeholder consultations and further developments of the International Accounting Standards Board related to investment funds. The changes impact investment fund requirements relating to the presentation of financial statements and terminology to reflect the transition to IFRS.

Fund Facts

Blacklined Fund Facts

As required by subsection 2.3(3) of National Instrument 81-101 *Mutual Fund Continuous Disclosure*, mutual funds file blacklines of Fund Facts with their pro forma prospectus filings.

We remind filers that blacklines of Fund Facts filed for review must be blacklined to show changes, including the text of deletions and additions, from the latest Fund Facts previously filed. All changes must be shown and the changes must be clearly shown in a readable format, e.g., deleted text can be shown with strikethrough formatting. Changes made to the previously filed Fund Facts should not be shown by way of comment bubbles. Side-by-side comparisons of the current Fund Facts and the previously filed Fund Facts are not considered to be blacklines and are not acceptable. Word documents listing the changes made to the previously filed Fund Facts, in text or in table format, are also not acceptable.

Recent Decision

In the Matter of Crown Hill Capital Corporation and Wayne Lawrence Pushka

We note the recent issuance of the Commission's decision concerning *In the Matter of Crown Hill Capital Corporation and Wayne Lawrence Pushka* on August 23, 2013. The decision sets out the Commission's views on the statutory duty of care of fund managers under section 116 of the *Securities Act* (Ontario) and the role of IRCs generally.

The decision can be found on the OSC website.³

³ At <http://www.osc.gov.on.ca/en/41599.htm>