

1.1.4 The Investment Funds Practitioner – March 2018 – Issue #20

OSC

THE INVESTMENT FUNDS PRACTITIONER

From the Investment Funds and Structured Products 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 and Structured Products 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 20th edition of the Practitioner. Previous editions of the Practitioner are available on the OSC website [www.osc.gov.on.ca](http://www.osc.gov.on.ca) under *Investment Funds & Structured Products* on the *Industry* tab. 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](mailto:investmentfunds@osc.gov.on.ca).

**ANNOUNCEMENTS**

**Registered Firms and Cryptocurrencies**

Canadian Securities Administrators (CSA) Staff Notice 46-307 *Cryptocurrency Offerings* (CSA Staff Notice 46-307) was published on August 24, 2017 and included guidance on cryptocurrency offerings, including the sale of securities of cryptocurrency investment funds.

For registered firms that plan to establish, manage, advise and/or trade in securities of investment funds with holdings of bitcoin and/or other cryptocurrencies, cryptocurrency assets and coins and token offerings, such firms are required to report changes in their business activities by completing and filing Form 33-109F5 *Change of Registration Information* (Form F5) and updating information previously reported in Form 33-109F6 *Firm Registration* to include cryptocurrency products and/or services.

Staff will review the information provided in the Form F5 and analyze the proposed product or services. The OSC may impose terms and conditions on the firm's registration to ensure adequate investor protection. For example, terms and conditions have been imposed on firms that have proposed to establish, manage or advise cryptocurrency investment funds to ensure the firm's compliance with securities law requirements such as custody requirements.

In addition, firms that establish, manage or advise in securities of a cryptocurrency investment fund in the exempt market are reminded of the custodial requirements under part 14.5.2 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103), which become effective June 4, 2018.

For more information on the Form F5 requirement, please contact the OSC's inquiries line by calling 1-877-785-1555 or 416-593-8314 or e-mailing [inquiries@osc.gov.on.ca](mailto:inquiries@osc.gov.on.ca).

Businesses that wish to learn more about their obligations under securities laws with respect to cryptocurrency investment funds may refer to the guidance in CSA Staff Notice 46-307 and/or contact the OSC LaunchPad team for direct support at [osclaunchpad@osc.gov.on.ca](mailto:osclaunchpad@osc.gov.on.ca).

## REPORTS

### Transition to the Harmonized Report of Exempt Distribution

The new harmonized report of exempt distribution that came into force on June 30, 2016 in all CSA jurisdictions (the New Report) prescribed additional disclosure requirements for investment fund issuers. The annual filing deadline for investment fund issuers also changed from financial year-end to calendar year-end.

We remind all annual filers reporting distributions that occurred on or after January 1, 2017, that they are required to use the New Report and file their New Report for 2017 distributions pursuant to the prescribed transitional periods with the introduction of the New Report for investment fund issuers.

As a reminder, the Schedule 1 (Confidential Purchaser Information) to the New Report must be filed using the prescribed Excel template in an acceptable format to the securities regulatory authority. A link to the Schedule 1 can be found in Item 7 of the New Report on the OSC's electronic filing portal.

For further guidance and information on the New Report and transitional provisions, please refer to Annex 4 (Table 2: Transition Period for Investment Fund Issuers that Report Annually) of CSA Staff Notice 45-308 (Revised) *Guidance for Preparing and Filing Reports of Exempt Distribution* ([http://www.osc.gov.on.ca/en/SecuritiesLaw\\_csa\\_20160407\\_45-308\\_revised-guide-exempt-distribution.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20160407_45-308_revised-guide-exempt-distribution.htm)).

## APPLICATIONS

### Reorganizations of Corporate Class Mutual Funds

Staff have received inquiries regarding reorganizations of a multi-class mutual fund corporation into multiple mutual fund trusts. Our understanding is that fund managers are evaluating these reorganizations because of the elimination of the ability to switch tax-free between investment funds held in the same mutual fund corporation. While some reorganizations may meet all the criteria for pre-approval in section 5.6(1) of National Instrument 81-102 *Investment Funds* (NI 81-102), fund managers that determine that they require regulatory approval for their reorganizations under s.5.5(1)(b) of NI 81-102 are encouraged to file applications for such approval in a timely manner to avoid potential delays in implementing their reorganizations.

## STRUCTURED PRODUCTS

### New SEDAR Document Types for Prospectus Supplements

We remind filers that SEDAR has been updated to add new document types to facilitate the filing of the various types of prospectus supplements to a base shelf prospectus, along with the related filing fee.

Separate document types have been added for the following prospectus supplements:

- Prospectus (non-pricing) supplement
  - to be used in connection with the filing of a prospectus supplement using shelf procedures as set out in National Instrument 44-102 *Shelf Distributions* (NI 44-102)
- Non-offering prospectus product supplement
  - to be used in connection with, for example, initiating the offering of specified derivatives or asset-backed securities or an at-the-market distribution
- Pricing supplement (other than specified derivative)
  - to be used in connection with the filing of a pricing supplement using shelf procedures as set out in NI 44-102
- Pricing supplement (specified derivative)
  - to be used in connection with the offering of specified derivatives or asset-backed securities
- Novel (per NI 44-102) pricing supplement
  - to be used in connection with the filing of a pricing supplement for a specified derivative or asset-backed security that requires pre-clearance under section 4.1 of NI 44-102

New document types for amendments to each of the above prospectus supplements, except for novel pricing supplements, have also been added. Please use the applicable amendment document type for amended and restated filings, as well as any re-filings.

## PROCESS MATTERS

### Standards for Prospectuses and Exemptive Relief Applications

In the course of our review of prospectuses and applications for exemptive relief, staff have noticed repeat occurrences of filings that contain material deficiencies. Staff are concerned that materially deficient filings have the potential to negatively impact our ability to process filings, which in turn, could result in unnecessary backlogs and delays. This can be particularly problematic in circumstances where filings involve time-sensitive transactions or regulatory deadlines (e.g., prospectus lapse date).

We remind filers and their counsel that staff cannot provide legal or other advice. Accordingly, staff should not be expected to conduct legal analysis on the filer's behalf. In addition, our review and comment process should not be relied upon to identify and correct material deficiencies in a filing.

To ensure prompt and fair consideration of all filings, we ask that filers and their counsel take due care in the preparation and review of all materials prior to filing. In circumstances where staff have identified a materially deficient filing, staff will not proceed with the review and will instead ask the filer to submit an amended filing or to withdraw the filing, and in the case of a materially deficient preliminary prospectus filing, staff may ask the filer to file an amended and restated preliminary prospectus. In such cases, the review and comment process will restart from the date of the amended filing. We remind filers that the OSC's service standard and timelines for reviews (see [http://www.osc.gov.on.ca/en/About\\_service-standards\\_index.htm](http://www.osc.gov.on.ca/en/About_service-standards_index.htm)) apply when a complete filing is made. Generally, staff's review of an amended filing will not be abridged as staff do not consider an amended filing to be a compelling reason for requesting an abridgement.

A deficient prospectus filing will not only delay staff's review of the prospectus, it may also indicate that the investment fund manager does not have adequate systems in place for operating the funds it manages in compliance with securities legislation in accordance with applicable requirements of section 11.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

### *Prospectus Filings*

Some examples of common material deficiencies in prospectus filings include:

- failure to comply with applicable form requirements, including outdated disclosure, and
- significant inconsistencies within or between disclosure documents, for example, mismatched fee or risk rating disclosure either within or between a prospectus, Fund Facts or ETF Facts.

We remind you that, pursuant to subsection 61(2)(a)(i) of the *Securities Act* (Ontario) (the Act), the Director shall not issue a receipt for a prospectus where it appears that the document does not comply in any substantial respect with the requirements of the Act or the regulations.

### *Exemptive Relief Applications*

Some examples of common material deficiencies in exemptive relief applications include:

- failure to identify the relevant or correct provisions from which an exemption is sought,
- failure to provide an explanation of what specific facts trigger the application of the provision from which an exemption is sought,
- failure to provide an explanation of why exemptive relief is necessary,
- failure to provide submissions that support a recommendation in favour of the exemption sought, and
- failure to identify applicable prior decisions or to appropriately distinguish from applicable prior decisions.

Please refer to the article, "*Materials to be Filed with Exemptive Relief Applications*" in the September 2016 edition of the *Investment Funds Practitioner* newsletter for a discussion of the materials to be filed with exemptive relief applications.

## Reviews of Prospectus Amendments

Staff have observed an increase in prospectus amendments that fundamentally change the name, nature, type of securities offered and features of an existing fund. For example, in certain cases involving conventional mutual funds, these types of amendments require amending a substantial portion of the disclosure required under Part B of Form 81-101F1 *Contents of a Simplified Prospectus*.

In connection with these types of amendments, filers should consider filing an amended and restated prospectus. Where a substantial portion of the disclosure is being amended, staff may ask filers to file an amended and restated prospectus.

As the review of such an amendment or amended and restated prospectus requires more time for staff to complete than a standard amendment, we will follow the same service standard and timeline that is applicable to reviews of preliminary prospectuses in these cases (see [http://www.osc.gov.on.ca/en/About\\_service-standards\\_index.htm](http://www.osc.gov.on.ca/en/About_service-standards_index.htm)).

## Compliance with Conditions of Exemptive Relief Decisions

Filers who have obtained exemptive relief relevant to investment funds they manage or advise, are reminded that they are required to comply with the terms and conditions of such decisions in order to rely on the relief granted. Exemptive relief may have been granted on conditions that require, for example, certain reporting, record-keeping, certification and investment restrictions that supported the policy rationale for granting the relief.

Filers cannot rely on exemptive relief if they do not comply with the conditions of such relief. Accordingly, filers are encouraged to regularly review their exemptive relief decisions to ensure that any obligations arising from the conditions of exemptive relief decisions are built into their compliance systems.

## Reminder of Mandatory Electronic Delivery of Documents

Filers are reminded that OSC Rule 11-501 *Electronic Delivery of Documents to the Ontario Securities Commission* (Rule 11-501) came into force on February 19, 2014 and requires all market participants to electronically file a number of documents that were previously filed in paper format with the OSC through the OSC's electronic filing portal page. Staff are still receiving some regulatory documents in paper format (for example, s. 2.11(c) notices under National Instrument 81-106 *Investment Fund Continuous Disclosure* and s. 3.10(4) notices under National Instrument 81-107 *Independent Review Committee for Investment Funds*), and we remind filers that such documents are required to be filed pursuant to Rule 11-501 through the OSC portal.

For more information, please refer to Rule 11-501 and the OSC's electronic filing portal page.

## PUBLIC INQUIRIES

### Update on Rehypothecation of Collateral for OTC Derivatives

In the April 2015 *Investment Funds Practitioner*, staff published guidance in which we stated our view that rehypothecation of collateral deposited by an investment fund with a counterparty in respect of a specified derivatives transaction is generally not permitted under of NI 81-102, including the basis for this view.<sup>1</sup> This remains the only public guidance staff have provided on this issue.

Since that time, we have continued to receive inquiries about this issue and have in some cases been asked to offer our views with regards to very specific scenarios that may or not be directly referenced in the derivatives custodial provisions in section 6.8 of NI 81-102. This has led to further questions concerning staff's position on application of the custody provisions in that section.

In this context, we confirm that staff's position regarding rehypothecation of collateral posted for specified derivatives transactions under section 6.8 of NI 81-102 remains unchanged from the guidance published in the April 2015 *Investment Funds Practitioner*. We remind fund managers to be mindful of staff's position when negotiating any supporting documentation for OTC derivatives transactions, such as an ISDA or other agreements, to ensure that those agreements make it clear that any collateral deposited by the investment fund is not to be used for any purpose other than the purpose for which it was originally pledged to the counterparty – that is, the completion of the particular specified derivatives transaction.

We would add that, to the extent a fund manager or counterparty believes that there may be a scenario in which such a restriction is unnecessary or inappropriate, the best avenue for exploring that view would be the exemptive relief process, through which staff would have the ability to consider a response to specific fact patterns and representations.

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<sup>1</sup> See the article titled "Rehypothecation of Collateral for OTC Derivatives" in the April 2015 edition of *The Investment Funds Practitioner*.

## CONTACT INFORMATION

Issuers and their counsel are encouraged to direct their inquiries to the appropriate branch manager.

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