Investment Funds Practitioner Archive

As of February 2021

IFSP Branch staff have reviewed articles from past editions of the Practitioner and removed articles that are no longer relevant. This document only includes past articles from the Practitioner that are still relevant.

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APPLICATIONS FOR RELIEF

Disclosing Tax Consequences of Fundamental Changes

17th edition, September 2016

Certain proposed fundamental changes to an investment fund, such as a proposed merger of funds or a proposed change in the investment objectives of a fund, may have tax consequences for the funds involved and their investors. In recent reviews, staff have raised questions about the adequacy of the disclosure of these potential tax consequences in the related information circular.

In staff's view, managers are in the best position to analyze and provide information as to the overall tax impact of a proposed change on the fund and investors in the fund. We appreciate that the manager's analysis is based on prevailing conditions and may change as conditions change. However, in staff's view, the potential for changing conditions may be addressed in the disclosure and does not preclude providing meaningful disclosure about the various potential tax consequences of the proposed change for the various types of investors in the fund.

To inform the investor's decision on the proposed change and avoid misleading investors, staff's view is that the disclosure in the information circular should provide a balanced discussion of the potential tax consequences of the change. For example, some fund mergers are effected on a "tax-deferred" rollover basis, but only after a portion of the terminating fund's portfolio has been liquidated before the merger. In circumstances where this pre-merger liquidation is expected to result in distributions for taxable investors, staff's view is that the information circular could mislead investors if it describes the merger as tax-deferred without also disclosing the expected tax consequences of the pre-merger liquidation, i.e. distributions for taxable investors.

Staff note that section 5.6 of NI 81-102 requires that the materials sent to investors in connection with a proposed merger include a circular that describes, amongst other things, the income tax considerations for the funds participating in the transaction and their investors. However, other types of fundamental changes may result in tax consequences for investors as well. For example, a proposed change in investment objectives could involve liquidations of portfolio securities expected to result in distributions for taxable investors. Staff view tax consequences arising from a fundamental change to be relevant information for investors. As such, our view is that the circular provided to investors in connection with a fundamental change should describe the income tax considerations for the funds participating in the transaction and provide sufficient detail to enable reasonable investors to make an informed decision.

Staff also expect that, when referring a proposed fundamental change to the IRC for its approval or recommendation, the investment fund manager would provide the IRC with the manager's analysis of the expected overall tax impact of the change on the fund and investors in the fund, so that the IRC may consider whether the proposed fundamental change, in its entirety, meets the standard for IRC approval or recommendation as set out in subsection 5.2(2) or subparagraph 5.3(1)(a) of National Instrument 81-107 *Independent Review Committee for Investment Funds,* as appropriate.

Fund on Fund Relief and the Conflicts Provisions

4th edition, January 2010

The Director sometimes grants relief under NI 81-102 to facilitate fund on fund arrangements that do not comply with all of the conditions in section 2.5(2) of NI 81-102. Such applications are sometimes accompanied by a parallel application for relief from the conflicts of interest prohibitions under the Act. This second application is normally filed out of concern that the exemption codified under section 2.5(7) of NI 81-102 may not apply in instances where the fund on fund arrangement is exempt from some of the conditions in section 2.5(2). We generally do not request that applicants file the parallel Act application. We intend to amend section 2.5(7) at the next available opportunity to clarify that it still applies even where a fund has obtained an exemption from some of the conditions in section 2.5(2).

Sub-Adviser Conflicts of Interest

8th edition, November 2012

We recently received an application for relief from subsection 4.1(1) of NI 81-102 to allow mutual funds to invest in a private placement underwritten by an underwriter that is related to the funds' portfolio sub-adviser. Both the sub-adviser and the underwriter are not related to the funds' investment fund manager who also acts as the portfolio adviser. As subsection 4.1(1) of NI 81-102 applies only to dealer managers which are defined in NI 81-102 as portfolio advisers, staff's position is that on a technical reading of subsection 4.1(1) of NI 81-102, the funds' investments in securities underwritten by an underwriter related to a sub-adviser are not prohibited and exemptive relief is not required.

While staff are of the view that subsection 4.1(1) of NI 81-102 is not triggered, the fact that a sub-adviser and an underwriter are related does raise a conflict of interest pursuant to NI 81-107. Such a conflict of interest is contemplated in item 4 in the commentary to section 1.2 of NI 81-107 and in item 1 in the commentary to section 1.3 of NI 81-107. Staff expect the manager of the funds to refer this conflict of interest matter to the funds' Independent Review Committee.

Sub-Adviser Conflicts of Interest

6th edition, December 2011

Recently, we have received a few novel applications in which filers have requested interfund trading or principal trading relief on behalf of both the filer, as portfolio manager, and on behalf of third party subadvisers to the filer's funds. Prior to NI 31-103, we did not receive applications for similar relief specifically from subadvisers.

Where the filer for exemptive relief is the manager and portfolio manager, our view is that separate relief is not needed on behalf of the subadviser as long as the subadviser operates on the same conditions applicable to the lead portfolio manager pursuant to any conflict relief granted specifically to the lead portfolio manager.

NI 81-107 imposes the obligation on a fund manager to identify conflict of interest matters and to refer them to the Independent Review Committee (IRC) of the manager's funds. Since the implementation of NI 81-107, staff's view has been that a fund manager should have in place policies and procedures to identify, monitor, and to address conflicts at the subadviser level. To the extent such matters raise a conflict of interest under section 1.2 of NI 81-107, the manager is responsible for referring such conflicts to the IRC of the funds.

CONTINUOUS DISCLOSURE

Awards in Sales Communications

15th edition, July 2015

As part of staff's ongoing continuous disclosure review of sales communications, we have reviewed selected investment fund managers (IFMs) with advertising and marketing materials that reference various industry awards. It is staff's view that awards are, in substance, performance based ratings, and that sales communications that contain references to such ratings or rankings should comply with the requirements set out in National Instrument 81-102 *Investment Funds* (NI 81-102).[1] Based on staff's review of the criteria and methodology applied to the selection of award winners, while the quantitative considerations are performance based, criteria generally also includes a subjective component.

The sales communication requirements for mutual funds in Part 15 of NI 81-102 do not permit the use of a performance rating or ranking of a mutual fund that is based partially on a subjective component. NI 81-102 permits the use of a performance rating or ranking in a sales communication where it meets certain requirements, including the requirement that the performance rating or ranking be prepared by a mutual fund rating entity. While other methodologies employed may fall within the definition of "mutual fund rating entity", in staff's view, given the subjective component of industry awards generally, these awards are typically not a rating or ranking permitted to be used in a sales communication for a mutual fund.

While staff note that the references to industry awards in sales communications appear to be a wide-spread practice among mutual funds and exchange-traded funds in the marketplace, staff's view is that this practice should be discontinued. Staff recognize the importance of sales communications and strongly encourage IFMs and their counsel to contact staff regarding sales communications that may give rise to questions concerning this issue.

Portfolio Disclosure of Cash

11th edition, March 2014

We received an inquiry as to the appropriate disclosure of cash and money market funds in the management report of fund performance (MRFP), Fund Facts, and quarterly portfolio disclosure. In staff's view, cash is a portfolio holding and must be included in a summary of investment portfolio in order to provide the reader with a complete understanding of the portfolio, especially if the level of cash held is significant.

The summary of investment portfolio in the MRFP is comprised of a listing of the top 25 positions and a portfolio breakdown into subgroups. In the top 25, staff expect cash and cash equivalents to be disclosed on a line separate from an investment in a money market fund. Cash, cash equivalents and money market funds cannot be treated interchangeably because

[1] Subsection 15.3(4) of NI 81-102.

money market funds, as defined in securities legislation,[2] have the ability to invest in short-term debt in addition to cash and cash equivalents. Additionally, presenting a money market fund as a separate holding is consistent with how we expect any investment in another mutual fund to appear in the top 25. In the portfolio breakdown, however, holdings in money market funds can be grouped with cash and cash equivalents into one category. Staff hold this view because the summary nature of the portfolio breakdown allows for flexibility to group money market funds, cash and cash equivalents together.

In the Fund Facts, the same treatment should be applied in the top 10 investments, separating cash and cash equivalents from money market funds. We remind investment funds of the instruction in the Fund Facts form to use subgroups in the investment mix that are consistent with the fund's MRFP disclosure.

The top 25 holdings in the quarterly portfolio disclosure should be exactly the same as the fund's MRFP disclosure because of the requirement to prepare the quarterly portfolio disclosure in accordance with MRFP requirements.

Portfolio Disclosure Practices of Exchange-Traded Funds

18th edition, December 2016

Staff have recently reviewed the practices of managers of exchange-traded mutual funds (ETFs) for disclosing the portfolio holdings of their ETFs. We have focused our review on instances where ETF managers disclose the daily portfolio holdings of their ETFs to authorized dealers, but not to the public.

Authorized dealers play a critical role in an ETF's liquidity. They are dealers who have entered into agreements with ETF managers that give them the ability to subscribe for securities in large blocks from the ETF at the net asset value per security calculated at the end of the day. Knowledge of the portfolio holdings of an ETF enables authorized dealers to assess whether there is a discrepancy between the market price of the ETF's securities and the underlying market value of the ETF's portfolio holdings (the underlying value) and to determine hedges for their positions. Where there is a divergence in these two values, authorized dealers carry out arbitrage trades that bring the market price of the ETF's securities closer to the ETF's underlying value. While investors who are not authorized dealers cannot engage in arbitrage trades with precise portfolio knowledge and the ability to transact directly with the ETF, the arbitrage activities generally help the ETF's securities to trade close to their underlying value with narrower bid-ask spreads.

Staff questioned whether disclosing an ETF's daily portfolio holdings to authorized dealers without concurrently disclosing the same information to the public creates a material information asymmetry between the authorized dealers and other investors, particularly retail investors. We focused on whether the information advantage that authorized dealers possess may make it possible for them to engage in unfair trading against other investors that is not consistent with market making activities to provide liquidity. As part of our review, we met with ETF managers, the Investment Industry Regulatory Organization of Canada (IIROC), the Toronto Stock Exchange, and other market participants to discuss our concerns and to better understand ETF portfolio disclosure practices and their impact.

[2] Item 1.1 of National Instrument 81-102 *Mutual Funds*.

We found that most ETF managers are disclosing portfolio holdings to the public daily and that the issue of asymmetric information is confined to a comparatively small segment of ETFs that are actively managed, where the ETF managers consider portfolio holdings to be proprietary.[3] This segment is, by our estimate, approximately 3% of the ETF market, comprising $3.5 billion in assets as of June 2016.

ETF managers submitted that entering into agreements with multiple authorized dealers for an ETF reduces the possibility of an authorized dealer unfairly benefitting from the portfolio holdings information, because competition for trades among the authorized dealers will narrow the quoted spread on the ETF's securities and bring the market price of the ETF's securities in line with their underlying value. We also heard submissions that ETF portfolio holdings information may be of limited use for retail investors, who are more concerned with the identity of the portfolio manager and the investment objectives, strategies and performance of the ETF.

Staff had extensive discussions with IIROC about the risks that may arise from the authorized dealers' possession of the portfolio holdings information of actively managed ETFs. IIROC currently conducts market surveillance and trading reviews of trades of all securities, including ETF securities. We understand that IIROC, as part of its Trading Conduct Compliance (TCC) reviews, will examine the appropriateness of supervisory controls an authorized dealer has implemented to monitor the use of portfolio holdings information.

Based on our review and discussions to date, we believe that access to actively managed ETFs affords additional choices to investors, and that any risks from asymmetric information can be limited by IIROC's oversight through its TCC reviews. Staff, along with IIROC, will continue to monitor these practices and other developments in the industry, including the introduction of platform trading for mutual funds by various exchanges, which may offer a new avenue for managers of actively managed ETFs to offer their products without the need to disclose daily portfolio holdings to authorized dealers. If the product landscape changes and we find any harm to investors or the public interest as a result of the current portfolio disclosure practices, staff will recommend appropriate regulatory action, including further action to regulate such practices, or any other remedy required by the circumstances.

Review of Fund-of-Funds Disclosure of Fees and Expenses

17th edition, September 2016

Last year, staff commenced an issue-oriented continuous disclosure review focused on the disclosure of fees and expenses for fund-of-funds. Our review had the following objectives:

- to determine whether the calculation of the management expense ratio (MER) and the trading expense ratio (TER) for fund-of-funds includes the expenses of underlying funds in compliance with National Instrument 81-106 *Investment Fund Continuous Disclosure*,

- to review fund manager policies and procedures regarding the prohibition on the duplication of fees for funds that invest in underlying funds, and

[3] ETFs may be broadly classified into "index" ETFs that track a transparent index or asset and "non-index" ETFs that do not. Within the "non-index" group, there are (a) "rules-based" ETFs: ETFs that generally hold a portfolio that is rebalanced periodically in accordance with a rules-based investment methodology, and (b) "actively managed" ETFs: ETFs that have discretion to invest without regard to any index or rules-based methodology.

- to assess whether the disclosure about fees and expenses for funds that invest in underlying funds is clear and transparent.

Our review included 29 investment funds managed by 16 fund managers, consisting of conventional mutual funds, exchange-traded funds (ETFs) as well as pooled funds.

The main findings from our review are:

1. MER and TER Calculations

We found that a number of top funds that invest in underlying ETFs did not include the expenses of the ETFs in the calculation of MER and/or TER. Many of these top funds disclosed MERs and TERs that were materially understated. This resulted in re-filings of their management reports of fund performance to correct the MER and/or TER.

We remind fund managers to "look-through" the expenses in fund-of-funds when calculating the MER and the TER for top funds, including top funds that invest in third party conventional mutual funds and ETFs. Fund managers should use reasonable estimates when determining the expenses of underlying funds managed by third parties.

2. Duplication of Fees

Our review confirmed that fund managers generally have policies and procedures in place to ensure that there is no duplication of fees in fund-of-funds. We observed that top funds generally invest in a series of securities of affiliated mutual funds that do not have management fees or performance fees. However, we also observed top funds that invest in underlying funds with management fees and/or performance fees.

3. Prospectus Disclosure

For top funds with investment objectives to invest in underlying funds, we have seen prospectus disclosure of a minimal management fee even though the underlying funds have higher management fees. Staff are concerned that the management fee disclosure provided by top funds, particularly for new funds without historical MERs, may be misleading if there is no prospectus disclosure explaining that the underlying funds may have higher management fees. Staff expect the top fund to provide sufficient disclosure to clearly explain the impact of the expected management fees of the underlying funds on the top fund's MER.

Split Shares – MER Disclosure

4th edition, January 2010

We remind filers of the requirement contained under section 15.1(4) of NI 81-106 to calculate the MER for each class of securities. In the case of investment funds having capital shares and preferred shares outstanding, section 15.1(4) requires that MER be calculated for each of the capital shares and the preferred shares. We recognize that the preferred shares do not normally bear any costs until the net asset value of the capital shares has diminished completely. Preferred shares may also be considered as a liability to the capital shares and any distribution made to the preferred shares as interest costs to the capital shares. Consequently, we have been raising comments on both prospectus and continuous disclosure reviews to confirm whether a filer will be calculating MERs for each of the capital and preferred shares and whether the MER for the capital shares will include distributions paid on the preferred shares.

Yield/Income Funds Review

7th edition, April 2012

Staff recently conducted a review of select investment funds which make regular distributions to investors. The scope of this review included the distribution policies and related disclosures as well as the investment fund manager's decision-making process on the amount and the form of the distributions.

Our review identified a few key issues. We note that several funds pay distributions which are regularly and significantly in excess of the fund's increase in NAV from operations, both on an annual basis as well as on a cumulative basis since inception. In these cases, the distributions, in substance, are a return to the investor of their own capital, whereas the use of the terminology 'yield' or 'income' in the Fund's name or elsewhere implies underlying performance or earnings to investors. Additionally, cash distributions in excess of earnings deplete the asset base of the fund and can hinder the fund's ability to meet its other investment objectives.

We further note that some funds typically pay distributions in the form of reinvested units unless, for funds held in non-registered plans, the investor expressly chooses to receive cash distributions. In our view, this default form of distributions (i.e., reinvested units) tends to conflict with the funds' stated focus of providing investors with a regular income stream. The onus is on investors to expressly advise the fund manager and/or dealer if they want distributions in the form of cash.

Finally, to the extent that investors may be assessing a fund's performance based on its distribution rates or yield, they may reach incorrect conclusions about their returns on these funds. The fund's distribution rate or yield is based on its distributions, rather than its earnings or performance.

For these types of funds, staff will ask for the following:

Prospectus Disclosure

- Include prominent disclosure that investor action is needed if distributions in the form of cash are desired. Disclosure should also highlight that if an investor subsequently desires to convert a distribution that has been made in the form of reinvested units into cash, the order of redemption (as specified in the prospectus) would generally result in reinvested units being redeemed last, triggering payment of redemption fees.

- In bold typeface and in plain language, that any distributions made in excess of the fund's cumulative income generated since the fund's inception represent a return of the investor's capital back to the investor.

- Where a distribution or yield is quantified in the prospectus, sales communication or elsewhere (such as a website), the disclosure should specify all of the following: a) the basis of the calculation, b) the percentage of total distributions comprising reinvested units, c) whether the yield is calculated based on the NAV or market price of the fund's securities, d) the time period covered by the distributions and the NAV (or market price, as applicable), e) the key assumptions, and f) the impact of changes in key assumptions on the target distribution or yield.

- The form of the distribution (i.e., cash or reinvested units) should be specified whenever a reference to distributions is made (e.g., in the investment objective or elsewhere).

Continuous Disclosure

- When distributions during a period exceed the fund's earnings from operations during that period, staff expect the fund's MRFP to discuss why the distribution was made despite insufficient earnings. Further, in case of a shortfall between total distributions and the fund's earnings since inception to-date, the MRFP should discuss the rationale for continuing to make distributions, the impact of the distributions made by the fund on the fund's ability fulfill its investment objectives, and how the shortfall will be made up going forward in the future.

Staff will continue to consider whether additional guidance or rule-making is needed in this area.

INDEPENDENT REVIEW COMMITTEES

Consideration of Different Securityholder Interests

18th edition, December 2016

An investment fund manager's duty of care is set out in s.116 of the *Securities Act* (Ontario). Members of an Independent Review Committee (IRC) have a similar duty with respect to conflict of interest matters referred to them by the investment fund manager. Section 3.9(1) of National Instrument 81-107 *Independent Review Committee for Investment Funds* imposes a fiduciary duty on a member of an IRC to (a) act honestly and in good faith, with a view to the best interests of the investment fund, and (b) exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

To act in the best interests of the investment fund, IRC members should have a good understanding of the broad investor groups invested in the fund. Staff encourage IRC members to conduct their analyses of the issues presented by fund managers not only by considering the interest of the investment fund itself, but also the interests of the securityholders of the fund. While conducting these analyses the interests of the investors in the fund should not be considered at an individual level but rather, take into account the impact of the proposed action on different groups of securityholders invested in the fund. For example, the analysis could consider the impact of the proposed action on taxable versus non-taxable investors, on newer investors versus longer term investors in the fund, and on investors who purchased under a deferred sales charge versus investors who purchased on a front-end load basis.

Staff remind IRC members of the need to balance and consider the varied interests of securityholders when determining whether a proposed action concerning a conflict of interest matter is in the best interests of the investment fund.

IRC Reporting under Section 4.5 of NI 81-107

17th edition, September 2016

Staff have received inquiries about whether a materiality threshold applies to the reporting requirement on Independent Review Committees (IRCs) pursuant to section 4.5 of National Instrument 81-107 *Independent Review Committee for Investment Funds* (NI 81-107).

Section 4.5 of NI 81-107 requires an IRC to provide written notice to the principal regulator when the IRC becomes aware of any instance in which the fund manager acted in certain conflict of interest matters[4] but did not comply with *a condition imposed by securities legislation or any IRC approval*. A similar requirement has also been included in exemptive relief decisions granting relief from the conflict prohibitions to permit, for example, interfund trading involving pooled funds or pooled fund purchases of securities of related issuers. Staff were recently asked whether IRCs who become aware of a breach of this type of condition are still required to notify the fund's principal regulator if the IRC or the fund manager consider the breach to be, in their view, 'inconsequential' or 'immaterial' to the fund or its securityholders.

Staff's view is that a materiality threshold should not be applied to the IRC's reporting requirement under section 4.5 of NI 81-107 or the mirrored requirement in exemptive relief decisions. If an IRC becomes aware of any instance involving a breach of condition imposed by securities legislation or IRC approval concerning conflict of interest matters, it is required to report it to the fund's principal regulator. Staff understand that, in the IRC or the fund manager's view, the consequence of the breach may not be material, but the reporting obligation enables staff to know why the compliance procedures of the fund manager may not have worked and how the fund manager proposes to avoid similar breaches in the future.

Staff expect the letter reporting such instances to come from the Chair of the IRC and to discuss (i) the circumstances and facts leading to the breach of condition, (ii) factors relevant to the IRC's consideration of the matter, (iii) how the breach was remedied, (iv) whether the IRC is satisfied with the fund manager's handling of the matter, and (v) how the fund manager plans to avoid similar instances in the future. Staff also remind IRCs of the requirement in section 4.4(1)(h) of NI 81-107 to disclose such instances in the IRC Report to Securityholders that is prepared annually for investment funds that are reporting issuers.

PROCESS MATTERS

Materiality Thresholds for Repayments to Investors

12th edition, July 2014

On occasion, a fund manager has miscalculated and overpaid fees from a fund's assets due to error and then proposes to make repayments to investors. In certain instances, fund managers have proposed to make repayment to affected investors only where the repayment

[4] The three conflict of interest matters are set out in subsection 5.2(1) of NI 81-102, namely (i) interfund trading (ii) purchases of securities of a related issuer and (iii) investment in securities offerings underwritten by a related party.

amount exceeds a materiality threshold of $50 per investor. These fund managers have submitted that the costs of mailing and the administrative burden of tracking down affected investors are significant if the materiality threshold is set below $50, such that the actual cost to the fund manager of making those investors whole exceeds the amounts owed to them. Some fund managers have pointed staff to The Investment Funds Institute of Canada (IFIC) Bulletin 22 Correcting Portfolio NAV Errors, last updated in December 2009, as support for a $50 threshold.

Staff note that Bulletin 22 has been removed from IFIC's public website and caution fund managers against placing too much reliance on that policy as it may be outdated. Fund managers should use their judgement in determining whether a $50 threshold is appropriate in their particular situation and be mindful of their statutory duty as fund manager when selecting a materiality threshold. In staff's view, that duty requires that fund managers have the obligation to make full repayment to investors. We continue to consider whether use of a threshold is appropriate in any circumstance and whether it is appropriate not to fully repay any overpaid amounts to investors.

Reviews of Prospectus Amendments

20th edition, March 2018

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).

Transition of Investment Funds to Corporate Issuer Status

16th edition, December 2015

We have recently seen closed-end investment funds seeking to transition to corporate issuers for various reasons, one of which is to change the investment strategy of the fund to focus on obtaining control of, or becoming involved in, the management of underlying investee companies.

Staff generally take the view that a fund manager's decision to change a fund's operation from investment fund to corporate issuer constitutes a "restructuring" that triggers the requirement for a securityholder vote as contemplated by subparagraph 5.1(1)(h)(iii) of NI 81-102.

Staff's view is that the following disclosure should be provided in the management information circular[5] for the securityholder meeting:

- financial statements and management's discussion & analysis for the issuer's two most recently completed financial years and most recent interim period prepared in accordance with applicable Canadian securities legislation as if the issuer were a corporate issuer instead of an investment fund;

- a discussion of the key differences between the requirements in securities legislation that apply to an investment fund versus a corporate issuer, for example, the differences in the disclosure requirements; and

- a statement of executive compensation prepared in compliance with Form 51-102F6 *Statement of Executive Compensation.*

Fund managers considering the transition of investment funds they manage to corporate issuers should be mindful of the above requirements and are encouraged to engage staff in the Corporate Finance Branch of the Commission prior to transitioning if their framework for transition raises novel issues outside of the above-noted parameters.

PROSPECTUSES

Auditor Consents

4th edition, January 2010

We remind filers of the requirements to file auditor consents contained in sections 2.6(1)(a) and 2.6(2) of NI 81-101. Section 2.6(2) also includes a requirement to file a consent in connection with future statements incorporated by reference at the time those future financial statements are filed.

The following is a general summary of some staff practices relating to the filing of auditor consents under NI 81-101 in connection with an amendment to a simplified prospectus and/or AIF.

- For slip-sheet amendments and amended and restated simplified prospectuses and AIFs, if new annual financial statements have been incorporated by reference since the date of filing the simplified prospectus and AIF, we will generally issue a comment regarding the filing of a new auditor's consent letter in respect of the new audited annual financial statements if the consent letter wasn't filed concurrently with the annual financial statements (see section 2.6 of NI 81-101).

- If there have been no new annual financial statements filed since the date of the simplified prospectus and AIF, but the slip-sheet amendment or the amended and restated simplified prospectus and AIF refers to a correction to the annual financial statements or contains amended information derived from annual financial statements, we will generally raise a comment regarding the filing of a new auditor's consent letter.

[5] Refer to section 5.4 of NI 81-102 and Part 12 of NI 81-106 for requirements relevant to the management information circular required for securityholder meetings pursuant to section 5.1 of NI 81-102.

Currency Hedging in Investment Objectives

13th edition, November 2014

Staff are aware that many investment funds employ currency hedging as a strategy to reduce foreign currency risk for investors. Sometimes the ability to employ currency hedging is discretionary and the investment fund's prospectus discloses that the portfolio manager may hedge the foreign currency exposure and that the hedge may be anywhere from 0% to 100% of the fund's foreign currency exposure. However, for other funds, the prospectus discloses that all or substantially all of the fund's foreign currency exposure will be hedged, and that the hedging is not at the portfolio manager's discretion.

In the second scenario discussed above, staff's view is that the currency hedging described is an essential feature of the investment fund, and, therefore, should be disclosed in the fund's investment objectives (as required by Instruction (3) to Item 6 of Form 81-101F1 and Instruction (3) to Item 5.1 of Form 41-101F2). Accordingly, in our prospectus reviews, we have been indicating this expectation to filers.

Default Rate Feature – Direct Payment of Ongoing Dealer Service Fees

12th edition, July 2014

Further to staff's continued focus on mutual fund fee structures and dealer compensation models, we have recently become aware of certain investment fund series that have a default rate feature attached to the direct payment by investors of ongoing dealer service fees. Staff have reviewed the disclosure documents of several fund families to evaluate the extent of this practice. While not all funds or fund managers have this practice, staff have seen similar disclosure among those that do.

As reflected in the disclosure, typically the fund manager does not pay trailing commissions for ongoing dealer services out of the management fee for these series. Instead, investors in these series pay their dealers directly and the fund manager facilitates this direct payment by regularly (typically, each quarter) redeeming investor holdings of the series and remitting the proceeds to the dealer.

In terms of the amount of the fee, the disclosure for these series typically provides that, in the absence of receiving instructions from the dealer as to the rate of the fee within a stated range (for example, 0 to 1.5% of average net asset value per security), the fund manager will apply a stated default rate, which may be as much as the maximum rate of the stated range (in our example, 1.5%).

We understand that fund managers may have introduced the default rate feature to help optimize the administrative efficiency of dealer back offices and assist dealers who may wish to transition from the embedded fee (i.e. trailing commission) model to a direct payment model of paying ongoing dealer service fees.

While we generally do not take issue with fund managers facilitating direct payment arrangements, and would expect that a maximum rate be disclosed where the fund manager facilitates such payments, staff are of the view that no such payment should be made pursuant to the application of a default rate. We further consider that disclosure related to the direct payment arrangement should be made in the "Fees and Expenses" section of a simplified prospectus in the table under “Fees and Expenses Payable Directly by You” rather than only in the "Dealer Compensation" section, as is often currently the case.

In staff’s view, the default rate feature is inconsistent with a critical attribute of the direct payment series, namely the negotiation of the service fee, which is intended to provide investors with heightened transparency and a clear expectation of the services to be rendered in exchange for the negotiated fee. While the default rate feature may contribute to administrative efficiency, it may have the unintended consequence of replacing the negotiation of the service fee. Staff’s view is that the default rate feature blurs the lines between the attributes of the direct payment series and the embedded fee (trailing commission) series and is potentially misleading for investors.

We have consulted with staff in the OSC’s Compliance and Registrant Regulation Branch, who further note that ongoing dealer fees of this kind are “operating charges” that dealers must disclose to their clients under the provisions of Part 14 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

We have indicated to filers our expectation that new funds not have a default rate feature. Going forward, we anticipate that on the reviews of renewal prospectuses, we will be asking fund managers for enhanced disclosure on these facilitated, direct payment arrangements, and in instances where a default rate feature exists, for the fund manager to tell us what would be a reasonable transition period needed to remove the application of any default rate.

We continue to review and monitor developments on mutual fund fee structures and dealer compensation models and will provide further guidance as needed. Issuers and their counsel are encouraged to contact staff in the planning stage of any structure that may give rise to questions concerning this issue.

Disclaimers of Liability for Third Party Information in Prospectuses

9th edition, May 2013

We have seen disclaimers in prospectuses that relate to the accuracy of third-party information. The disclaimers indicate that the issuer is not responsible for information provided by third parties, which is typically information that is publicly available, including economic data or index information provided by an index sponsor. Staff are of the view that such disclaimers do not reflect the liability for prospectus misrepresentations under securities law. Section 130 of the *Securities Act* (Ontario) makes an issuer liable for any misrepresentation in a prospectus, even if the misrepresentation was taken from a reliable third-party source. The only defence to a misrepresentation claim available to an issuer is that the purchaser making the claim was aware of the misrepresentation at the time of purchase. As issuers are unable to disclaim liability for third party information in a prospectus, staff’s position is that such disclaimers should not be included in prospectuses.

Disclosure of Management Fees

19th edition, June 2017

As noted in the December 9, 2011 edition of the Practitioner, some mutual funds have management fees that are payable directly by securityholders and may vary from securityholder to securityholder. The disclosure about these management fees provided in the fund's simplified prospectus and Fund Facts include the highest possible rate or range of those management fees, as contemplated by Instruction 5, Part A, Item 8.1 of Form 81-101F1, or how fees applicable to that series compare to those applicable to other series offered by the same fund.

For mutual funds that have management fees that are payable directly by securityholders but do not vary from securityholder to securityholder, the management fee should be disclosed in the simplified prospectus and Fund Facts as a specified amount and should not be disclosed as a "maximum" management fee or "up to" the highest possible rate or range of those management fees, as any increase in the management fee would be subject to securityholder approval under Part 5, NI 81-102. The management fee disclosed in the simplified prospectus and Fund Facts should be the specified amount that is payable by the securityholders before any management fee rebates or waivers.

ETFs that Track an Index

7th edition, April 2012

A wide range of exchange-traded funds (ETFs) propose to track specified indices. In some cases, the index has been created specifically for the fund and is, therefore, not widely used or recognized.

In a recent filing for new ETFs, staff advised the fund manager that it was not sufficient for the investment objectives to merely state that the fund aimed to replicate the performance of the specified index, without stating the primary asset composition and key features of the fund under normal market conditions. We also confirmed our view that the investment strategies section of the fund's prospectus had to sufficiently describe each index, to state the key factors in determining which securities form part of each index and where the public can access the composition of each index at any given point in time.

Fees Disclosure in Short-Form Prospectuses

9th edition, May 2013

A prospectus must provide full, true and plain disclosure of all material facts relating to the securities being distributed. Filers who use short-form prospectuses to qualify their investment funds are reminded that staff consider the fees and expenses of the fund to be material facts that should be disclosed in the investment fund's prospectus. In addition to the form requirements of Form 44-101F1 - *Short Form Prospectus*, filers are expected to include a "Fees and Expenses" section in their short-form prospectus of an investment fund which describes the (i) expenses of the offering, (ii) the subscription fee, (iii) management fees, (iv) operating expenses, (v) other fees and expenses of the fund, if any, and (vi) fees payable by securityholders of the investment fund, as applicable.

Flow-Through Limited Partnerships – Finder's Fees

11th edition, March 2014

Staff have reviewed prospectuses for certain flow-through limited partnerships which permit compensation arrangements involving entities related to the fund's manager. These entities are typically paid a fee for sourcing investment opportunities in the securities of resource issuers for the flow-through limited partnership. The fees payable to such related entities are often referred to as 'finder's fees'.

Staff's view is that finder's fee arrangements represent a conflict of interest matter under National Instrument 81-107 Independent Review Committee for Investment Funds and should be referred to the fund's Independent Review Committee (IRC) for its recommendation. Staff also expect that appropriate disclosure of these arrangements will be made in the prospectus.[6] Such disclosure should (a) identify the arrangement as a conflict of interest under NI 81-107; (b) indicate that the arrangement has been referred to the fund's IRC for its recommendation; (c) state the fees associated with the arrangement and payable to the related entity; (d) identify who pays the finder's fee and the basis for payment; (e) explain the details of the services provided by the related entity in exchange for the fee; and (f) state any limits on the arrangements, for example, on the amount of fees payable to the related entity or on the percentage of the fund's portfolio investments that may be sourced by the related entity.

Forward Fees

5th edition, May 2011

When the use of forward agreements is a material feature of a fund, we have been raising comments to request the disclosure of fees and any other costs associated with the forward agreements. One filer submitted that full, true and plain disclosure would be provided without the disclosure of such fees, and that this information was proprietary; however, the forward agreement fees, generally, have been material enough to persuade staff that this information is key to investors. Filers have shown the fees as a percentage of the forward agreement and have disclosed either the maximum percentage or a range.

Investment Funds Offering Currency Hedged Class or Series

17th edition, September 2016

Staff have observed recent developments in how a class or series of an investment fund is established for the purpose of employing currency hedging strategies (the Hedged Series).

Under subsection 1.3(1) of National Instrument 81-102 *Investment Funds* (NI 81-102), each class or series of an investment fund that is referable to a separate portfolio of assets is considered to be a separate fund. As gains and losses associated with Hedged Series derivatives used to deliver currency hedging are referable only to the Hedged Series and not to all classes or series of the fund, the Hedged Series portfolio may differ from that of other series offered by the fund. Historically, fund managers have offered Hedged Series to provide this attribute to investors in the fund in order to allow for greater operational efficiency. This practice has been based on expectations that fund managers:

(i) have systems in place to accurately track the currency hedging instruments used in a Hedged Series, separate from the other class or series of the fund,

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[6] For an example of this disclosure, refer to the prospectus for *Pathway Mining 2011 Flow-Through Limited Partnership* dated January 27, 2011 at page 72.

(ii) properly apportion currency hedging costs to a Hedged Series, and

(iii) have structured a Hedged Series such that investors understand the features and performance of the Hedged Series versus the other classes or series of the fund.

While staff's acceptance of the Hedged Series was historically based on the expectation that the Hedged Series would hedge all or substantially all of the foreign currency exposure associated with the investment fund's portfolio, recently we have seen some variations on this concept. For example, we have seen a Hedged Series employing discretionary currency hedging where a portfolio manager hedges anywhere from 0% to 100% of the Hedged Series' foreign currency exposure. In such circumstances, staff question whether it continues to be appropriate to consider the Hedged Series to not be a separate investment fund. Other variations that could result in different series having differing levels of discretionary currency hedging also cause us to question the appropriateness of this structure. Accordingly, we may raise comments during our prospectus reviews with a view to better understanding how these concerns are addressed.

Also, in giving further consideration to this type of structure, staff are concerned that, as currency hedging is typically not disclosed as part of the investment objectives of an investment fund that offers a Hedged Series, the manager may take the view that it can change or eliminate the currency hedging employed by the Hedged Series without securityholder approval. Staff, however, take the view that currency hedging is an essential aspect of a Hedged Series, which may be further bolstered by the name of the Hedged Series, or the manner in which the Hedged Series is marketed.

Accordingly, staff will request, as part of our prospectus reviews, that a fund that has a Hedged Series include in its prospectus disclosure that prior approval of securityholders of the Hedged Series will be obtained before the currency hedging strategy of the Hedged Series is changed. This will ensure that securityholders who purchased the Hedged Series for the purpose of obtaining currency hedging are given an opportunity to vote on any changes to this fundamental aspect of their securities.

Staff will continue to review and monitor developments with respect to currency hedging strategies employed by investment funds and will consider whether additional guidance or rule-making is needed in this area. Filers are encouraged to consult with staff in structuring classes or series of securities that may give rise to these issues.

Investment Objectives for a Fund of Funds

8th edition, November 2012

We have observed fund-of-fund structures involving conventional mutual funds under common management where only the name of the bottom fund is referenced in the investment objectives of the top fund, along with a statement that the top fund will invest in securities of the bottom fund. These structures have involved a one-to-one relationship between a top and bottom fund. Absent from the investment objectives of the top fund, however, has been disclosure about the specific investment objectives of the bottom fund.

Where there is a one-to-one relationship between conventional mutual funds under common management, staff do not consider it sufficient for the investment objectives of the top fund to only state that the top fund's investment objectives are to invest in a named bottom fund. Disclosure of the bottom fund's investment objectives in the top fund's investment objectives is appropriate in view of the fund-of-fund structure which provides direct exposure to the portfolio of securities held by the bottom fund and is also consistent with disclosure rules.[7] Issuers are reminded to provide this disclosure for conventional funds where there is a one-to-one relationship between top and bottom funds.

New Scholarship Plans – Up-Front Commission Structure

16th edition, December 2015

Staff have previously raised comments in respect of group scholarship plans that require subscribers to pay up-front commissions to sales representatives. We have recently observed that some plan providers appear to be shifting their focus towards the development of new individual plans with similar features.

Group scholarship plans (**GSPs**) have historically required the up-front payment of sales commissions to sales representatives who sell them. Currently, most plan providers require 100% of a subscriber's initial contributions to a GSP to be directed to the payment of the sales commission until half of the commission is paid. Subsequently, 50% of the subscriber's contributions are directed to the payment of the sales commission until it is paid in full.

This practice only allows for a small portion of a subscriber's initial contributions, if any, to be invested in the plan's actual portfolio investments. Depending on the circumstances, it can take two years or longer before the sales commission is fully paid. Staff have determined to no longer recommend prospectus receipts for new scholarship plans with similar up-front commission structures that lack the ability of a subscriber to receive a refund, in whole or in part, for paid sales commissions in appropriate circumstances.

We recently received a prospectus which proposed to establish a new individual scholarship plan. The plan, however, required subscribers to pay an up-front sales commission without the possibility of any refund should the subscriber withdraw from the plan. Staff indicated that we would not be willing to recommend a prospectus receipt for this plan on the basis that receipting it, without a mechanism to provide for a refund, in whole or in part, of any sales charges to subscribers, would not, in our view, be in the public interest. The prospectus was subsequently withdrawn.

We encourage any scholarship plan providers that are contemplating the creation of new scholarship plans to consult with staff prior to developing new compensation models for their sales representatives.

Past Performance Presentation in Fund Facts

14th edition, April 2015

Under the "How has this fund performed?" section of the Fund Facts, mutual funds are required to provide disclosure of past performance. The form requires inclusion of a year-by-year return chart, a best and worst 3-month return chart, and the average annual return for the mutual fund. In the course of our prospectus reviews, we have noticed that there are

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[7] Instruction 9 to Item 3 – *Investments of the Fund in Form 81-101F3 Contents of Fund Facts Document.*

certain scenarios that are not contemplated by the form requirements, which could lead to inconsistent or unclear disclosure.

The Fund Facts is required to be prepared for each class or series of a mutual fund. Occasionally, we encounter situations where certain classes or series of a fund have had periods during which no shares or units were outstanding. In such circumstances, it may not be possible to show performance for a complete calendar year, or to calculate an average annual return since there will be gap periods during which the class or series would not have had any assets (asset gaps).

In order to maximize the utility of the Fund Facts for investors, staff have been asking fund managers to consider alternative approaches to the presentation of past performance. For example, in situations where a class or series of a mutual fund experiences periods where there are asset gaps, some fund managers have used the performance record of another class or series of the mutual fund as a "proxy" for the missing performance information. In selecting the proxy class or series, the fund manager should ensure that the fees are not lower than those of the class or series with the asset gap. In addition, the proxy class or series should not have any special features that would cause a material difference in performance (e.g., currency hedging).

Where a fund manager does adopt an alternative approach to deal with any asset gap issues, staff would expect the Fund Facts to include a notation indicating that the performance of a proxy class or series has been presented.

Use of Short Form Prospectus

5th edition, May 2011

We have noted a number of issuers who make one or more subsequent offerings within a year of filing a long form prospectus in connection with their initial public offering. We remind filers that a new reporting issuer is not qualified to use a short form prospectus unless it can rely on the exemption in section 2.7 of NI 44-101 *Short Form Prospectus Distributions*. One criterion of using the short form is that a new reporting issuer must have a final prospectus that includes "comparative annual financial statements for its most recently completed financial year" (section 2.7(1)(b)).

We remind filers that the short form prospectus regime incorporates by reference a reporting issuer's continuous disclosure record; accordingly, a fund must have an established continuous disclosure record before it can file a short form prospectus. If a new fund has not yet completed a financial year, staff's view is that the fund's continuous disclosure record is not comprehensive enough because it does not have comparative annual financial statements[8] and, therefore, it cannot rely on the new reporting issuer exemption to use the short form prospectus.

[8] In the case of a fund with a final prospectus that incorporates audited annual financial statements for the first completed financial year, staff have not taken issue when that fund relies on the new reporting issuer exemption, even though the financial statements are not comparative. While the inclusion of comparative figures in the financial statements is a requirement, they cannot be provided if the fund has only been in operation for one year.

One filer thought that it could rely on the new reporting issuer exemption because its final prospectus included an audited opening balance sheet and it intended to include unaudited interim financial statements in its short form prospectus. Staff were of the view that the combination of these documents could not replace audited "annual financial statements" because: (i) an opening balance sheet, although audited, does not reflect the results of a completed financial year since there have not yet been any operations of the fund; and (ii) while interim financial statements capture the recent operations of the fund, they are not accompanied by an auditor's report. In this case, staff asked the filer to use the long form prospectus.

Use of the Term "Guarantee"

10th edition, November 2013

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.

OTHER

Definition of Index Participation Unit

5th edition, May 2011

We have received a number of inquiries seeking staff's views on what constitutes a "widely quoted market index" for the purposes of the definition of "index participation unit" in NI 81-102. In particular, we have been asked whether an index that tracks the price of a commodity or the price of options on a commodity could be considered a "market index".

Staff are generally of the view that the term "market index" should be interpreted in a manner that is consistent with the investment restrictions set out in NI 81-102. As a result, an index, which provides exposure to asset classes or strategies that a mutual fund would not be able to engage in directly, would not generally qualify as a "market index".

On this basis, staff would not generally consider an index that tracks the price of a commodity to be a "market index". The same conclusion would apply to an index that purports to track the performance of hedge funds, real property, or that incorporates leverage or shorting strategies.

We note that over the past few years there has been a proliferation in the number of product offerings from index providers. We also recognize that there is an interest on the part of exchange traded fund providers to differentiate themselves in the market by branching out beyond the traditional indices. Staff caution filers and their advisors that, while an index provider may label something as an "index" and that index may appear to be widely quoted, it still may not qualify as a "market index" under NI 81-102.

Additionally, we note that the prospectus for certain exchange traded funds includes disclosure stating that the fund qualifies as an IPU for the purposes of NI 81-102. Mutual fund managers and portfolio managers, however, should conduct their own analysis of whether that fund is an IPU and should not rely solely on the disclosure provided by the exchange traded fund.

Frequently Asked Questions – Structured Notes Distributed Under the Shelf Prospectus System

17th edition, September 2016

In January 2015, CSA staff published CSA Staff Notice 44-305 – 2015 *Update – Structured Notes Distributed Under the Shelf Prospectus System* (the Notice) to provide further guidance regarding disclosure that issuers should consider in offering documents for structured notes. Since that time, we have received several questions with respect to the Notice to which we wish to respond as well as discuss some other issues. Our responses to these questions are set out in the attached Appendix.

Appendix

Frequently Asked Questions and Other Issues Concerning Structured Notes

Q: *Can I use the term "estimated value" of the note as opposed to the "estimated fair value"?*

A: We received some questions regarding whether issuers may refer to the "estimated value" of a note as opposed to the term "estimated fair value" which we used in the Notice. Our primary objective in the Notice was to encourage issuers to be more transparent regarding the estimated value of the notes which they internally prepared and the potential profit to be made on a note, but not mandate specifically how the estimates should be calculated or to impose specific fair value accounting concepts. We believe this approach to be consistent with the approach taken in the U.S. by the Securities and Exchange Commission (SEC). We leave it to issuers to decide which term they are more comfortable using when disclosing their estimates.

Q: *What discount rate should I use when estimating the value of a zero coupon bond?*

A: We received questions regarding whether there was a staff view on which discount rate issuers should use for the valuation of the zero coupon bond that issuers partially hedge their exposure under the notes with. As discussed above, staff did not express a view in the Notice regarding specifically how estimates should be prepared. As such, issuers should continue to use the reasonably selected discount rate they have been using. We expect, however, that issuers will disclose what discount rate they have used and why.

Q: *Can I include contingent costs in my estimate of a note's value?*

A: It is our understanding that industry practice is not to include contingent costs in the estimate of a note's value. The estimate is generally based upon the valuation of the note's bond and derivative components. If an issuer does choose to include contingent costs, we expect it to disclose what contingent costs are included and why those costs are included in the calculation.

Q: *Can I disclose a straight-line depreciation of the difference between the note's issue price and its estimated value or fair value?*

A: It is our understanding that industry practice is not to disclose a straight line depreciation of the difference between the issue price of the notes and their estimated fair value. Also, in our view, this information may be of limited assistance and cannot fairly be compared against annual management fees investors must pay in connection with other investment products such as mutual funds.

Q: *Where on the cover page should I disclose the note's estimated value or estimated fair value?*

A: We encourage issuers to include the disclosure on the first page of the pricing supplement in a prominent location or, if formatting is an issue, in the introductory paragraph that immediately follows the description of the notes offered.

Q: *How should I disclose the estimated value or fair value for Delta-1 notes?*

A: In instances where banks offer notes that are linked to a particular strategy, usually a quantitative model, and that have no derivative component that either boosts the return, calls the note or provides some downside protection, there may not be an embedded profit in their offering price. As such, the fair value estimate is typically the offering price minus the dealer costs. In instances where banks are offering such notes, we ask for additional disclosure to be included in the paragraph on the cover page that discloses the fair value estimate. We have requested that the additional disclosure be bolded and state that the estimated value or fair value does not include the other fees (i.e. management fee, withholding taxes, etc.) that will be charged to the notional portfolio over the term of the notes and reference the fees and expenses section in the pricing supplement.

Q: *What disclosure is expected to explain why the estimated value may be different than the price at which an investor can sell the note in the secondary market?*

A: As noted in section 1.1 of the Notice, issuers are expected to include an explanation as to why the estimated value of the note and the initial secondary market price will differ (the Delta). In order to satisfy this disclosure expectation, the disclosure should focus on the Delta immediately once the note is issued rather than the Delta once time elapses and market forces affect the note's price.

Q: *Should I disclose the note's estimated value or fair value in the note's marketing documents?*

A: Staff note that the marketing documents that are typically used to sell notes often do not include disclosure of the estimated value or fair value of the notes. We encourage issuers to include the disclosure of the estimated value or fair value and a brief explanation of its meaning in marketing materials going forward.

Guidance on Mutual Fund Sales Practices

18th edition, December 2016

The Compliance and Registrant Regulation Branch of the Ontario Securities Commission has completed a focused review of mutual fund sponsored conferences organized and presented by investment fund managers to assess compliance with Part 5 of National Instrument 81-105 *Mutual Fund Sales Practices* (NI 81-105).

Based on the results of this focused review, we wish to provide the following guidance relating to the selection of representatives attending mutual fund sponsored conferences.

Paragraph 5.2(b) of NI 81-105 permits an investment fund manager to provide a non-monetary benefit to a representative of a participating dealer by allowing the representative to attend a conference or seminar that the investment fund manager has organized if the selection of the participating representatives is made exclusively by the participating dealer, uninfluenced by the investment fund manager.

Paragraph 7.3(2) of the companion policy to NI 81-105 clarifies that the identification of specific representatives of a participating dealer by an investment fund manager to that participating dealer does not constitute compliance with section 5.2 of NI 81-105. The requirement in paragraph 5.2(b) of NI 81-105 reflects the CSA's position that investment fund managers should generally be dealing with participating dealers, rather than individual dealing representatives, in connection with mutual fund sponsored conferences. This permits participating dealers to maintain better supervisory control over their representatives and reduces the potential conflicts that may arise between the duties owed to clients by representatives and the benefits provided by investment fund managers to those representatives.

To avoid non-compliance with the requirements of paragraph 5.2(b) of NI 81-105, investment fund managers should put a process in place that will require the investment fund manager to:

a) first, contact a participating dealer's head office requesting its involvement in the selection of representatives to attend the investment fund manager's mutual fund sponsored conference and request that the participating dealer distribute the mutual fund sponsored conference invitation to its representatives;

b) ensure the opportunity to attend the mutual fund sponsored conference is available to all representatives;

c) ensure the mutual fund sponsored conference is widely advertised (for example, in the advisor section of an investment fund manager's website and/or through widely known industry publications); and

d) ensure that attendance is filled in a manner that does not influence the selection of representatives (for example, attendance is filled on a first come first served basis).

Staff will continue to monitor compliance with these requirements going forward.

Hedging Activities – UBS Settlement and Market Price Movements as a Result of Hedging Activities by the Issuer

17th edition, September 2016

Staff are aware that some issuers may hedge the liability under their notes sold by purchasing and/or selling the reference asset in the market. Staff are concerned that such hedging activity, if conducted prior to the notes notionally buying/selling those same reference assets, could, in some instances, materially affect the notional purchase or selling price that is used in calculating the return on the notes. This could be of particular concern when the reference asset is thinly traded or illiquid.

We encourage issuers to review the settlement agreement entered into between UBS and the SEC[9] and consider whether they have adequate systems and procedures in place to help ensure:

- their hedging activities do not have a material adverse impact on the value of the note's return,
- the value of the different inputs that comprise the return on the note are derived as objectively as possible, and
- all relevant costs associated with the note are adequately disclosed.

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

3rd edition, September 2008

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 sub-sections 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.

[9] See: https://www.sec.gov/litigation/admin/2015/33-9961.pdf