

This summary may be of interest to managers of public investment funds and investment funds subject to NI 81-106¹ that engage in securities lending. Private equity entities, venture capital entities and mortgage investment corporations, which are generally not considered investment funds, are not subject to the Amendments.

On June 19, 2014, the Canadian Securities Administrators (CSA), as part of their Modernization of Investment Fund Product Regulation Project (the Modernization Project), published the final amendments (collectively, the Amendments) to the following:

- National Instrument 81-102 – *Mutual Funds* (NI 81-102)
- National Instrument 81-106 – *Investment Fund Continuous Disclosure* (NI 81-106)
- National Instrument 81-101 – *Mutual Fund Prospectus Disclosure* (NI 81-101)
- National Instrument 41-101 – *General Prospectus Requirements* (NI 41-101)
- the corresponding companion policies

The Amendments came into force on September 22, 2014. See the Transition Periods and Effective Dates table at the end of this summary.

In light of the Amendments, investment fund managers should do the following:

- review fund documentation and agreements with service providers to assess whether any changes may be required, such as changes to the investment objectives, strategies or restrictions of a publicly offered non-redeemable investment fund, which is also known as a closed-end fund (CEF);
- engage in discussions with the independent review committee (IRC) regarding the IRC's new obligations and oversight of CEFs;
- assess whether any of a CEF's holdings are now prohibited and should be divested; and
- consider whether exemptive relief may be required from the Amendments.

Background: The Modernization Project

The Modernization Project is the CSA's review of product regulation of publicly offered investment funds in Canada. Phase 1 of the Modernization Project focused primarily on publicly offered mutual funds. The Phase 1 amendments came into force on April 30, 2012, except for provisions relating to money market funds, which came into force on October 30, 2012. For Phase 2, the CSA's objective is to identify and address any market efficiency, investor protection and fairness issues that arise out of the differing regulatory regimes that apply to publicly offered mutual funds and CEFs.

Summary of the Amendments

The Amendments extend the scope of certain provisions of NI 81-102 to CEFs by introducing certain core investment restrictions and fundamental operational requirements that previously applied only to publicly offered mutual funds, and enhancing disclosure requirements regarding securities lending activities.

The following is a summary of certain key changes pursuant to the Amendments that affect publicly offered investment funds, especially CEFs.

Investment Restrictions

Control Restriction

A CEF cannot purchase more than 10% of the outstanding voting or equity securities of an issuer. The extension of the control restriction to CEFs is consistent with the CSA's view that an investment fund is a passive investment vehicle and should not be involved in the management of its investee issuers.

Investments in Real Property, Loan Syndications and Mortgages

A CEF cannot purchase real property or an interest in a loan syndication participation, if the purchase would require the CEF to assume any responsibilities in administering the loan in relation to the borrower.

A CEF is also prohibited from purchasing a mortgage other than a guaranteed mortgage. This restriction reflects the CSA's view that investments in non-guaranteed mortgages may be akin to engaging in a lending business, which is generally outside the scope of portfolio management typically engaged in by publicly offered investment funds. Existing CEFs that have adopted fundamental investment objectives to permit them to invest in non-guaranteed mortgages may avail of the grandfathering provisions from this restriction.

Fund-of-Fund Structures

A CEF may invest in another investment fund, provided that: (i) the CEF complies with the requirements for fund-of-fund investing currently imposed on publicly offered mutual funds under NI 81-102; (ii) the underlying investment fund is subject to NI 81-102 or complies with the provisions of NI 81-102 that apply to

¹ Generally, NI 81-106 applies to investment funds that are reporting issuers, and to mutual funds that are not reporting issuers, except mutual funds that are organized under the laws of Alberta, British Columbia, Manitoba, and Newfoundland and Labrador.

CEFs pursuant to the Amendments; and (iii) the underlying investment fund is a reporting issuer in at least one Canadian jurisdiction in which the CEF is a reporting issuer. The third requirement was imposed by the CSA to ensure that the underlying fund is subject to the continuous disclosure regime under NI 81-106, so that securityholders of a CEF can readily access information about the underlying fund. It also allows the CSA to access the underlying fund's prospectus to review the fund-of-fund structure being offered to the public.

The following must seek exemptive relief from the regulators to allow the investment funds to continue with such investments:

- an existing CEF that invests in a foreign investment fund, which does not comply with the new requirements
- a publicly offered mutual fund that invests in a CEF

Securities Lending, Repurchases and Reverse Repurchases

The restrictions under NI 81-102 regarding securities lending, and repurchase and reverse repurchase transactions, now extend to CEFs.

A key provision of the Amendment is that the aggregate market value of securities loaned by a publicly offered investment fund is capped at 50% of the investment fund's net asset value (NAV). This change – from a cap on the total assets to a cap on NAV – is intended to offset the effect of leverage employed by a CEF, which may lead to the value of the CEF's total assets being greater than its NAV.

Specified Derivatives and Short Selling

An exchange-traded mutual fund that is not in continuous distribution and a CEF must issue a news release if the fund intends to begin using specified derivatives (as defined in NI 81-102) or engage in shorting. A news release is not required if the prospectus of the fund, since the fund's inception, contains the prescribed disclosure about these activities.

Conflicts of Interest

The conflicts of interest provisions under NI 81-102, which impose restrictions on dealer-managed funds and self-dealing, and impose liability and indemnification provisions on a mutual fund and its manager, now extend to CEFs. IRCs for CEFs must assume responsibilities for these additional duties.

Operating Requirements

Fundamental Changes

The Amendments extend the application of securityholder and regulatory approval requirements under NI 81-102 for fundamental changes to CEFs. Fundamental changes include a change in manager or investment objective of the investment fund, and,

generally, a reorganization with, or a transfer of, an investment fund's assets to or from another investment fund.

New Requirements for Securityholder Approval

In addition to existing securityholder approval requirements under NI 81-102, securityholder approval is now required for a conversion of: (i) a CEF into a publicly offered mutual fund; (ii) a publicly offered mutual fund into a CEF; and (iii) a publicly offered investment fund into a publicly offered issuer that is not an investment fund. Securityholder approval is also required for a CEF that was designed to convert into a mutual fund on or after a specified date even if the prospectus of the CEF discloses the conversion. The Amendments also mandate that a publicly offered investment fund must not bear any of the restructuring costs and expenses.

The Amendments introduce an exemption from securityholder approval requirements for fund mergers involving a flow-through fund, provided that it satisfies certain requirements, including tailored prospectus disclosure. These flow-through CEFs are typically organized as limited partnerships and have the investment objective of providing returns through tax-assisted investments in flow-through shares.

New Requirements for Pre-Approved Fund Mergers

A pre-approved merger (i.e., a merger without securityholder or regulatory approval) of a CEF with another publicly offered investment fund must be in accordance with the conditions for such transactions imposed on publicly offered mutual funds under NI 81-102. In addition, the Amendments require a CEF to permit securityholders to redeem their securities of the fund at a price equal to the NAV of the securities at a date before the effective date of the merger. Securityholders of publicly offered mutual funds continue to have the right to redeem securities of the mutual fund up to the close of business on the business day immediately before the effective date of the merger.

The Amendments require all pre-approved fund mergers to be effected at the NAV of the publicly offered investment fund.

Termination of CEFs

A CEF must generally terminate no earlier than 15 days and no later than 90 days after filing a press release disclosing the intended termination.

Redemptions

Some of the key redemption provisions set out under NI 81-102 that now extend to CEFs are as follows:

- an annual reminder must be sent to investors of the redemption procedures
- securities of the fund must not be redeemed at a price that is greater than the NAV of the securities on the redemption date
- redemption proceeds must be paid no more than 15

business days after the redemption is effected, subject to any suspension of redemption

- redemptions can be suspended only if certain conditions under NI 81-102 are met

A CEF must also disclose its redemption procedures, including the redemption date(s), and payment of and deductions from redemption proceeds, in its prospectus.

Custodianship Requirements

The Amendments extend the NI 81-102 custodianship requirements to CEFs, which are generally similar to the current custodianship requirements that CEFs are subject to under NI 41-101.

Sale of Securities for Follow-On Offerings

The Amendments extend the NI 81-102 requirement to issue securities at NAV to CEFs and exchange-traded mutual funds that are not in continuous distribution. Consequently, the issue price of a security of these funds must not: (i) as far as reasonably practicable, cause dilution of the NAV of the outstanding securities; and (ii) be at a price that is less than the most recent NAV per security of that class or series, calculated prior to the pricing of the offering.

Warrant Offerings

A publicly offered investment fund is now prohibited from issuing warrants or rights, or entering into a position in a specified derivative if that derivative's underlying interest is a security of the investment fund.

The CSA may consider applications for exemptive relief in limited and exceptional circumstances if a CEF can demonstrate market necessity, and where steps are taken to mitigate any potential dilution and conflicts of interest for the CEF so that the benefits of the warrant offering outweigh any costs of dilution.

Commingling of Cash

The Amendments extend provisions regarding the segregation of monies from the sale and redemption of securities into a trust account to CEFs. Similar to the exemption currently provided to IIROC and MFDA members, the Amendments create an exemption for CDS.

Sales Communications

A CEF is now subject to the sales communications requirements under NI 81-102, which require CEFs to calculate and disclose performance data in accordance with NI 81-102. The current restrictions on CEFs relating to the sales and marketing during the waiting period and during the distribution period following the issuance of a receipt for the final prospectus, continue to apply to CEFs.

If a publicly offered mutual fund that converted from a CEF wishes to present performance data, it must also present past performance data for the period when it existed as a CEF.

Securities Lending Disclosure Requirements

The Amendments introduce new disclosure requirements for investment funds, which are subject to NI 81-106, in respect of their securities lending activities. The new requirements include the following:

- disclosure in the notes to the financial statements of the fund of a reconciliation of the gross amount generated from securities lending transactions to the revenue from securities lending transactions
- disclosure in the prospectus or annual information form, as applicable, of
 - the name of each securities lending agent and the agent's head office
 - whether any securities lending agent is an affiliate or associate of the manager
 - a brief description of the essential terms of the securities lending agreement

2013 Proposal and Alternative Funds Framework

The proposed amendments for Stage 1 of Phase 2 of the Modernization Project were first published for comment on March 27, 2013 (the 2013 Proposals). The following provisions from the 2013 Proposals with respect to CEFs have *not* been included in the Amendments:

- Restrictions concerning investments in physical commodities, the use of specified derivatives, borrowing cash, purchasing securities on margin and selling securities short
- Payment of incentive fees
- Concentration restrictions
- Restrictions concerning illiquid assets
- Restrictions on a CEF from purchasing securities of another CEF or of a commodity pool. A CEF may now make such purchases if the underlying fund is subject to NI 81-102 or complies with the Amendments that apply to CEFs
- Restrictions on a CEF investing in an underlying fund, unless the underlying fund is a reporting issuer in the same jurisdiction(s) as the CEF
- Prohibition on paying organizational costs

The above provisions may be reconsidered at the next stage of the Modernization Project, which will involve amendments to National Instrument 81-104 – *Commodity Pools* (NI 81-104). The proposed redesign of NI 81-104 is part of the CSA's initiative to create a framework for alternative funds.

This document is an overview only and it does not constitute legal advice. It is not intended to be a complete statement of the law or an opinion on any matter. No one should act upon the information in this document without a thorough examination of the law as applied to the facts of a specific situation.

Transition Periods and Effective Dates



Amendments	Existing CEF ²	New CEF	Existing mutual fund ³	New mutual fund
Control restrictions (section 2.2 of NI 81-102)	March 21, 2016	September 22, 2014	Already applicable	
Investments in real property and loan syndication (section 2.3(2)(a) and (c) of NI 81-102)	March 21, 2016	September 22, 2014	Already applicable	
Investments in non-guaranteed mortgages (section 2.3(2)(b) of NI 81-102)	March 21, 2016 Existing CEFS that have adopted fundamental investment objectives to permit them to invest in non-guaranteed mortgages are grandfathered from this provision.	September 22, 2014	Already applicable	
Fund-of-fund structure (section 2.5 of NI 81-102)	March 21, 2016	September 22, 2014	The restriction from investing in a CEF is effective as of: March 21, 2016 September 22, 2014	
Specified derivatives and short selling (section 2.11 of NI 81-102)	As of September 22, 2014, an exchange-traded mutual fund that is not in continuous distribution and a CEF must issue a news release if the fund intends to begin using specified derivatives or sell a security short, unless the prospectuses of the fund, since the fund's inception, contain the prescribed disclosure in respect of such activity.			
Securities lending, repurchases and reverse repurchases (sections 2.12 to 2.17 of NI 81-102)	September 21, 2015	September 22, 2014	As of September 22, 2014, the amount of securities loaned or sold in repurchase transactions are limited to 50% of NAV, rather than 50% of total assets.	
Conflicts of interest (Part 4 of NI 81-102)	September 22, 2014		Already applicable	
New securityholder approval requirements (section 5.1 of NI 81-102)	September 22, 2014		As of September 22, 2014, securityholder approval is required for a merger with any issuer (not just another publicly offered mutual fund) and for conversion into a CEF or an issuer that is not an investment fund.	
New conditions for pre-approved fund mergers (section 5.6 of NI 81-102)	September 22, 2014		As of September 22, 2014, all pre-approved fund mergers must be effected at NAV of the fund.	
Termination of a non-redeemable investment fund (section 5.8.1 of NI 81-102)	September 22, 2014		Not applicable	
Custodianship requirements (Part 6 of NI 81-102)	September 22, 2014		Already applicable	
Sale of securities and issue price (section 9.3(2) of NI 81-102)	As of September 22, 2014, an exchange-traded mutual fund that is not in continuous distribution and a CEF are prevented from dilutive issuances.			
Warrant offerings (Part 9.1 of NI 81-102)	As of September 22, 2014, the restriction on the issuance of warrants and similar instruments becomes effective.			
Redemptions (Part 10 of NI 81-102)	September 22, 2014		As of September 22, 2014, an exchange-traded mutual fund that is not in continuous distribution must pay redemption proceeds no more than 15 business days after redemption is effected.	
Commingling of cash (Part 11 of NI 81-102)	September 22, 2014		Already applicable	
Sales communications (Part 15 of NI 81-102)	September 22, 2014		As of September 22, 2014, if the publicly offered mutual fund existed as a CEF, performance data in sales communication must include such data for the period the fund existed as a CEF.	
Securities lending disclosure in financial statements (section 3.8 of NI 81-106)	Investment funds are required to comply for financial years beginning on or after January 1, 2016.			
Securities lending disclosure in prospectus and annual information forms (item 10.9.1 of Form 81-101F2 and item 19.11 of Form 41-101F2)	September 22, 2014			

² An existing CEF means a CEF that filed a prospectus on or before September 22, 2014.

³ An existing mutual fund refers to a mutual fund that filed a prospectus on or before September 22, 2014.



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