

## ANNEX A

### SUMMARY OF CHANGES TO THE 2013 PROPOSAL

This Annex describes the key changes the Canadian Securities Administrators (the CSA or we) have made to the 2013 Proposal in response to the comments we received. In addition, some of these changes reflect the announcement in CSA Staff Notice 11-324 *Extension of Comment Period* (CSA Staff Notice 11-324) that the CSA consider certain investment restrictions proposed in the 2013 Proposal, as specified in CSA Staff Notice 11-324, to be interrelated with the proposed amendments to National Instrument 81-104 *Commodity Pools* (NI 81-104) (the Alternative Funds Proposals). Accordingly, CSA Staff Notice 11-324 stated that these investment restrictions (the Interrelated Investment Restrictions) would be considered in conjunction with the Alternative Funds Proposals and would come into force at a later date.

The changes to the 2013 Proposal include the following:

#### 1. Investment Restrictions

##### *Interrelated Investment Restrictions and Incentive Fees*

- As stated in Staff Notice 11-324, the CSA are deferring implementation of the Interrelated Investment Restrictions, and the proposed restrictions on a non-redeemable investment fund's payment of incentive fees, until the Alternative Funds Proposals are published for comment. As a result, the following changes have been made to the 2013 Proposal:
  - We deleted proposed paragraphs 2.3(2)(c) and (d) and proposed subsection 2.3(3) of National Instrument 81-102 *Mutual Funds* (NI 81-102), which would have restricted a non-redeemable investment fund's investments in physical commodities.
  - We deleted proposed subsection 2.3(2)(e), and did not amend sections 2.7 and 2.8 of NI 81-102, which would have restricted a non-redeemable investment fund's use of specified derivatives.
  - As a result of the foregoing, proposed paragraph 2.3(2)(f) of NI 81-102 is now paragraph 2.3(2)(c) of NI 81-102.
  - We did not proceed with the proposed amendments to paragraphs 2.6(a) to (c) of NI 81-102, which would have placed restrictions on a non-redeemable investment fund borrowing cash, purchasing securities on margin or selling securities short.
  - We did not amend section 2.6.1 of NI 81-102, which would have only permitted short selling by non-redeemable investment funds on the same terms as mutual funds are permitted to sell securities short.
  - We did not amend Part 7 of NI 81-102.

### ***Concentration Restriction***

- After reviewing the comments received with respect to the proposed amendment to section 2.1 of NI 81-102, the CSA are deferring the introduction of a concentration restriction for non-redeemable investment funds. The CSA may consider, in connection with the Alternative Funds Proposals, whether investment funds subject to NI 81-104 should have a different concentration restriction than other investment funds. At that time, the CSA will reconsider the concentration restriction that should apply to non-redeemable investment funds.

### ***Restrictions Concerning Illiquid Assets***

- After reviewing the comments received with respect to the proposed amendments to section 2.4 of NI 81-102, the CSA are deferring the implementation of these proposed amendments until such time as we have revisited the definition of “illiquid asset” in NI 81-102. At that time, the CSA will reconsider the issue of illiquid asset restrictions for non-redeemable investment funds.
- Nonetheless, the CSA remain concerned if a non-redeemable investment fund were to invest a large proportion of its net asset value in illiquid assets, as we believe that an investment fund which invests a large proportion of its portfolio in illiquid assets will generally have difficulty accurately calculating its net asset value. The CSA are also concerned that such a fund may have difficulty in managing its liquidity risk to meet redemption requests and other ongoing obligations. Accordingly, section 3.3.1 has been added to Companion Policy 81-102CP to National Instrument 81-102 *Mutual Funds*, which describes the CSA’s expectations with respect to illiquid asset investments by non-redeemable investment funds.

### ***Investments in Other Investment Funds***

- As a result of comments received on the fund-of-fund provisions of NI 81-102, the following changes have been made to the proposed amendments to subsection 2.5(2) of NI 81-102 since the 2013 Proposal:
  - We introduced paragraph 2.5(2)(a.1) which permits a non-redeemable investment fund to purchase securities of another investment fund so long as the underlying fund is either subject to NI 81-102 or complies with the provisions of NI 81-102 applicable to a non-redeemable investment fund. As a result of this change, non-redeemable investment funds will not be restricted from purchasing securities of another non-redeemable investment fund or of a commodity pool (as defined in NI 81-104).
  - We introduced paragraph 2.5(2)(c.1) such that a non-redeemable investment fund may invest in another investment fund if the other investment fund is a reporting issuer in a jurisdiction in which the non-redeemable investment fund is a reporting issuer. In the 2013 Proposal, the proposed amendment to paragraph 2.5(2)(c)

required the underlying fund to be a reporting issuer in the same jurisdictions as the non-redeemable investment fund.

## **2. Organizational Costs**

- After reviewing the comments received with respect to section 3.3 of NI 81-102, the CSA are deferring implementation of any provisions dealing with the payment of organizational costs by a non-redeemable investment fund. However, we remain concerned about the potential for regulatory arbitrage where a manager launches an investment fund as a non-redeemable investment fund and, after a short period, converts it to a mutual fund. The CSA believe that such a transaction permits a manager to circumvent the requirements of Part 3 of NI 81-102. Accordingly, we may publish, concurrently with the Alternative Funds Proposals, proposed amendments to NI 81-102 which would address this potential arbitrage.

## **3. Fundamental Changes**

- Proposed subsection 5.3(2) of NI 81-102 in the 2013 Proposal contained a limited exemption from the securityholder approval requirement in subparagraph 5.1(1)(h)(i) of NI 81-102 for a non-redeemable investment fund that is structured from inception to convert to a mutual fund upon the occurrence of a specified event. Conditions for this proposed exemption included prospectus and sales communication disclosure of the conversion and securityholder notice prior to the conversion. After considering the comments received and the other changes made as a result of the comments, the CSA have deleted proposed subsection 5.3(2) of NI 81-102. The CSA consider a change to the nature of an investment fund to be a fundamental change which requires securityholder approval, and we are generally of the view that the investor benefit provided by the securityholder approval requirements in section 5.1 of NI 81-102 cannot be replaced with disclosure in the prospectus.
- Furthermore, as discussed above, unlike the 2013 Proposal, the Amendments do not contain a restriction on a non-redeemable investment fund paying its own organizational costs. Accordingly, the CSA think the requirement to obtain securityholder approval prior to a conversion from a non-redeemable investment fund to a mutual fund will mitigate the potential arbitrage of launching an investment fund in the form of a non-redeemable investment fund and then converting it to a mutual fund shortly after launch.

## **4. Sale of Securities**

- The 2013 Proposal contained proposed subsections 9.3(2) and (3) of NI 81-102, which governed the issue price of securities of a non-redeemable investment fund. In response to comments received regarding the practical issues of complying with proposed subsection 9.3(3) of NI 81-102, the CSA have consolidated these two subsections into subsection 9.3(2) of NI 81-102 such that the different treatment of the issue price of securities, depending on whether the securities are issued under a

prospectus, is removed. The same anti-dilution requirements will apply to all issuances of securities by non-redeemable investment funds.

## **5. Commingling of Cash**

- After reviewing comments received with respect to the application of Part 11 of NI 81-102 to non-redeemable investment funds, we have added a carve out, in subsection 11.4(1.3) of NI 81-102, from section 11.1 for CDS Clearing and Depository Services Inc.

## **6. Securities Lending Disclosure Requirements**

- Based on the feedback we received in response to the potential measures to enhance the transparency of the benefits, costs and risks of securities lending, repurchase and reverse repurchase transactions by investment funds detailed in the 2013 Proposal, the CSA have introduced the Securities Lending Disclosure Requirements. These requirements comprise certain of the disclosure requirements in respect of which we sought detailed feedback, which the CSA consider to be particularly important and relevant to investors. These requirements are described under the heading “(x) Securities Lending Disclosure Requirements” in the Notice.

## **7 Transition Period and Grandfathering**

- As described in the Notice, the CSA are providing transition periods for existing investment funds to comply with certain of the Amendments. In addition to the transition periods contemplated in the 2013 Proposal, the CSA are providing existing non-redeemable investment funds that are reporting issuers with 12 months to comply with the securities lending, repurchase and reverse repurchase provisions of NI 81-102.
- Moreover, under new section 18.5.2 of National Instrument 81-106 *Investment Fund Continuous Disclosure* (NI 81-106), investment funds are not required to comply with the amendments to NI 81-106, which relate to the Securities Lending Disclosure Requirements, for financial years beginning before January 1, 2016.
- Finally, subsection 20.4(2) of NI 81-102 provides an exemption for existing non-redeemable investment funds which are reporting issuers and have adopted fundamental investment objectives to permit them to invest in mortgages, such that paragraph 2.3(2)(b) of NI 81-102 does not apply to such non-redeemable investment funds.