



# Modernization of Investment Fund Product Regulation – Alternative Mutual Funds

Presenter: **Christopher Bent**, Senior Legal Counsel, Investment Funds and Structured Products Branch

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# Outline

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# Background

- Final Amendments published October 4, 2018, came into force January 3, 2019
- Amendments completed final steps of Investment Fund Modernization Project:
  - Established framework for a new category of mutual fund called “alternative mutual fund” – defined as a mutual fund that can invest in commodities or use leverage in a manner not permitted for other mutual funds. Replaced the old term “commodity pool”.
  - Amendments also include new prospectus form requirements in NI 41-101 and NI 81-101, and financial disclosure in NI 81-106 for alternative mutual funds.
  - Finalized consolidation of investment restrictions for reporting issuer investment funds within NI 81-102, including final integration of non-redeemable investment funds (NRIFs) within NI 81-102 framework.

# NI 81-102 Amendments Investment Restrictions

## Concentration Restriction – s. 2.1

Type of Fund	Prior Restriction	Amended Restriction
<b>Commodity Pool/Alternative Mutual Funds</b>	<ul style="list-style-type: none"> <li>• 10% of NAV at time of purchase, in securities of an issuer</li> <li>• Subject to certain prescribed exemptions</li> </ul>	<ul style="list-style-type: none"> <li>• 20% of NAV at time of purchase – same exceptions apply</li> </ul>
<b>NRIF</b>	<ul style="list-style-type: none"> <li>• N/A (NRIFs exempt)</li> </ul>	<ul style="list-style-type: none"> <li>• Same as above</li> </ul>
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"> <li>• 10% of NAV at time of purchase</li> <li>• Same exceptions as for alternative mutual funds</li> </ul>	<ul style="list-style-type: none"> <li>• No change</li> </ul>

# NI 81-102 Amendments Investment Restrictions *(cont'd)*

## Restrictions on Investing – s. 2.3

Type of Fund	Prior Restriction	Amended Restriction
<b>Commodity Pool / Alternative Mutual Funds</b>	<ul style="list-style-type: none"> <li>No restriction on investing in commodities directly or indirectly</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>
<b>NRIF</b>	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"> <li>Can invest only in gold*, up to 10% of NAV at time of purchase</li> </ul> <p><i>* Includes certificates or indirectly through derivatives referencing the metal</i></p>	<ul style="list-style-type: none"> <li>Can invest in gold*, silver*, platinum*, palladium* – combined limit of 10% of NAV</li> <li>“precious metals funds” may invest up to 100% of NAV in gold*, silver*, platinum* or palladium*.</li> </ul>

# NI 81-102 Amendments Investment Restrictions *(cont'd)*

## Illiquid Assets – s. 2.4

Type of Fund	Prior Restriction	Amended Restriction
<b>Commodity Pool / Alternative Mutual Funds</b>	<ul style="list-style-type: none"> <li>Up to 10% of NAV at time of purchase, 15% hard cap</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>
<b>NRIF</b>	<ul style="list-style-type: none"> <li>No restriction</li> </ul>	<ul style="list-style-type: none"> <li>Up to 20% of NAV at time of purchase, 25% hard cap</li> </ul>
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"> <li>Up to 10% of NAV at time of purchase, 15% hard cap</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>

# NI 81-102 Amendments Investment Restrictions *(cont'd)*

## Fund of Fund Investing – s. 2.5

Type of Fund	Prior Restriction	Amended Restriction
<b>Commodity Pool / Alternative Mutual Funds</b>	<ul style="list-style-type: none"> <li>• Can invest only in mutual funds subject to NI 81-102 that file an SP/AIF (this restriction currently prohibits investing in other commodity pools)</li> <li>• Other restrictions same as mutual funds (see below)</li> </ul>	<ul style="list-style-type: none"> <li>• Can invest in any investment fund that is a reporting issuer subject to NI 81-102 in any jurisdiction (includes NRIFs and other alternative mutual funds)</li> </ul>
<b>NRIF</b>	<ul style="list-style-type: none"> <li>• Can invest in any investment fund that is a reporting issuer subject to NI 81-102 in the jurisdiction</li> </ul>	<ul style="list-style-type: none"> <li>• Same as above</li> </ul>

# NI 81-102 Amendments Investment Restrictions *(cont'd)*

## Fund of Fund Investing – s. 2.5 *(cont'd)*

Type of Fund	Prior Restriction	Amended Restriction
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"><li>Can invest only in mutual funds subject to NI 81-102 that file an SP – exception for IPUs</li></ul>	<ul style="list-style-type: none"><li>Can invest up to 100% in any mutual fund (other than an alternative mutual fund) that is a reporting issuer subject to NI 81-102 in any jurisdiction</li><li>Can invest up to 10% combined in alternative mutual funds/NRIFs that are subject to NI 81-102</li></ul>



# NI 81-102 Amendments Investment Restrictions *(cont'd)*

## Investment Practices - s. 2.6

Type of Fund	Prior Restriction	Amended Restriction
<b>Commodity Pool / Alternative Mutual Funds</b>	<p>Not permitted to:</p> <ul style="list-style-type: none"> <li>Borrow cash except for up to 5% of NAV on a temporary basis to fund redemptions</li> </ul>	<ul style="list-style-type: none"> <li>Can borrow up to 50% of NAV, subject to certain conditions including only borrowing from permitted custodian/subcustodian</li> <li>IRC approval required if borrowing from an affiliate of the Manager</li> </ul>
<b>NRIF</b>	<ul style="list-style-type: none"> <li>No restrictions on borrowing</li> <li>Same restrictions on lending, underwriting as above</li> </ul>	<ul style="list-style-type: none"> <li>Same as alternative mutual funds</li> </ul>
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"> <li>Same as commodity pools above</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>

# NI 81-102 Amendments Investment Restrictions *(cont'd)*

## Short Selling – s. 2.6.1, 2.6.2

Type of Fund	Prior Restriction	Amended Restriction
<b>Commodity Pool / Alternative Mutual Funds</b>	<ul style="list-style-type: none"> <li>Up to 20% of NAV in total</li> <li>No more than 5% of NAV on one issuer</li> <li>Must hold 150% cash cover</li> <li>Proceeds from short sales must be paid in cash</li> </ul>	<ul style="list-style-type: none"> <li>Up to 50% of NAV in total</li> <li>Up to 10% of NAV on one issuer (exception for “government securities”)</li> <li>No cash cover required, no prohibition on using proceeds to buy long</li> <li><b>Subject to combined cap with cash borrowing of 50%</b></li> </ul>
<b>NRIF</b>	<ul style="list-style-type: none"> <li>No restrictions (NRIFs exempt)</li> </ul>	<ul style="list-style-type: none"> <li>Same as alternative mutual funds</li> </ul>
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"> <li>Same as commodity pools above</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>

# NI 81-102 Amendments Investment Restrictions *(cont'd)*

## Aggregate Exposure to Leverage – s. 2.9.1 (New Section)

Type of Fund	Prior Restriction	Amended Restriction
<b>Commodity Pool / Alternative Mutual Funds</b>	<ul style="list-style-type: none"> <li>No direct leverage</li> <li>Only permitted synthetically through derivatives - No prescribed limit</li> </ul>	<ul style="list-style-type: none"> <li>300% of NAV, calculated as sum of cash borrowing, short-selling, derivatives (minus derivatives used for hedging) divided by NAV</li> </ul>
<b>NRIF</b>	<ul style="list-style-type: none"> <li>No restrictions</li> </ul>	<ul style="list-style-type: none"> <li>Same as alternative mutual funds</li> </ul>
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"> <li>Not applicable - use of leverage not permitted, directly or synthetically</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>

# NI 81-102 Amendments (*cont'd*)

## Seed Capital/Organizational Costs – s. 3.1

Type of Fund	Prior Requirement	Amended Requirement
<b>Commodity Pool/Alternative Mutual Funds</b>	<ul style="list-style-type: none"><li>• Manager to pay start-up costs</li><li>• Min. \$50,000 seed capital – must remain in fund at all times</li></ul>	<ul style="list-style-type: none"><li>• Same seed capital requirements as conventional mutual funds (see below)</li></ul>
<b>NRIF</b>	<ul style="list-style-type: none"><li>• Fund can pay start-up costs</li><li>• No seed capital requirements</li></ul>	<ul style="list-style-type: none"><li>• No change</li></ul>

# NI 81-102 Amendments (cont'd)

## Seed Capital/Organizational Costs – s. 3.1 (cont'd)

Type of Fund	Prior Requirement	Amended Requirement
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"><li>• Manager to pay start-up costs</li><li>• Min. \$150,000 seed capital – cannot be withdrawn until \$500,000 in outside investment received</li></ul>	<ul style="list-style-type: none"><li>• No change</li></ul>

# NI 81-102 Amendments (cont'd)

## Entities Permitted to Act as Custodians – s. 6.2

Type of Fund	Prior Requirement	Amended Requirement
<b>Commodity Pool / Alternative Mutual Funds</b>	<ul style="list-style-type: none"><li>• Must be Canadian Bank, Trust Company (per Bank Act or LTCA/provincial equivalent)</li><li>• Can also be affiliate of above if (a) parent guarantees all obligations or (b) has asset &gt; \$10M as per publicly available audited financial statements</li></ul>	<ul style="list-style-type: none"><li>• Affiliate of bank/trust company does not need “publicly available” financial statements, the but rest of the criteria still applies</li></ul>

# NI 81-102 Amendments (*cont'd*)

## Entities Permitted to Act as Custodians – s. 6.2 (*cont'd*)

Type of Fund	Prior Requirement	Amended Requirement
<b>NRIF</b>	<ul style="list-style-type: none"><li>• Same as above</li></ul>	<ul style="list-style-type: none"><li>• Same as above</li></ul>
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"><li>• Same as above</li></ul>	<ul style="list-style-type: none"><li>• Same as above</li></ul>

# NI 81-102 Amendments (cont'd)

## Entities Permitted to Act as Sub-Custodians – s. 6.3

Type of Fund	Prior Requirement	Amended Requirement
<b>Commodity Pool / Alternative Mutual Funds</b>	<ul style="list-style-type: none"><li>• Must be Canadian Bank, Trust Company, or foreign equivalent (if assets held outside of Canada)</li><li>• Can also be affiliate of above if (a) parent guarantees all obligations or (b) has asset &gt; \$10M as per publicly available audited financial statements</li></ul>	<ul style="list-style-type: none"><li>• Affiliate of bank/trust company does not need “publicly available” financial statements, but rest of criteria still applies</li></ul>



## NI 81-102 Amendments (*cont'd*)

### Entities Permitted to Act as Sub-Custodians – s. 6.3 (*cont'd*)

Type of Fund	Prior Requirement	Amended Requirement
<b>NRIF</b>	<ul style="list-style-type: none"><li>• Same as above</li></ul>	<ul style="list-style-type: none"><li>• Same as above</li></ul>
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"><li>• Same as above</li></ul>	<ul style="list-style-type: none"><li>• Same as above</li></ul>

# Prospectus Disclosure – NI 81-101/ NI 41-101 Amendments

## Form of Prospectus/Disclosure

Type of Fund	Prior Requirement	Amended Requirement
<b>Commodity Pool/Alternative Mutual Funds</b>	<ul style="list-style-type: none"><li>• Must use Form 41-101F2 long form prospectus</li><li>• Delivery within 2 days of trade</li><li>• Must prepare ETF Facts if traded on an exchange</li></ul>	<ul style="list-style-type: none"><li>• Same prospectus form requirements as conventional mutual funds (<i>see below</i>)</li><li>• Must also provide certain alternative mutual fund specific disclosure re: investment restrictions, leverage, borrowing</li></ul>

# Prospectus Disclosure – NI 81-101/ NI 41-101 Amendments (*cont'd*)

## Form of Prospectus/Disclosure (*cont'd*)

Type of Fund	Prior Requirement	Amended Requirement
<b>NRIF</b>	<ul style="list-style-type: none"><li>• Must use Form 41-101F2 long form prospectus</li></ul>	<ul style="list-style-type: none"><li>• No change in prospectus form requirement</li><li>• Must provide certain additional disclosure about borrowing and leverage activities</li></ul>

# Prospectus Disclosure – NI 81-101/ NI 41-101 Amendments (*cont'd*)

## Form of Prospectus/Disclosure (*cont'd*)

Type of Fund	Prior Requirement	Current Requirement
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"><li>• Must use NI 81-101 Forms (SP, AIF, Fund Facts) unless exchange-traded</li><li>• If exchange-traded, must use Form 41-101F2 long form prospectus and ETF Facts</li><li>• <u>Fund Facts</u>: point of sale delivery</li><li>• <u>ETF Facts</u> – delivery within 2 days of trade</li></ul>	<ul style="list-style-type: none"><li>• No change</li></ul>

# Financial Statement Disclosure – NI 81-106 Amendments

Type of Fund	Prior Requirement	Current Requirement
<b>Commodity Pool / Alternative Mutual Funds</b>	<ul style="list-style-type: none"> <li>• Must disclose min. and max. leverage during reporting period*</li> <li>• No prescribed methodology for calculating leverage</li> </ul> <p><i>*Reporting requirement was previously in NI 81-104, not NI 81-106**</i></p>	<ul style="list-style-type: none"> <li>• Description of use of leverage including min and max exposure to leverage, calculated based on new NI 81-102 requirements in financial statements and MRFP</li> <li>• MRFP disclosure to also include description of impact of hedging on overall leverage exposure calculation</li> </ul>
<b>NRIF</b>	<ul style="list-style-type: none"> <li>• No specific leverage reporting requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Same requirements as for alternative mutual funds</li> </ul>
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"> <li>• Not applicable</li> </ul>	<ul style="list-style-type: none"> <li>• No change</li> </ul>

# Mutual Fund Dealer Proficiency - NI 81-104 Amendments

Type of Fund	Prior Requirement	Current Requirement
<b>Commodity Pool / Alternative Mutual Funds</b>	<ul style="list-style-type: none"> <li>Standard proficiency in NI 31-103, MFDA rules</li> <li>In addition, dealer must have one of: (a)CSC, (b)Derivatives Fundamentals Course,(c) CFA, or (d) additional proficiency prescribed by the MFDA</li> </ul>	<ul style="list-style-type: none"> <li>No change – same standard to apply to distribution of alternative mutual funds</li> </ul>
<b>NRIF</b>	<ul style="list-style-type: none"> <li>N/A</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>
<b>Conventional Mutual Funds</b>	<ul style="list-style-type: none"> <li>N/A – not subject to NI 81-104</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>

# Transition / Grandfathering

- Amendments came into force on January 3, 2019 – applies to all new investment funds as of that date.
- NRIFs that were in operation prior to October 4, 2018 are exempt from the new NRIF investment restrictions in Part 2 of NI 81-102.
- However, any NRIF (including pre-existing ones) that files a preliminary prospectus after October 4, 2018 must fully comply with the Amendments as of the coming into force date.
- Commodity pools existing before January 3, 2019 will have until July 4, 2019 to adapt to the Amendments.



# QUESTIONS?

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