

Chapter 2

Decisions, Orders and Rulings

2.1 Decisions

2.1.1 Franklin Templeton Investments Corp. et al.

Headnote

National Policy 11-203 Process for Exemptive Relief Applications in Multiple Jurisdictions – Relief from the cash cover requirements under section 2.8 of NI 81-102 to permit mutual funds to include as cash cover any non-rated short-term debt that is issued, or fully and unconditionally guaranteed as to principal and interest, by the U.S. government or the government of another sovereign state if other evidences of indebtedness of the government or sovereign state that are rated as short-term debt by a designated rating organization or its DRO affiliate have a designated rating – The definition of ‘cash cover’, which refers to the definition of ‘cash equivalent’, treats the short-term debt obligations issued or guaranteed by governments of sovereign states differently than the short-term debt obligations issued or guaranteed by Canadian or foreign financial institutions – NI 81-102 permits non-rated short-term debt instruments of financial institutions to be used as cash cover provided at least one short-term debt instrument of the financial institution has a designated rating issued by a DRO – Inability to use non-rated sovereign debt from highly rated sovereign states as cash cover in the same way as non-rated bank debt is permitted to be used as cash cover limits the universe of short-term debt that qualifies as cash cover for derivative transactions and requires maintenance of higher levels of cash and cash equivalents by the mutual funds, while reducing the cash available for investment, thereby negatively impacting returns of the mutual funds – Relief granted subject to conditions ensuring the creditworthiness and liquidity of the non-rated sovereign debt used as cash cover, including that the sovereign state have a credit rating of A (Fitch), A2 (Moody’s) and A (S&P) or higher.

Applicable Legislative Provisions

National Instrument 81-102 Investment Funds, ss. 2.8 and 19.1.

January 28, 2022

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
ONTARIO
(the Jurisdiction)

AND

IN THE MATTER OF
THE PROCESS FOR EXEMPTIVE RELIEF
APPLICATIONS
IN MULTIPLE JURISDICTIONS

AND

IN THE MATTER OF
FRANKLIN TEMPLETON INVESTMENTS CORP.
(the Filer)

IN THE MATTER OF
TEMPLETON GLOBAL BOND FUND AND
TEMPLETON GLOBAL BALANCED FUND
(the Existing Funds)

DECISION

Background

The principal regulator in the Jurisdiction has received an application from the Filer for a decision under the securities legislation of the Jurisdiction of the principal regulator (the **Legislation**) for an exemption pursuant to section 19.1 of National Instrument 81-102 *Investment Funds (NI 81-102)* permitting the Existing Funds and each current and future mutual fund, including exchange-traded fund, managed or sub-advised from time by the Filer or one of the Franklin Templeton Companies (as defined below) (together with the Existing Funds, the **Funds**) to include as cash cover for derivative transactions under section 2.8 of NI 81-102 any evidence of indebtedness that has a remaining term to maturity of 365 days or less and that is issued, or fully and unconditionally guaranteed as to principal and interest, by the government of the United States of America or the government of another sovereign state (the United States of America and each other sovereign state, a **sovereign state**) if other evidences of indebtedness of the government of that sovereign state that are rated as short-term debt by a designated rating organization or its DRO affiliate (as such terms are defined in NI 81-102) have a designated rating (the **Requested Relief**).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a passport application):

- (a) the Ontario Securities Commission is the principal regulator for the application; and
- (b) the Filer has provided notice that Section 4.7(1) of Multilateral Instrument 11-102 *Passport System (MI 11-102)* is intended to be relied upon in Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island, Québec, Saskatchewan and Yukon (together with Ontario, the **Jurisdictions**).

Interpretation

Terms defined in National Instrument 14-101 *Definitions*, MI 11-102 and NI 81-102 have the same meaning if used in this decision, unless otherwise defined.

Representations

This decision is based on the following facts represented by the Filer:

1. The Filer is the investment fund manager of the Existing Funds. The Filer is registered as an investment fund manager, portfolio manager, mutual fund dealer and exempt market dealer in the Province of Ontario. The Filer is also registered as a portfolio manager, mutual fund dealer and exempt market dealer in all other Canadian provinces and the Yukon Territory and as an investment fund manager in the Provinces of Alberta, British Columbia, Manitoba, Newfoundland and Labrador, Nova Scotia and Québec. The head office of the Filer is in Toronto, Ontario.
2. Either the Filer or one of the global Franklin Templeton group of companies (collectively, the **Franklin Templeton Companies**), each of which is an affiliate of the Filer, is, or will be, the investment advisor or the sub-advisor to the Funds.
3. Each Fund is, or will be, a mutual fund created either under the laws of the Province of Ontario or Alberta or under the laws of Canada and is, or will be, subject to the provisions of NI 81-102, subject to any relief therefrom granted by the securities regulatory authorities.
4. None of the Filer nor the Existing Funds are in default of securities legislation in any Jurisdiction.
5. The securities of each Fund are, or will be, qualified for distribution pursuant to a prospectus that was, or will be, prepared and filed in accordance with the securities legislation of the Jurisdictions. Accordingly, each Fund is, or will be, a reporting issuer or the equivalent in each Jurisdiction.
6. The investment strategies of each Fund permit, or will permit, the Fund to enter into, among other things, derivative transactions for non-hedging purposes. As a result, each Fund is required to hold, from time to time, cover in accordance with section 2.8 of NI 81-102.
7. In many cases, the portfolio manager of a Fund believes that the most appropriate cash cover to be held by the Fund in respect of its derivative positions are short-term debt instruments issued by, or fully and unconditionally guaranteed as to principal and interest by, the government of one or more sovereign states. In some instances, the actual debt instruments held by the Fund have a designated rating. However, in other cases, the Fund would like to hold short-term debt instruments that are issued, or fully and unconditionally guaranteed as to principal and interest, by the government of sovereign states where the debt instruments are not rated.
8. The definition of cash cover in NI 81-102 includes, among other things, cash equivalents (as defined in NI 81-102).
9. Paragraph (b) of the definition of cash equivalent in NI 81-102 includes an evidence of indebtedness that has a remaining term to maturity of 365 days or less and that is issued, or fully and unconditionally guaranteed as to principal and interest, by the government of the United States of America, the government of one of the states of the United States of America, the government of another sovereign state or a permitted supranational agency, if, in each case, the evidence of indebtedness has a designated rating. As defined, only those short-term debt instruments that are issued, or fully and unconditionally guaranteed as to principal and interest, by the government of a sovereign state and that have a designated rating meet the definition of cash equivalent and, therefore, can be held as cash cover.
10. Paragraph (c) of the definition of cash equivalent in NI 81-102 includes an evidence of indebtedness that has a remaining term to maturity of 365 days or less and that is issued, or fully and unconditionally guaranteed as to principal and interest, by a Canadian financial institution, or a financial institution that is not incorporated or organized under the laws of Canada or of a jurisdiction if, in either case, evidences of indebtedness of that issuer or guarantor that are rated as short-term debt by a designated rating organization or its DRO affiliate have a designated rating. As defined, provided that at least one short-term debt instrument of the Canadian or foreign financial institution has a designated rating, then any short-term debt instrument of that Canadian or foreign financial institution qualifies as a cash equivalent and can be held as cash cover.
11. Neither NI 81-102 nor Companion Policy 81-102CP explains why the definition of cash cover, which refers to the definition of cash equivalent, treats the short-term debt obligations issued or guaranteed by governments of sovereign states differently than the short-term debt obligations issued or guaranteed by financial institutions.
12. The Filer believes that if the government of a sovereign state has at least one of its short-term debt obligations rated with a designated rating, then all of that government's short-term evidences of indebtedness, and all short-term evidences of indebtedness that are fully and unconditionally guaranteed as to principal and interest by that government, should be capable of being treated as cash cover for purposes of NI 81-102. Whether a rating agency issues a rating for the particular evidence of indebtedness of a government of a sovereign state or for any short-term evidence of indebtedness of that government, the Filer understands that the rating agency conducts a

similar analysis of the financial condition of the government. Given the cost of obtaining a credit rating and the length of time that it can take to rate a particular financial instrument, the Filer believes that many governments of sovereign states choose not to have all of their short-term debt obligations rated. Assuming that at least one short-term debt obligation of the government of a sovereign state has a designated rating, the Filer believes that all short-term debt obligations of that government have similar creditworthiness parameters.

13. The creditworthiness of the sovereign states whose short-term debt will be used as cash cover meets the designated rating requirement in a manner that is consistent with the requirements under NI 81-102. The Filer believes that it is appropriate to assume that sovereign short-term debt instruments that do not have an explicit credit rating have the same creditworthiness of the sovereign state itself, or the sovereign state's other short-term debt. If the sovereign state does not meet the designated rating requirement, or if there is no short-term debt issued by the sovereign state that meets the designated rating requirement, then the unrated short-term debt issued by such sovereign state could not be used as cash cover.

14. Without the ability to use unrated sovereign debt from highly rated sovereign states as cash cover, the universe of short-term debt that qualifies as cash cover is limited. In order for the Funds to hold the required cash cover, they currently have to purchase additional short-term debt and/or maintain higher cash balances. This leads to a long-term increase in the level of cash and cash equivalents held by the Funds, while reducing the cash available for investment, thereby negatively impacting the return of the Funds.

15. It would not be prejudicial to the public interest to grant the Requested Relief to the Funds.

(c) the Fund ceases including the unrated short-term debt as cash cover if:

(i) the credit rating of the government of the sovereign state falls below the rating specified in (a) above;

(ii) the rated short-term debt of the sovereign state falls below the level of a designated rating issued by a designated rating organization or its DRO affiliate referenced in (b) above; or

(iii) the unrated short-term debt becomes rated as short-term debt that has a rating that is below the level of a 'designated rating' issued by a designated rating organization or its DRO affiliate.

"Darren McKall"
Manager
Investment Funds and Structured Products Branch
Ontario Securities Commission

Application File #: 2021/0574
SEDAR #: 3333651 & 3333679

Decision

The principal regulator is satisfied that the decision meets the test set out in the Legislation for the principal regulator to make the decision.

The decision of the principal regulator is that the Requested Relief is granted, provided that:

(a) the sovereign state whose short-term debt is used as cash cover has a credit rating of A (Fitch), A2 (Moody's) and A (S&P) or higher;

(b) the sovereign state that issues the unrated short-term debt has other evidences of indebtedness that are rated as short-term debt that have a designated rating issued by a designated rating organization or its DRO affiliate; and