

COMPANION POLICY 81-106CP TO NATIONAL INSTRUMENT 81-106 INVESTMENT FUND CONTINUOUS DISCLOSURE

PART 1 PURPOSE AND APPLICATION OF THE COMPANION POLICY

1.1 Purpose

The purpose of this Companion Policy is to provide guidance to assist investment funds in complying with their obligations under National Instrument 81-106 Investment Fund Continuous Disclosure (the “Instrument”).

1.2 Application

- (1) Section 1.2 of the Instrument states that the Instrument applies, to investment funds, which includes scholarship plans and non-redeemable investment funds. These funds have similar characteristics to mutual funds and so are appropriately subject to similar reporting requirements.
- (2) In addition, the Instrument applies to a mutual fund in the jurisdiction, which is defined in the Instrument as “a mutual fund that is a reporting issuer in, or that is organized under the laws of, the local jurisdiction”. Market participants are reminded that the definition of mutual fund may include mutual fund securities distributed by private placement (so-called “pooled funds”) if organized under the laws of the local jurisdiction.

1.3 Plain Language Principles

The Canadian securities regulatory authorities believe that plain language will help investors understand an investment funds’ disclosure documents so that they can make informed investment decisions. Investment funds are encouraged to adopt the following plain language principles in preparing documents filed under the Instrument:

- use short sentences
- use definite, concrete, everyday language
- use the active voice
- avoid unnecessary words
- organize the document into clear, concise sections, paragraphs and sentences
- avoid legal or business jargon
- use strong verbs

- use personal pronouns to speak directly to the reader
- avoid reliance on glossaries and defined terms unless it helps to understand the disclosure
- avoid vague boilerplate wording
- use concrete terms or examples
- avoid excessive detail
- avoid multiple negatives.

If technical or business terms are required, clear and concise explanations should be used.

1.4 Signature and Certificates

The directors of an investment fund or the manager or the trustee of an investment fund are not required to file signed or certified continuous disclosure documents. The directors or the manager or trustee of an investment fund are responsible for the information in the investment funds disclosure documents whether or not a document is signed or certified, and it is an offence under securities legislation to file a document that contains a misrepresentation.

1.5 Filings on SEDAR

Investment funds are reminded that all documents required to be filed under the Instrument must be filed in accordance with National Instrument 13-101 – System for Electronic Document Analysis and Retrieval (SEDAR).

PART 2 FINANCIAL STATEMENTS

2.1 Interrelationship of Financial Statements with Canadian GAAP

- (1) Investment funds are required to prepare their annual and interim financial statements and their annual and quarterly management reports of fund performance in accordance with both Canadian GAAP and the Instrument.
- (2) Canadian GAAP provides some general requirements for the preparation of financial statements that are applicable to investment fund financial statements. Investment funds are required to comply with those requirements.
- (3) However, Canadian GAAP does not contain detailed requirements applicable to the contents of investment fund financial statements. The Canadian securities regulatory authorities believe that certain information

should properly be contained in the financial statements of investment funds in order to provide full disclosure, and require that this information be included.

- (4) The information required by the Instrument to be included in financial statements, or an annual or interim management report of fund performance, is minimum information only. Persons preparing these documents should include any other additional information required to ensure that all material information concerning the financial position or results of the investment fund is disclosed.

2.2 Timing and Content of Interim Financial Statements

- (1) Interim financial statements are also required to be prepared in accordance with both Canadian GAAP and the requirements of the Instrument. For example, Section 1751 Interim Financial Statements of the Handbook requires that the interim financial statements include, at a minimum: each of the headings and subtotals included in the most recent annual financial statements; and the specific disclosures required by Section 1751. Investment funds must ensure that interim financial statements comply with both Section 1751 of the Handbook and the Instrument. Separate fourth quarter interim financial statements are not required.

2.3 Auditor's Report

- (1) An auditor's report required by section 2.3 of the Instrument may not contain a reservation of opinion unless exemptive relief is granted under 19.1. The Canadian securities regulatory authorities would have serious concerns where the reservation is:
 - (a) due to a departure from Canadian GAAP; or
 - (b) due to a limitation in the scope of the auditor's examination that:
 - (i) results in the auditor being unable to form an opinion on the financial statements as a whole because of a limitation in the scope of the audit;
 - (ii) is imposed or could reasonably be eliminated by management; or
 - (iii) could reasonably be expected to be recurring.
- (2) The Canadian securities regulatory authorities encourage investment funds to file their financial statements as soon as practicable after the date of the audit report.

2.4 Auditor's Report - Multiple Class Funds

- (1) As provided in section 8.2 of the Instrument, an investment fund that has more than one class or series of securities outstanding that are referable to a single portfolio, may, at its option, prepare separate financial statements and annual and quarterly management reports of fund performance for each class or series, or may consolidate the information concerning all of the classes or series into one set of financial statements and management reports of fund performance.
- (2) To satisfy the requirement to produce audited annual financial statements, an investment fund that has more than one class or series outstanding must ensure that the annual financial statements for each class or series are audited. If the investment fund is preparing separate financial statements for each class or series, it should ensure that the auditor's report for each set of financial statements pertains specifically to the relevant class or series, but also indicates that the investment fund as a whole has been reported on for the same period without reservation.
- (3) It is expected that once an investment fund makes an initial decision as to whether to prepare separate or consolidated financial statements or management reports of fund performance for its classes or series of securities, it will continue with the same approach for subsequent financial periods in order to ensure that the financial statements and management reports of fund performance for different financial periods are easily comparable. The Canadian securities regulatory authorities believe investment funds should explain, in notes to financial statements or in a management report of fund performance, the reasons for any change in approach taken from one financial period to another.

2.5 Auditor's Involvement with the Annual Management Reports of Fund Performance

Investment funds' auditors are expected to comply with section 7500 – The Auditor's Involvement with the Annual Reports, of the Handbook¹, in connection with the preparation of the annual management reports of fund performance required by the Instrument.

2.6 Delivery of Financial Statements

- (1) Prior to the implementation of the Instrument, securities legislation of most Canadian jurisdictions required investment funds to deliver annual and, in certain circumstances, interim financial statements to securityholders concurrent with filing. The Instrument eliminates this mandated delivery, replacing it with a requirement that an investment fund

¹ "Handbook" is defined in the NI 14-101 Definitions to mean the Handbook of the Canadian Institute of Chartered Accountants.

must deliver annual and interim financial statements only to those securityholders who request them subject to the annual notice requirement. Investment funds are reminded that they remain subject to all applicable corporate law requirements that may still require delivery of annual financial statements to securityholders.

- (2) Eliminating the delivery requirement enables investment funds governed by either the CBCA or provincial corporate statute to take advantage of provisions in these statutes that allow companies not to deliver annual financial statements to securityholders who have elected not to receive them.
- (3) The Instrument requires the delivery of various notices to securityholders by investment funds. Investment funds are reminded of the provisions of National Policy 11-201 Delivery of Documents by Electronic Means. In particular, it is noted that the notices required to be given under sections 2.2, 3.2, 5.2 and 6.2 of the Instrument may be given in electronic form and may be combined into one or more notices. Such notices may alternatively be sent with account statements or other materials sent to securityholders by an investment fund as is convenient to the investment fund.

2.7 Change in Ending Date of Financial Year

Where an investment fund changes the ending date of its financial year, the investment fund should refer to National Policy Statement 51 Changes in the Ending Date of a Financial Year and in Reporting Status for guidance concerning reporting periods, filing deadlines and notification procedures.

PART 3 OTHER PROVISIONS

3.1 Accounting for Securities Lending Transactions

- (1) Section 7.1 of the Instrument imposes certain reporting requirements on investment funds in connection with any securities lending transactions entered into by the investment fund. These requirements were included to ensure that all securities lending transactions are accounted for on the same basis. The general accounting principle concerning whether a given transaction is a recordable transaction is based on determining whether risk and rewards have transferred in the transaction. The substance of a securities lending transaction is that the portfolio adviser treats the original securities as if they have never been lent. The investment fund must be able to call the original securities back at any time, and the securities returned must be the same or substantially the same as the original securities. These conditions reduce the risk of the investment fund not

being able to transact the original securities. The original securities remain on the books of the investment fund.

- (2) The accounting treatment of the collateral in a securities lending transaction depends on the ability of the lender to control what happens with the collateral. If non-cash collateral is received by the investment fund, the collateral is not reflected on the statement of net asset of the investment fund if the non-cash collateral cannot be sold or repledged. If cash collateral is received by the investment fund lender, the investment fund has the ability to either hold or reinvest the cash. The lender has effective control over the cash, even though it uses an agent to effect the reinvestment on its behalf. The cash collateral, and subsequent reinvestment, and an obligation to repay the collateral are recorded on the books of the investment fund.

3.2

Costs of Distribution of Securities

- (1) Section 7.5 of the Instrument provides that all costs and expenses associated with the issue and distribution of securities of an investment fund on a continuous basis shall be recognized as expenses in the statement of operations of the investment fund in the period in which they were incurred.
- (2) Section 3.3 of National Instrument 81-102 Mutual Funds prohibits a mutual fund from paying for the costs of incorporation or organization of the mutual fund. However, apart from this restriction, a mutual fund may pay security issue costs for renewal prospectuses, which may include costs associated with legal fees relating to the preparation of a prospectus, costs associated with the distribution of the securities of the mutual fund, including underwriting, agency or similar costs, the cost of printing a prospectus, any fees that may be paid to have the securities of an exchange traded fund listed or quoted on a marketplace, and the cost of tax opinions relating to the issue of securities.
- (3) The Canadian securities regulatory authorities consider it important that investors fully understand the costs associated with the ownership of securities of an investment fund. For this reason, section 7.5 of the Instrument has been implemented, in order to ensure that costs associated with the continuous distribution of securities are shown as expenses of the investment fund on the statements of operations for the financial period in which they are incurred, and are not deferred and amortized to retained earnings, or charged directly to capital.
- (4) Non redeemable investment funds that offer their securities on a one time offering basis should account for the initial offering costs as a capital transaction in accordance with Capital Transactions, Section 3610 of the

Handbook. The amount of the costs should be disclosed separately in the financial statements of the fund for at least the period in which the relevant costs are incurred. Initial offering costs are all costs incurred to complete an offering, including costs of preparing and printing the prospectus, legal expenses, marketing expenses and agents' fees. In CSA staff's view, it is not appropriate for such costs to be deferred and recognized as an asset to be amortized to either income or retained earnings over the life of the fund.

- 3.3 Trailing Commissions** - Trailing fees or commissions are those fees paid to dealers over time based on the client assets maintained in the fund. The Manager normally pays these fees however exemptions have been given to certain labour sponsored funds for the fund to pay these fees. Section 7.6 of the Instrument provides that any trailing fees paid by an investment fund, by way of an exemptive order, must be accounted for as an expense.

PART 4 FORMAL VALUATIONS

4.1 Formal Valuations

Part 8 of the Instrument is designed to address the concerns raised by labour sponsored funds that disclosing a fair value for its venture investments may potentially disadvantage the private companies in which it invests.

Section 8.3 permits alternative disclosure by labour sponsored funds of its statement of investment portfolio.

Labour sponsored funds must disclose the individual securities in which they invests, however, the labour sponsored fund may aggregate all changes from costs of the venture investments, thereby only showing an aggregate adjustment from cost to fair value for these securities.

This alternative disclosure is only permitted if the labour sponsored fund has obtained a formal valuation in accordance with Part 9 of the Instrument. The CSA are of the view that a report on Compliance with stated valuation policies and practices cannot take the place of a formal valuation.

- (1) An investment fund obtaining a formal valuation should, at the request of the valuator, promptly furnish the valuator with access to the investment fund manager and its advisers and to all material information in their possession relevant to the formal valuation. The valuator is expected to use that access to perform a comprehensive review and analysis of information upon which the formal valuation is based. The valuator should form its own independent views of the reasonableness of this information, including any forecasts or projections or other measurements of the expected future performance of the enterprise, and of any of the

assumptions upon which it is based, and adjust the information accordingly.

- (2) The disclosure in the valuation of the scope of review should include a description of any limitation on the scope of the review and the implications of the limitation on the valuator's conclusion.
- (3) The person or company responsible for obtaining a formal valuation should work in co-operation with the valuator to ensure that the requirements of the Instrument are satisfied.

4.2

Independent Valuators

- (1) Except in certain prescribed situations, the Instrument provides that it is a question of fact as to whether a valuator is independent of the investment fund. In determining the independence of the valuator from the investment fund, a number of factors may be relevant, including whether
 - (a) the valuator or an affiliated entity of it has a material financial interest in future business in respect of which an agreement, commitment or understanding exists involving the investment fund or a person or company listed in paragraph (2)(a);
 - (b) the valuator or an affiliated entity of it is a lender of a material amount of indebtedness to any of the issuers of the investment fund's illiquid investments.
- (2) The Canadian securities regulatory authorities would generally consider a valuator to not be independent of an investment fund where
 - (a) the valuator or an affiliated entity of the valuator is
 - (i) the manager of the investment fund,
 - (ii) a portfolio adviser of the investment fund,
 - (iii) an insider of the investment fund,
 - (iv) an associate of the investment fund,
 - (v) an affiliated entity of the investment fund, or
 - (vi) an affiliated entity of any of the persons or companies named in this clause (a);
 - (b) the compensation of the valuator or an affiliated entity of the valuator depends in whole or in part upon an agreement,

arrangement or understanding that gives the valuator, or an affiliated entity of the valuator, a financial incentive in respect of the conclusions reached in the formal valuation;

- (c) the valuator or an affiliated entity of the valuator has a material investment in the investment fund or a portfolio asset of the investment fund.

PART 5 MATERIAL/SIGNIFICANT CHANGE

5.1 Material/Significant Change

The Canadian securities regulatory authorities are of the view that in order for an investment fund to file a confidential material/significant change report under subsection 11.1(3) of the Instrument, the investment fund or its manager must advise insiders of the prohibition against trading during the filing period of a confidential material change report and also must take steps to monitor trading activity.

PART 6 INFORMATION CIRCULARS

6.1 Sending of Proxies and Information Circulars

The Canadian securities regulatory authorities remind that an investment fund is required to send the proxy-related materials referred to in section 12.1 of the Instrument to its securityholders in accordance with the requirements of National Instrument 54-101.