

Headnote

Mutual Reliance Review System for Exemptive Relief Applications – certain mutual funds granted exemptions from National Instrument 81-102 *Mutual Funds* to engage in short selling of securities up to 20% of net assets, subject to certain conditions and requirements – future oriented relief granted as well.

Rules Cited

National Instrument 81-102 *Mutual Funds*, subsections 2.6(a) and (c), 6.1(1) and section 19.1.

Citation: Webb Enhanced Growth Fund and Webb Enhanced Income Fund, 2008 ABASC 56 **Date:** 20080122

IN THE MATTER OF
THE SECURITIES LEGISLATION OF
BRITISH COLUMBIA, ALBERTA, SASKATCHEWAN, MANITOBA, ONTARIO,
NEW BRUNSWICK, NOVA SCOTIA, PRINCE EDWARD ISLAND,
NEWFOUNDLAND AND LABRADOR, YUKON TERRITORY,
NORTHWEST TERRITORIES AND NUNAVUT TERRITORY
(the Jurisdictions)

AND

IN THE MATTER OF
THE MUTUAL RELIANCE REVIEW SYSTEM
FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER OF
WEBB ASSET MANAGEMENT CANADA, INC.
(the Filer)

AND

IN THE MATTER OF
THE WEBB ENHANCED GROWTH FUND AND
THE WEBB ENHANCED INCOME FUND
(the Existing Funds)

MRRS DECISION DOCUMENT

Background

The local securities regulatory authority or regulator (the **Decision Maker**) in each of the Jurisdictions has received an application from the Filer, on behalf of the Existing Funds and each mutual fund hereafter created and managed by the Filer or any of the affiliates of the Filer (the **Future Funds**, and together with the Existing Funds, the **Funds**), for a decision under the securities legislation of the Jurisdictions (the **Legislation**) exempting the Funds from the following requirements of the Legislation, subject to certain terms and conditions:

- (a) the requirement contained in subsection 2.6(a) of National Instrument 81-102 *Mutual Funds* (**NI 81-102**) prohibiting a mutual fund from providing a security interest over a mutual fund's assets;
- (b) the requirement contained in subsection 2.6(c) of NI 81-102 prohibiting a mutual fund from selling securities short; and
- (c) the requirement contained in subsection 6.1(1) of NI 81-102 prohibiting a mutual fund from depositing any part of a mutual fund's assets with an entity other than the mutual fund's custodian.

Paragraphs (a), (b) and (c) together shall be referred to as the Requested Relief.

Under the Mutual Reliance Review System (**MRRS**) for Exemptive Relief Applications:

- (a) the Ontario Securities Commission is the principal regulator for this application; and
- (b) this MRRS decision document evidences the decision of each Decision Maker.

Interpretation

Defined terms contained in National Instrument 14-101 *Definitions* have the same meaning in this decision unless they are defined in this decision.

Representations

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

General

1. The Filer is a corporation existing under the laws of Ontario. The Filer will be the trustee, manager, portfolio adviser and promoter of the Funds.
2. Each of the Funds will be established as an open-end trust pursuant to a Master Declaration of Trust dated January 11, 2008.

3. Upon the issuance of a receipt for the (final) simplified prospectus and (final) annual information form, each of the Funds will be a reporting issuer in all of the provinces and territories of Canada, except Quebec.
4. The investment practices of each of the Funds will comply in all respects with the requirements of Part 2 of NI 81-102, except to the extent that the Funds have received permission from the Decision Makers to deviate therefrom.
5. The Filer proposes that the Funds be permitted to engage in a limited, prudent and disciplined amount of short selling. The Filer is of the view that the Funds will benefit from the implementation and execution of a controlled and limited short selling strategy which would complement the Funds' primary discipline of buying and holding securities with the expectation that they will appreciate in market value.
6. Short sales will be made consistent with each Fund's investment objectives.
7. In order to effect a short sale, a Fund will borrow securities from either its custodian or a dealer (in either case, the **Borrowing Agent**), which Borrowing Agent may be acting either as principal for its own account or as agent for other lenders of securities.
8. Each Fund will implement the following controls when conducting a short sale:
 - (a) securities will be sold short for cash, with the Fund assuming the obligation to return to the Borrowing Agent the securities borrowed to effect the short sale;
 - (b) the aggregate market value of all securities sold short by the Fund will not exceed 20% of the net assets of the Fund on a daily marked-to-market basis;
 - (c) the short sale will be effected through market facilities through which the securities sold short are normally bought and sold;
 - (d) the Fund will receive cash for the securities sold short within normal trading settlement periods for the market in which the short sale is effected;
 - (e) the Fund will hold "cash cover" (as defined in NI 81-102) in an amount, including the Fund assets deposited with Borrowing Agents as security in connection with short sale transactions, that is at least 150% of the aggregate market value of all securities sold short by the Fund on a daily marked-to-market basis;
 - (f) no proceeds from short sales by the Fund will be used by the Fund to purchase long positions in securities other than cash cover;
 - (g) the securities sold short will be liquid securities, "liquid" securities being securities that:
 - (i) are listed and posted for trading on a stock exchange; and

- (1) the issuer of the security has a market capitalization of not less than CDN \$300 million, or the equivalent thereof, at the time the short sale is effected; or
- (2) the Fund has pre-arranged to borrow for the purpose of such sale; or
- (ii) are bonds, debentures or other evidences of indebtedness of or guaranteed by the Government of Canada or any province or territory of Canada or the Government of the United States of America;
- (h) at the time securities of a particular issuer are sold short:
 - (i) the aggregate market value of all securities of that issuer sold short by the Fund will not exceed 5% of the net assets of the Fund; and
 - (ii) the Fund will place a “stop-loss” order with a dealer to immediately purchase for the Fund an equal number of the same securities if the trading price of the securities exceeds 120% (or such lesser percentage as the Filer may determine) of the price at which the securities were sold short;
- (i) the Fund will deposit Fund assets with the Borrowing Agent as security in connection with the short sale transaction;
- (j) for short sale transactions in Canada, every dealer that holds Fund assets as security in connection with short sale transactions by the Fund will be a registered dealer in Canada and a member of a self-regulatory organization that is a participating member of the Canadian Investor Protection Fund;
- (k) for short sale transactions outside of Canada, every dealer that holds Fund assets as security in connection with short sale transactions by the Fund will:
 - (i) be a member of a stock exchange and, as a result, be subject to a regulatory audit; and
 - (ii) have a net worth in excess of the equivalent of CDN \$50 million determined from its most recent audited financial statements that have been made public;
- (l) except where the Borrowing Agent is the Fund’s custodian, when the Fund deposits Fund assets with a Borrowing Agent as security in connection with a short sale transaction, the amount of Fund assets deposited with the Borrowing Agent will not, when aggregated with the amount of Fund assets already held by the Borrowing Agent as security for outstanding short sale transactions of the Fund, exceed 10% of the total assets of the Fund, taken at market value as at the time of the deposit;

- (m) the security interest provided by the Fund over any of its assets that is required to enable the Fund to effect short sale transactions will be made in accordance with industry practice for that type of transaction and relate only to obligations arising under such short sale transactions;
 - (n) the Fund will keep proper books and records of all short sales and Fund assets deposited with Borrowing Agents as security; and
 - (o) the Fund will develop written policies and procedures for the conduct of short sales prior to conducting any short sales;
9. the Fund will provide disclosure in its simplified prospectus and annual information form of the short selling strategies and the details of this exemptive relief prior to implementing the short selling strategy;

Webb Enhanced Income Fund

10. in order to achieve its objectives, the Webb Enhanced Income Fund (the “Enhanced Income Fund”) intends to invest primarily in equity securities of Canadian issuers (the “Canadian Equity Portfolio”);
11. to produce tax-efficient distributions, the Enhanced Income Fund will also enter into one or more forward agreements (the “Forwards”) to obtain exposure to an underlying portfolio (the “Underlying Portfolio”), which includes dividend-paying common and preferred shares, bonds, debentures, income trusts, equity-related securities and convertible securities issued by issuers anywhere in the world;
12. the Forwards will comply with sections 2.7, 2.8 and 2.11 of NI 81-102;
13. the objective of the Enhanced Income Fund is to provide investors with returns based on performance of the Underlying Portfolio and not the Canadian Equity Portfolio;
14. the Underlying Portfolio will be held in a separately managed account established with an investment dealer;
15. since the Underlying Portfolio will not be an “issuer” of securities, it is not a “mutual fund” or an “investment fund” and is not subject to NI 81-101 or NI 81-102;
16. the Underlying Portfolio will be managed by the Filer and the Filer intends to engage in limited short selling activity in the Underlying Portfolio and to apply all of the terms and conditions contemplated in paragraphs 6 through 9, above, *mutatis mutandis*, to the Underlying Portfolio’s short selling activities;
17. except as described in paragraph 16, the Filer intends to manage the Underlying Portfolio in accordance with Part 2 of NI 81-102.

Decision

Each of the Decision Makers is satisfied that the test contained in the Legislation that provides the Decision Maker with the jurisdiction to make the Decision has been met. The decision of the Decision Makers under the Legislation is that the Requested Relief is granted provided that in respect of each Fund:

- I. the aggregate market value of all securities sold short by the Fund will not exceed 20% of the net assets of the Fund on a daily marked-to-market basis;
- II. the Fund will hold “cash cover” (as defined in NI 81-102) in an amount, including the Fund assets deposited with Borrowing Agents as security in connection with short sale transactions, that is at least 150% of the aggregate market value of all securities sold short by the Fund on a daily marked-to-market basis;
- III. no proceeds from short sales by the Fund will be used by the Fund to purchase long positions in securities other than cash cover;
- IV. the Fund will maintain appropriate internal controls regarding its short sales including written policies and procedures, risk management controls and proper books and records;
- V. any short sales made by the Fund will be subject to compliance with the investment objectives of the Fund;
- VI. the Requested Relief will not apply to a Fund that is classified as a money market fund or a short-term income fund;
- VII. the Requested Relief will not apply to any Future Fund having the characteristics described in representations of the Webb Enhanced Income Fund described in representations contained in paragraphs 10 through 17;
- VIII. for short sale transactions in Canada, every dealer that holds Fund assets as security in connection with short sale transactions by the Fund shall be a registered dealer in Canada and a member of a self-regulatory organization that is a participating member of the Canadian Investor Protection Fund;
- IX. for short sale transactions outside of Canada, every dealer that holds Fund assets as security in connection with short sale transactions by the Fund shall:
 - (a) be a member of a stock exchange and, as a result, be subject to a regulatory audit; and
 - (b) have a net worth in excess of the equivalent of CDN \$50 million determined from its most recent audited financial statements that have been made public;
- X. except where the Borrowing Agent is the Fund's custodian, when the Fund deposits Fund assets with a Borrowing Agent as security in connection with a short sale transaction, the amount of Fund assets deposited with the Borrowing Agent does not, when aggregated with the amount of Fund assets already held by the Borrowing Agent as security for

outstanding short sale transactions of the Fund, exceed 10% of the total assets of the Fund, taken at market value as at the time of the deposit;

- XI. the security interest provided by the Fund over any of its assets that is required to enable the Fund to effect short sale transactions is made in accordance with industry practice for that type of transaction and relates only to obligations arising under such short sale transactions;
- XII. prior to conducting any short sales, the Fund discloses in its simplified prospectus a description of: (i) short selling, (ii) how the Fund intends to engage in short selling, (iii) the risks associated with short selling, and (iv) in the Investment Strategy section of the simplified prospectus, the Fund's strategy and this exemptive relief;
- XIII. prior to conducting any short sales, the Fund discloses in its annual information form the following information:
 - (a) that there are written policies and procedures in place that set out the objectives and goals for short selling and the risk management procedures applicable to short selling;
 - (b) who is responsible for setting and reviewing the policies and procedures referred to in the preceding paragraph, how often the policies and procedures are reviewed, and the extent and nature of the involvement of the board of directors or trustee of the Funds in the risk management process;
 - (c) trading limits or other controls on short selling in place and who is responsible for authorizing the trading and placing limits or other controls on the trading;
 - (d) whether there are individuals or groups that monitor the risks independent of those who trade; and
 - (e) whether risk measurement procedures or simulations are used to test the portfolio under stress conditions;
- XIV. prior to conducting any short sales, the Fund has provided to its securityholders not less than 60 days' written notice that discloses the Fund's intent to begin short selling transactions and the disclosure required in the Fund's simplified prospectus and annual information form as outlined in paragraphs XI and XII of this decision, or the Fund's initial simplified prospectus and annual information form and each renewal thereof has included such disclosure;
- XV. with respect to the Webb Enhanced Income Fund:
 - (a) notwithstanding paragraph I of this decision, the combined aggregate market value of all securities sold short by the Webb Enhanced Income Fund, directly, and by the Underlying Portfolio will not exceed 20% of the net assets of the Webb Enhanced Income Fund on a daily marked-to-market basis;

- (b) the Filer shall apply paragraphs II through V and VIII through XIV of this decision, *mutatis mutandis*, with respect to any short selling activity conducted by the Underlying Portfolio; and
- (c) the assets of the Underlying Portfolio shall otherwise be managed in compliance with Part 2 of NI 81-102;

XVI. the Requested Relief shall terminate upon the coming into force of any legislation or rule of the Decision Makers dealing with matters referred to in subsections 2.6(a), 2.6(c) and 6.1(1) of NI 81-102.

"Leslie Byberg"

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ONTARIO SECURITIES COMMISSION