CSA Regulatory Burden Reduction Proposals for Investment Funds: A solid step in the right direction

October 11, 2019

On September 12, 2019, the Canadian Securities Administrators (CSA) published CSA Notice and Request for Comment *Reducing Regulatory Burden for Investment Fund Issuers – Phase 2, Stage 1* (the CSA Notice), the latest step in the CSA's ongoing campaign to reduce regulatory red tape for securities issuers. The CSA propose to take action in eight "workstreams" in order to eliminate redundant or unnecessary regulatory requirements for investment funds, which will require amendments to various national instruments and policies. In the CSA Notice, the CSA describe the objective of each workstream and publish the associated rule and policy amendments associated with that workstream.

The changes described in this Bulletin are positive and in some cases even go beyond what we had hoped that the CSA would implement for investment funds by way of regulatory reduction. We believe a closer look at transition will be necessary and we expect to recommend some tweaks to the proposed rules and policies, but overall we consider the CSA's proposals to be a very solid step in the right direction. In many cases, the CSA's proposals respond to suggestions we made (echoed by other industry participants) as part of the Ontario Securities Commission's (OSC) call for regulatory burden reduction proposals set out in OSC Staff Notice 11-784 *Burden Reduction.* Our March 2019 comments are available here.

We strongly recommend industry participants respond to the CSA's questions about these proposed changes, particularly where the CSA are asking for feedback on areas that could be streamlined even further. The questions asked by the CSA are thoughtful and illustrate their commitment to reducing unnecessary regulations. The CSA's quantitative cost-benefit analysis should also be reviewed to determine if the CSA has over or under-estimated the cost reductions expected with the proposals, or has over or under-estimated the costs (usually the initial costs) of adhering to the new proposals. There will be costs to change disclosure and to change practices in response to any final proposals and these should be accurately noted by the CSA as an offset to the overall regulatory reduction inherent in the proposals.

Consolidating the Simplified Prospectus and Annual Information Form

The CSA have proposed the repeal of the requirement that a mutual fund in continuous distribution file an Annual Information Form (AIF) and instead require the investment fund manager to incorporate disclosure currently contained in the AIF into the fund's Simplified Prospectus (SP).

Consolidating the disclosure requirements into one document provides the opportunity to address redundancies and inefficiencies in the disclosure process. There is overlap in the information disclosed by both an SP and an AIF, and the CSA note that some elements of the required disclosure do not provide sufficient benefit to investors to justify the cost and time associated with their collection. Most notably (and among other items), the CSA propose to delete certain portions of the requirement that principal holders of securities be disclosed, as well as the illustrations of the costs associated with the different purchase options for a fund. The CSA request feedback on whether additional streamlining can be carried out. It will be important to review each item in the consolidated disclosure document to see if it can be eliminated or simplified and whether the various items "flow" appropriately to ensure a comprehensive understanding of the fund family by a reader. It would be a major step backwards if the CSA's proposals were to inadvertently create an unwieldy (and largely unread) document similar to the long-form prospectuses of pre-1986 (when the simplified prospectus regime for mutual funds was first introduced).

These changes will create increased upfront costs for funds and their managers given the work necessary to redraft documents to meet the proposed new combined disclosure requirements for the SP prepared in the year immediately after these proposed changes take effect. The CSA claim, however, that these costs will be outweighed by the cost savings from the elimination of the AIF requirement, which investment funds will realize beginning two years after implementation. Overall, we agree with the CSA's aims and we will be reviewing the disclosure requirements carefully to ensure their continued appropriateness and to seek to eliminate or simplify superfluous disclosure.

For investment funds not in continuous distribution, the CSA also propose that disclosure requirements could be met by filing a document prepared in accordance with the consolidated version of Form 81-101F1 or Form 41-101F2 *Information Required in an Investment Fund Prospectus* (as applicable, depending on the nature of the fund). They ask for feedback, however, as to whether such a document is even necessary on a continuous basis.

The CSA do not refer to the possibility of changes to the annual renewal process for publicly offered investment funds and we continue to believe that this would be an excellent way to achieve almost immediate cost savings and burden reduction for investment funds. Provided the SP was drafted in such a way to contain "evergreen" disclosure (subject to material changes), we urge the CSA to consider requiring two or three year cycles of renewals (perhaps with annual refilings of Fund Facts documents to keep them up-to-date). The CSA also make no proposals to refine Management Reports of Fund Performance (MRFPs) or other continuous disclosure documents and we

consider that a rethink of National Instrument 81-106 *Investment Fund Continuous Disclosure* is long overdue.

A thoughtful transition period will be required to eliminate the possibility that funds will have to immediately prepare a new SP under the new requirements. Even if the transition periods allow for the new requirements to be fulfilled at prospectus renewals, funds should be allowed at least three months in order to comply. This may mean that some funds will not have a new consolidated SP for some 18 months after the coming into force of the new rules.

Requiring investment funds to establish designated regulatory disclosure websites

The CSA have proposed the introduction of a requirement in NI 81-106 that all public investment funds must identify a designated website on which it will post all required regulatory disclosure. This website must be publicly accessible, and maintained by the fund (or related funds), its manager or an affiliate or associate of the manager. The posting of required disclosure documents on a fund's designated website will not replace the obligation to file all required disclosure on SEDAR.

The CSA claim that this will be of minimal cost to managers, as some regulatory provisions already require certain disclosure to be posted on a fund's website, and that hosting disclosure documents on a fund or manager's website is already widespread commercial practice.

The CSA are describing this proposal as the first step towards changing the delivery mechanisms for required disclosure documents, but fall short of saying anything about the potential for "access equals delivery". "Access equals delivery" is another example of a long-standing wish list item for the fund industry and something we urged the OSC (and the CSA) to consider in our March 2019 comment letter, particularly for financial statements and MRFPs. In order for this proposal to achieve the goal of burden reduction, we suggest that commenters identify to the CSA those disclosure document for which posting to the designated website, rather than delivery, would be appropriate.

Codifying exemptions granted in respect of notice-and-access applications

In 2013, the CSA amended National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer* to permit non-investment fund reporting issuers to deliver a notice and summary information about proxy-related materials to registered and beneficial owners of securities, along with instructions on how to access the complete materials (the notice-and-access system). Investment funds were required to seek specific exemptions in order to use the notice-and-access system, which we spearheaded in 2016 through an industry group application and subsequent decision. Since 2016, regulators have frequently granted these exemptions and accordingly, the CSA now propose to codify the relief to allow investment fund managers to use the notice-and-access system.

Reducing Personal Information Form Filings

The CSA propose to eliminate the requirement to file a Personal Information Form (PIF) for those individuals who are registrants and "permitted individuals" and therefore have already filed a Form 33-109F4 *Registration of Individuals and Review of Permitted Individuals* and accordingly, have been vetted by the regulators. As these forms require the disclosure of similar information, the CSA have acknowledged that the PIF requirement for these individuals is an unnecessary regulatory hurdle. This change is very welcome and we hope that this rule amendment will be implemented as soon as possible.

Codifying exemptions granted in respect of related party transactions

The CSA propose to amend National Instrument 81-102 *Investment Funds* and National Instrument 81-107 *Independent Review Committee for Investment Funds* in order to codify eight frequently granted types of exemption concerning related party transactions. Subject to specified conditions, these amendments would permit:

- Specified fund-on-fund investments by non-reporting issuer investment funds – this is a fairly narrow proposed amendment, as it would not cover investments in international funds, for example, or funds managed by an affiliate of a fund manager (much less a manager unrelated to the top fund manager).
- Investment funds that are reporting issuers to purchase specified non-approved rated debt and private placements of securities of reporting issuers under offerings by related underwriters.
- *In specie* subscriptions and redemptions involving related managed accounts and mutual funds (but not non-redeemable investment funds).
- Inter-fund trades among non-reporting issuer funds and managed accounts, including trades made at the last sale price for exchange-traded securities.
- Non-reporting issuer investment funds to invest in securities of a related issuer over an exchange.
- Reporting issuer investment funds and non-reporting issuer investment funds to invest in debt securities of a related issuer in the secondary market.
- Reporting issuer investment funds and non-reporting issuer investment funds to invest in long-term debt securities of a related issuer in primary market distributions.
- Reporting issuer investment funds, non-reporting issuer investment funds and managed accounts to trade, as principal, debt securities with a related dealer.

Notably, the CSA propose to have NI 81-102 and NI 81-107 apply to investment funds that are not reporting issuers for the purpose of providing for the above-noted exemptions.

The CSA do not address transition for those managers and funds that operate pursuant to previously obtained exemptions after the proposed changes come into effect, or whether all such relief is nullified and replaced by the rules. Not all existing exemptions have the exact same provisions (although in our experience, they are quite similar, particularly in recent years). The CSA proposals do make certain changes to the

conditions of previously granted relief, which we will review to ensure appropriateness. It will be important to review the exemptions that have been previously granted against the conditions proposed by the CSA to ensure compatibility and to identify new and enhanced compliance requirements. We will also urge the CSA to give comfort to managers and to independent review committees of funds (IRCs) about the expectations, if any, on essentially redoing referrals to IRCs and reconsideration by IRCs of previously granted approvals. This will be important if the CSA proposals do not align precisely with the previously granted relief.

Broadening pre-approval criteria for investment fund mergers

The CSA propose to codify the regulatory approval that is granted by securities regulators for investment fund mergers where the proposed merger does not satisfy all of the criteria for pre-approval under section 5.6 of NI 81-102 – namely, where a transaction is neither a tax-deferred transaction nor qualifying exchange or where the investment objectives, valuation procedures and/or fees for a terminating and continuing fund are not considered to be "substantially similar". The CSA explain that mergers proceeding under the broadened criteria remain subject to securityholder approval, and the related Information Circular should explain how the merger is in the best interests of securityholders, in light of not meeting these criteria.

Repealing regulatory approval requirements for change of manager, change of control of manager and change of custodian that occurs in connection with a change of manager

Acknowledging that there is overlap in the approval process required of an investment fund manager by section 5.5 of NI 81-102 and in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, the CSA propose to repeal the regulatory approval requirements in s. 5.5 of NI 81-102 for a change of manager, a change of control of manager and a change of custodian that occurs in connection with a change of manager. The CSA explain that securityholder approval will still be required for a change of manager and prescribe that certain information about the proposed change in manager be disclosed in the Information Circular.

Clarifying delivery obligations for Fund Facts in specific circumstances

The CSA propose various amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* in order to expand existing exceptions from the fund facts delivery requirements to include purchases of mutual funds made in managed accounts or by permitted clients that are not individuals, as well as similar purchases under model portfolio products, portfolio rebalancing services and automatic switch programs. The latter exceptions have a number of conditions, which are intended to mirror, with

modifications, the existing exceptions permitted for pre-authorized payment plans (PACs).

The requirement to deliver fund facts to aid an investor in making decisions is out of step with the objectives of these purchases, as post-sale delivery of fund facts isn't needed for managed accounts (and who would deliver the documents and to whom?) or in respect of permitted institutional clients. Requiring the delivery of fund facts in the case of portfolio rebalancing or automatic series-switching is similarly unnecessary as these purchases do not reflect new investment decisions by the investor. The CSA recognize that the requirements in these contexts are unreasonable, and notes that they have granted relief from the delivery requirements for these types of purchases.

We have long advocated for these changes, however, we consider that the managed account situation should not be dealt with by way of an exemption, but rather the CSA should recognize that no delivery requirements apply in these circumstances. We also note, however, that the same clarifications, particularly in connection with non-delivery of ETF facts documents in respect of investments in ETFs by managed accounts and by permitted institutional clients must be made to National Instrument 41-101 *General Prospectus Requirements.* We will recommend that a discussion of this issue be included in the Companion Policy to NI 41-101 to ensure clarity that no ETF facts documents need to be delivered in these circumstances as they apply to investments in ETFs.

Other changes

The CSA have also proposed amendments to Form 81-101F3 *Contents of Fund Facts Document* to provide clarified sample language for disclosure by newly-established mutual funds, funds that have not completed a calendar year, and funds that have not completed a full year of operation. The changes conform to the current requirements for ETF facts documents.

The CSA also identify that they have made other changes to certain instruments for reasons not related to burden reduction, without specifically highlighting these changes. As we continue our analysis of the proposed changes, we will watch for these other amendments.

Providing Comments – How BLG can help you

The comment period for the CSA proposals is open until **December 11, 2019** . We expect to submit comments on these matters and we welcome comments from our clients and industry participants, which we would be pleased to include with our comments, with or without attribution. The CSA have also indicated that some member jurisdictions may hold stakeholder roundtable discussions on these proposed measures, though dates for these sessions have yet to be announced.

We can also assist you in preparing your comments to the CSA, including outlining additional regulatory reduction initiatives that you believe should be undertaken. In our view, there are multiple ways that the CSA can reduce regulatory burdens which would not require new rules or amendments to existing regulations, although certainly there are many beneficial bigger-picture changes to regulation that could be made.

If you would like to discuss how these proposals might affect your business and operations or you would like to discuss your comments on them, please contact any of the authors of this Bulletin or your usual member of BLG's Investment Management Group.

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