THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

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Delivered By Email: QI-consultation-PA@fin.gc.ca

Qualified Investment Consultation
c/o Director General, Tax Legislation Division
Department of Finance Canada
90 Elgin Street
Ottawa ON
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Dear Sirs and Mesdames:

RE: Consultation on Qualified Investments for Registered Plans

Thank you for the helpful discussions we have had to date with Department of Finance ("**Finance**") officials regarding this consultation. Further to those discussions, we are grateful for the opportunity to provide you with comments on how the qualified investments ("**QI**") rules can be modernized to improve the clarity and coherence of the registered plans regime.

IFIC is the voice of Canada's investment funds industry. IFIC brings together 150 organizations, including fund managers, distributors, and industry service organizations, to foster a strong, stable investment sector where investors can realize their financial goals. IFIC operates on a governance framework that gathers member input through working committees. The recommendations of the working committees are submitted to the IFIC Board or board-level committees for direction and approval. This process results in a submission that reflects the input and direction of a broad range of IFIC members.

As noted on the Government of Canada's website, Finance has specifically welcomed feedback on five key questions for consideration as part of the QI consultation. This letter will only provide feedback on the last three questions; namely:

1) Are the conditions that certain pooled investment products must meet to be a qualified investment appropriate, including the ongoing value of maintaining a formal registration process for registered investments?
2) Should qualified investment rules promote an increase in Canadian-based investments, and if so, how?
3) Are crypto-backed assets appropriate as qualified investments for registered savings plans?

As part of that feedback, this letter recommends (i) the QI rules be consolidated in one section of the Income Tax Act (Canada) and the regulations promulgated thereunder (collectively, the "**Tax Act**"), (ii) that Finance add two new categories of QIs that are specific types of investment funds that are regulated under Canadian/provincial securities laws, (iii) that units of investment funds that are either "mutual fund trusts" for purposes of the Tax Act and/or are listed on a "designated stock exchange" for purposes of the Tax Act that provide investors with exposure to cryptocurrency ("**crypto funds**") continue to qualify as QIs, and (iv) that the foreign property rules not be reintroduced. To set the foundation for our recommendations, we first comment on our understanding of the policy underlying the QI regime.

The Policy Rationale Underlying the Qualified Investment Regime

We understand based on our recent discussions with Finance officials and previous Finance statements that the QI regime seeks to balance several competing objectives.

It was explained to us that two of the objectives of the QI regime are that: (i) a QI should have a readily determinable value, and (ii) there should be certainty as to whether an investment meets the QI requirements.

In addition, the Finance Technical Notes relating to amendments made to the definition of a QI in 2007 stated that the list of QIs is intended "to promote investment security and to prevent tax planning opportunities with respect to closely-held investments."[1]

Those Technical Notes explained the changes made at that time as follows:

> These changes will provide registered plan investors with greater investment choice and diversification opportunities by, for example, removing impediments to investing in foreign-listed trust and partnership units and Canadian dollar bonds issued by foreign entities, while recognizing the policy underlying the qualified investment rules.[2]

Accordingly, it can be said that the QI regime seeks to balance the competing objectives of promoting investment security with ensuring appropriate investment choice and diversification opportunities, while at the same time ensuring that QIs have a readily ascertainable value, can be determined with certainty, and prevent tax planning opportunities with respect to closely-held investments.

Finance recognized this need for balance in the following statement made in 2012 in the context of further amendments to the definition of a QI:

> Generally, the qualified investment rules provide individuals with the flexibility to choose investments suited to their own personal investment objectives and risk tolerances while ensuring that tax assistance for savings is provided at a reasonable cost to other taxpayers.[3]

IFIC submits that the prohibited investment rules that apply to all trusteed registered plans except deferred profit sharing plans are robust enough to adequately address the self-dealing policy concerns. As a result, we have not discussed that specific policy concern in this submission. However, we would be pleased to do so in a future submission if Finance should disagree with us.

Consolidation of the QI Rules

As noted in the 2024 Federal Budget (Canada), the QI regime is complex and has evolved over time in ways that are not entirely intuitive. We encourage Finance to align the QI rules across registered plans to the extent possible to avoid confusion and add clarity for investors, registered plan administrators and the Canada Revenue Agency ("**CRA**") that administers the regime, as well as consider consolidating the rules in one section of the Tax Act.

Registered Investment Regime

One way that Finance could simply the QI rules is to rationalize the registered investment regime. Currently the main categories of non-listed investment funds that are eligible for investment by registered plans are "mutual fund trusts" and "mutual fund corporations" as such terms are defined for purposes of the Tax Act, and the various types of "registered investments" outlined in subsection 204.4(2) of the Tax Act. The main

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[1] Department of Finance, Budget Supplementary Information (2007).

[2] *Ibid*.

[3] Department of Finance, Regulatory Impact Analysis Statement on Regulation 4900(1)(i.13) (2012).

category of "registered investment" that is applied for by IFIC members and the one we will be discussing below is the registered investment category provided in paragraph 204.4(2)(d) of the Tax Act.

A paragraph 204.4(2)(d) registered investment is a trust that would be a "mutual fund trust" ("**MFT**") if it had met the ownership and dispersal requirements in paragraph 132(6)(c) (also known as the "**150 unitholder requirement**"), and that holds only prescribed investments (i.e., QIs) for the type of plan or fund in respect of which it has applied for registration. Such registered investments are referred to as "quasi-mutual fund trusts". In general, there are two circumstances in which a fund manager would make an application on behalf of a fund for registered investment status as a quasi-mutual fund trust. The first circumstance is where they intend that the fund will become an MFT, but they are concerned that the fund will either not meet the 150 unitholder requirement in time to make the retroactive election to become an MFT with the trust's first tax return, or want assurances that if the fund fails to meet the 150 unitholder requirement in the future, the investors in the fund that are registered plans will not have to divest their investment. The second circumstance is where the fund is not launched with the expectation to meet MFT status, because the fund manager is not targeting such a wide base of investors, but they still want to accept registered plan monies and have an investment objective and strategy that largely can be accomplished by making investments in QIs. In both circumstances, we submit that the investment restrictions (i.e., only holding QIs) imposed on quasi-mutual fund trusts versus MFTs are inappropriate. In both circumstances, the only distinction between the quasi-mutual fund trust and the MFT is the number of investors. In the first circumstance, the fund manager has either not achieved its intended investor count or has lost investors during the life cycle of the fund. In the second circumstance, the fund manager may have decided to cap or limit the number of investors or assets under management for business reasons that have nothing to do with tax considerations.

If tax considerations were not an issue, the portfolio manager ("**PM**") responsible for designing the investment objective and strategy of a mutual fund would prefer the flexibility to be able to include non-QIs, such as shares listed on exchanges other than designated stock exchanges, unlisted shares, and derivative instruments as part of the fund's investment portfolio and strategies. Mutual fund issuers often encounter a "Catch 22" type of structuring issue at the time they are launching a fund for which they intend to apply for registered investment status, because if they do not or cannot restrict the investments to QIs, the fund will be subject to penalty tax under Part X.2 of the Tax Act. Although the Part X.2 tax is now proportionate to the amount of registered plan investors that are invested in the fund, it is punitive for all investors, including those investors that are not subject to the QI regime.[4]

However, circumstances (often beyond the fund's control) may arise that cause a fund to fail to achieve or maintain MFT status. For example, a fund that previously met the 150-unitholder requirement for MFT status may fall below that requirement due to redemption activities. In this situation, if the PM has not previously applied for RI status, the units of the fund will cease to be QIs which is extremely punitive for registered plan investors who purchased units either at a time when the fund qualified as an MFT or based on statements in the fund's offering documents that units of the fund were expected to be QIs at all material times. In such circumstances, investors will need to immediately dispose of their units and apply for relief from the non-QI penalty tax.

The quasi-mutual fund trust category is not helpful for funds that are never intended to become MFTs, or funds that have investment objectives and strategies that are more bespoke in nature, i.e., restricted to QIs. Accordingly, IFIC recommends that the Department of Finance add two new categories of QIs that are investment funds that are regulated under Canadian/provincial securities laws. We propose that these new categories would not be subject to the registered investment regime.

[4] Under subsection 204.4(7) in Part X.2, once a trust satisfies the 150-unitholder requirement and qualifies as an MFT, its registration changes automatically to that of an MFT/registered investment. An MFT/registered investment is not subject to the penalty tax under Part X.2 and, therefore, is not subject to any investment restrictions under that Part. If a trust ceases to meet the 150-unitholder requirement, its registration automatically changes back to that of quasi-mutual fund trust and the trust becomes subject to the penalty tax.

These new categories of QIs will also provide Canadian investors who may have a longer investment horizon with access to investment funds that are already available to investors in similar types of deferred income plans in countries like the U.S. and the U.K.[5] We believe these differential exposures are primarily to the benefit of investors but would also promote growth in the Canadian investment fund industry where issuers already have such funds in their investment fund offerings, but, to date, have been unable to open them up to the registered plan investor channel, because they would not meet the requirements of an MFT or a quasi-mutual fund trust.

We recommend that the new investment fund categories not be part of the registered investment regime in Part X.2 of the Tax Act. We also believe that if Finance were to grant these new categories of QIs, there largely would not be a need for the quasi-mutual fund trust category going forward. Although, the registration process would be less problematic because it would rarely be required, we recommend that the current registration process with the Registered Plans Directorate of the CRA be replaced by a self-assessment process, which would reduce the administrative burden on both the CRA and the investment fund industry.

Should Finance decide to maintain the registered investment regime, for those limited funds that do not meet the two new categories described above, we recommend that the quasi-mutual fund trust category be amended to permit a fund to register as a quasi-mutual fund trust with some small percentage of investments in non-QIs on its balance sheet. For example, a fund that has all or substantially all QIs in its portfolio should be able to register as a quasi-mutual fund trust. This proposed amendment will permit funds after their first year of operation to make an application for registered investment status if they wanted to open up their investor base to registered plans and also to protect registered plan investors who are in a mutual fund trust that is at risk of losing its status because of the 150 unitholder requirement.

New Categories of Qualified Investments for Investment Funds

The first new category of QI would be a fund that is subject to National Instrument 81-102 *Investment Funds* ("**NI 81-102**").

The second new category of QI would be a fund that (i) meets the requirements of an investment fund under securities laws, and (ii) is managed by a registered investment fund manager ("**IFM**") as defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**").

Both of these proposed new categories of QIs satisfy the policy objectives of the current QI regime as outlined above. In particular, by relying on current securities regulatory regimes, these new categories provide certainty of an investment's QI status for all participants, i.e., investors, managers, legislators and CRA officials. A further explanation of the requirements of NI 81-102 and NI 31-103 is provided below. We would also be happy to arrange a call with a securities lawyer who specializes in the investment funds space if you have any questions or concerns about these securities' regulatory regimes.

Overview of the Securities Law Regulation of Investment Funds

In general, there are two broad category of investment funds in Canada. The first category of investment fund is one that is a "reporting issuer" in one or more provinces or territories of Canada, which means that it has issued securities in respect of which a prospectus was filed (and a receipt issued) with the securities regulator of that province or territory prior to distributing securities. The second category of investment fund is one that relies on one or more exemptions from the requirement to file a prospectus (and receive a receipt) to distribute securities. These exemptions are set out in National Instrument 45-106 *Prospectus Exemptions*, and include limiting purchases to certain classes of investors, offering securities pursuant to a

[5] See, for example, https://caia.org/blog/2024/01/23/democratization-private-markets-and-closing-information-gap and https://www.torys.com/en/our-latest-thinking/publications/2023/02/the-democratization-of-private-equity

prescribed form of offering document in certain jurisdictions subject to certain conditions, or offering securities to non-individual investors making purchases of securities of at least C$150,000.

For registered plan investors, the most relied upon accredited investor exemptions are as follows:

a) a person in respect of which all of the owners of interests, direct, indirect or beneficial, except the voting securities by law to be owned by directors, are persons that are accredited investors, or,

b) a person acting on behalf of a fully managed account managed by that person, if that person is registered or authorized to carry on business as an adviser or the equivalent under the securities legislation of a jurisdiction of Canada or a foreign jurisdiction. [6]

NI 81-102 Funds

The first new category of QI is an investment fund that is subject to NI 81-102.

NI 81-102 regulates:

- a mutual fund that offers or has offered securities under a prospectus for so long as the mutual fund remains a reporting issuer;
- a non-redeemable investment fund that is a reporting issuer; and
- a person or company in respect of activities pertaining to an investment fund referred to above or pertaining to the filing of a prospectus to which subsection 3.1(1) of the instrument applies.

We note that the definitions of “mutual fund”, “non-redeemable investment fund” and “investment fund” referred to in NI 81-102 are the securities law definitions of those terms (see definitions below under the Investment Funds sub-heading) and not the equivalent Tax Act definitions. More specifically a fund could be considered a “mutual fund” for purposes of securities requirements and not a “mutual fund trust” for purposes of the Tax Act and *vice versa*. In addition, there is nothing that would prohibit a fund that is established as a limited partnership from meeting the definitions of mutual fund, non-redeemable investment fund, or investment fund, and many currently do. However, because limited partnerships that are not listed on designated stock exchanges are not currently QIs, the Tax Act creates a disincentive towards structuring a fund as a limited partnership for issuers trying to attract registered plan investments.

In general, a fund subject to NI 81-102 would be targeted at a more “retail” versus “institutional” investor. As a result, such funds are subject to greater restrictions on investments and investment practices than mutual funds that are not subject to NI 81-102. Appendix “A” to this submission provides a summary of those restrictions for your review and consideration.

Investment Funds

The second new category of QI is one that would qualify as an “investment fund” for Canadian securities law purposes.

We propose that this second category of QI also have a requirement that the fund must have a minimum valuation frequency to meet the requirements applicable to many of the registered plans to be able to file an information return to report the total fair market value of the fund securities at the end of the year. In this regard, we note that Canadian securities law requires, in all jurisdictions, non-reporting issuer investment funds to deliver continuous disclosure of financial information at least yearly. In some jurisdictions, the information is required to be delivered semi-annually.

[6] See https://www.osc.ca/sites/default/files/2023-10/ni_20230913_45-106_unofficial-consolidation.pdf. The second category would apply to investors who have managed accounts.

Under Canadian securities laws, an investment fund is generally defined as a mutual fund or a non-redeemable investment fund. A mutual fund is defined as a fund (i) whose primary purpose is to invest money provided by its security holders, and (ii) whose interests entitle the holder to receive on demand, or within a specified period after demand, an amount computed with reference to the value of a proportionate interest in the whole or part of the net assets of the fund (i.e., the interests are redeemable for a *pro rata* share of the fund's net asset value "**NAV**"). A non-redeemable investment fund is a fund (i) whose primary purpose is to invest money provided by its security holders, (ii) that does not invest for the purpose of exercising or seeking to exercise control of an issuer, or for the purpose of being actively involved in the management of an issuer in which it invests (other than an issuer that is a mutual fund or a non-redeemable investment fund), and (iii) that is not a mutual fund. A fund that invests for the purpose of (i) exercising or seeking to exercise control over the issuers in which it invests (other than an investment fund), or (ii) being actively involved in the management of the issuers in which it invests (other than an investment fund), generally will not be an investment fund. A fund that is categorised as an investment fund has important securities regulatory implications, including that its manager, unless exempt, must be registered as an "investment fund manager" (an "**IFM**") under applicable securities legislation in Canada, the adviser managing its portfolio, unless exempt, must be registered as a PM under applicable securities legislation in Canada, and generally, the securities of an investment fund must be distributed through a registered dealer.

Registered IFMs and PMs are subject to robust minimum capital requirements, financial reporting requirements and insurance requirements, among other requirements.

As an example of the type of regulatory oversight applicable to these registrants, we recommend a review of the annual Summary Report for Dealers, Advisers and Investment Fund Managers issued by the Compliance and Registrant Regulation Branch of the Ontario Securities Commission (the "**OSC**"). See, for example the latest report: https://www.osc.ca/en/securities-law/instruments-rules-policies/3/33-755/osc-staff-notice-33-755-crr-branch-summary-report, which highlights that the OSC's compliance review activity for 2023-2024 will prioritize:

- review of know-your-client (KYC), know-your product and suitability determination to assess the effectiveness of the implementation of the Client Focused Reforms;
- compliance reviews of high-risk firms, following the analysis of the data collected in response to the 2022 Risk Assessment Questionnaire; and
- compliance reviews of crypto asset trading platforms.

With respect to IFMs specifically, section 116 of the *Securities Act* (Ontario) imposes the following standard of care[7]:

> Every investment fund manager,
>
> (a) shall exercise the powers and discharge the duties of their office honestly, in good faith and in the best interests of the investment fund; and
>
> (b) shall exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances. 2006, c. 33, Sched. Z.5, s. 11.

There is also substantial case law about the duties of fiduciaries, such as trustees of mutual funds, which require them to discharge their duties honestly, in good faith and in the best interests of beneficiaries. One fiduciary duty is that the fiduciaries must disclose all relevant facts to beneficiaries, which would include accurate portfolio information. A failure to comply with this duty exposes fiduciaries to civil litigation liability.

[7] Equivalent standards of care on IFMs are provided under other provincial securities rules.

An IFM also needs to have detailed policies and procedures in place, including in relation to valuation.[8]

The OSC or equivalent provincial securities regulator could also use its public interest jurisdiction to sanction any IFM that does not value its portfolio accurately. So overall, there are regulatory and common law protections designed to ensure that investors receive accurate portfolio information and regulators, independent review committees and civil litigators can play an important oversight role.

In summary, both new categories of funds that IFIC proposes would become QIs are either highly regulated themselves or have participants that are highly regulated to ensure investor protection.

Continuation of Eligibility for Qualified Investment Status of Crypto Funds

The 2024 Federal Budget (Canada) materials stated that one of the specific items under consideration in this consultation was "[w]hether crypto-backed assets are appropriate as qualified investments for registered plans". We understand that this reference was intended to signal that one of the items that Finance intended to review was whether units of crypto funds should continue to be eligible as QIs. Currently, a unit of a crypto fund would qualify as a QI if the crypto fund were an MFT or if the unit is listed on a designated stock exchange, each for purposes of the Tax Act.

We submit that units of crypto funds should remain eligible to qualify as QIs, as such units meet the policy rationale of the QI regime discussed above, notwithstanding that cryptocurrency itself does not qualify as a QI.

We suspect that Finance has two main concerns with respect to including cryptocurrencies in the list of QIs. First, it is acknowledged that cryptocurrencies may be seen as relatively volatile investments and, second, Finance may have concerns with respect to whether cryptocurrency can be held securely.

In response to these potential concerns, we note that currently crypto funds are either structured as MFTs or listed on designated stock exchanges, or both. As a result, investments in such funds are highly liquid. However, even if cryptocurrency is a relatively volatile asset class, this should not preclude crypto funds from qualifying as QIs. This is because investments in crypto funds are increasingly becoming part of a well-diversified investment portfolio. According to ETFGI, a leading independent research and consultancy firm covering trends in the global exchange-traded funds ecosystem, crypto exchange-traded funds and exchange-traded products listed globally have gathered net inflows of US$44.50 billion in 2024, which is substantially higher than the US$135.7 million in net inflows at this point last year.[9]

In addition, the relative volatility associated with investments in cryptocurrency should not preclude crypto funds from qualifying as QIs since many other QIs may be viewed similarly from a risk tolerance perspective. An understanding of risk tolerance is a key component of constructing a well-diversified portfolio for a registered plan investor. As noted above, Finance explicitly recognized the need for balancing investment

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[8] Staff of the Ontario Securities Commission stated in OSC Staff Notice 33-750 *Summary Report for Dealers, Advisers and Investment Fund Managers* (August 8, 2019) that "An IFM has a legal obligation to determine fair value of the securities held by its investment fund for NAV calculation purposes. An IFM's valuation procedures should assess whether the investment fund would be able to dispose of the securities held at the publicly quoted price by taking market activity and conditions into consideration. A stock listing does not necessarily mean that an equity investment could be disposed of at closing market price. If the IFM believes that it would not be able to dispose of the securities at the publicly quoted trading price, the IFM must determine a value that is fair and reasonable in the circumstances by considering whether any adjustments to the publicly quoted price are required."

[9] We would note that Canada's securities regulators were on the front lines of crypto funds. See https://www.cbc.ca/news/business/armstrong-bitcoin-etf-sec-1.7079932. If any decision were made to remove crypto funds from the QI list, which we highly disagree with, we would note that such a decision should not disadvantage only crypto funds based in Canada.

security with appropriate investment choice and diversification opportunities in the following statement on the QI rules:

> Generally, the qualified investment rules provide individuals with the flexibility to choose investments suited to their own personal investment objectives and risk tolerances while ensuring that tax assistance for savings is provided at a reasonable cost to other taxpayers.[10]

With respect to Finance's potential concerns regarding security, we note that crypto funds are significantly more secure for investors than holding cryptocurrency directly. This was recognized by the OSC when it issued an Order directing the issuance of a receipt for a final prospectus of the first Canadian crypto fund that invests substantially all of its assets in bitcoin.[11] Crypto funds offer greater security than holding cryptocurrency directly because crypto funds that are regulated by Canadian securities regulators rely on custodians and sub-custodians ("**crypto custodians**") to hold cryptocurrency on their behalf. Crypto custodians have practices and policies concerning custody, which act to mitigate the risks associated with holding crypto assets, including (i) keeping crypto assets in offline storage (referred to as "cold wallet" storage), except as needed to facilitate purchases and sales or other portfolio transactions, (ii) maintaining insurance that a reasonably prudent person would maintain, and (iii) providing annual assurance reports prepared by public accountants assessing the design and effectiveness of internal controls and policies.[12]

Crypto funds are also consistent with the remaining policy objectives underlying the QI regime. First, crypto funds that are regulated by Canadian securities regulators have readily ascertainable value because such funds are required to restrict their investments to only certain types of crypto assets that promote market integrity and price discovery.[13] Currently, crypto funds regulated by Canadian securities regulators are only permitted to hold bitcoin and ether. Secondly, by being MFTs and/or listed on designated stock exchanges, crypto funds can be determined with certainty. Lastly, they are subject to the existing safeguards found in the prohibited investment regime applicable to other investment funds that address tax planning opportunities with respect to closely-held investments.

Once again, if you have any questions or require further information on the regulatory regime applicable to crypto funds, we would be happy to arrange a discussion with a securities law expert in this area.

Promoting an increase in Canadian-based investment

One of the questions that Finance has asked as part of the QI consultation is whether the QI regime should promote an increase in Canadian-based investments, and if so, how?

The 2005 Federal Budget (Canada) eliminated the foreign property rules that were introduced in 1971. One of the main reasons for this change was to ensure that Canadian investors had access to broader international diversification opportunities for their retirement investments. Investments, such as mutual funds and exchange traded funds, built around international equities can provide Canadian investors with exposure to important sectors of the global economy that are underrepresented in the domestic equity market. By diversifying, Canadian investors are better able to withstand downturns in performance and therefore stay on track to meet their retirement and/or savings goals.

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[10] Department of Finance, Regulatory Impact Analysis Statement on Regulation 4900(1)(i.13) (2012).

[11] *3iQ Corp (Re),* 2019 ONSEC 37, available online at Reasons and Decision: In the Matter of 3iQ Corp. and The Bitcoin Fund (osc.ca) at paras. 81-88.

[12] We note that the Canadian Securities Administrators (the "**CSA**") have proposed to codify these existing practices and policies in CSA Notice and Request for Comment – *Proposed Amendments to National Instrument 81-102 Investment Funds Pertaining to Crypto Assets* (January 18, 2024) (the "**CSA Notice**"), which developed mainly through the prospectus review process, and which have been the subject of exemptive relief previously granted to existing crypto funds.

[13] See *supra* note 11 at paras. 64 to 80. We note that the CSA have also proposed to codify certain of these restrictions in the CSA Notice.

We believe that ensuring Canadian investors have access to broader international diversification opportunities still applies in today's economic context, and we recommend that the government not reintroduce the foreign property rules as we do not believe that this measure provided the best outcome for the Canadian investors when it was in place. We also suggest that government not take a punitive approach to encouraging Canadian investment, but rather encourage it by expanding the ability of registered plans to invest in Canadian infrastructure and real estate funds, many of which would be permissible investments under IFIC's proposed new fund QI categories.

We thank the Department of Finance for considering our submission and we are available to meet with you at your convenience should you wish to discuss any aspect of the above further.

Please feel free to contact me by email at jbaillargeon@ific.ca or, by phone (416) 309-2323.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

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Appendix A

Canadian Mutual Funds:

Summary of

Restrictions on Investments and Investment Practices

Pursuant to National Instrument 81-102 *Investment Funds* (NI 81-102)

and related instruments[14]

Prepared by Borden Ladner Gervais LLP

July 4, 2024

1. INVESTMENTS

(a) Asset and Counterparty Diversification

(i) A mutual fund other than an alternative mutual fund cannot purchase securities of an issuer (other than a security which is a Canadian federal or provincial government security, a U.S. federal government security, a security issued by a clearing corporation, a security issued by an investment fund where the purchase complies with NI 81-102, an index participation unit that is a security of an investment fund[15], or an equity security if it is purchased by a fixed portfolio investment fund in accordance with its investment objectives) if, after the purchase, more than 10% of the mutual fund's net asset value would be invested in securities of that issuer (NI 81-102 s. 2.1(1) and (2)).

(ii) For each long derivative position (other than those held for hedging purposes) or index participation unit held, the investment fund is considered to hold directly the underlying security or the proportionate share of the securities held by the issuer of the index participation unit for the purposes of the above-noted test (NI 81-102 s. 2.1(3)). Do not include in this calculation a security that represents less than 10% of:

(A) a stock or bond index that is the underlying interest of a derivative; or

(B) the securities held by the issuer of an index participation unit (NI 81-102 s. 2.1(4)).

(iii) The mark-to-market value of derivatives positions of the investment fund with any one counterparty cannot exceed for a period of 30 days or more, 10% of the net asset value of the investment fund, unless either: a) the specified derivative is a cleared specified derivative; or b) the equivalent debt of the counterparty, or of the person or company that fully and unconditionally guarantees the obligations of the counterparty in respect of the specified derivative, has a "designated rating" (as defined in NI 81-102) (NI 81-102 s. 2.7(4)).

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[14] This document summarizes the restrictions on investments and investment practices under NI 81-102 that are applicable to investment funds that are reporting issuers. This document does not address certain provisions of NI 81-102 that apply to investment funds that are not reporting issuers.

[15] "Index participation unit" = security traded on a stock exchange in Canada or the United States and issued by an issuer the only purpose of which is to (a) hold the securities that are included in a specified widely-quoted market index in substantially the same proportion as those securities are reflected in that index or (b) invest in a manner that causes the issuer to replicate the performance of that index.

(b) **Control Restrictions**

(i) Cannot purchase securities of an issuer if after the purchase, the investment fund would hold more than 10% of the voting securities or the equity securities of that issuer (NI 81-102 s. 2.2(1)(a)); or if the security is purchased so the investment fund can exercise control over the management of the issuer (NI 81-102 s. 2.2(1)(b)).

(ii) In determining compliance with the above-noted restriction, assume the conversion of any special warrants[16] held; and consider that it holds directly the underlying securities represented by American depository receipts (NI 81-102 s. 2.2(3)).

(iii) If the investment fund *acquires* a security of an issuer (other than as a result of a purchase, for example, through the exercise of take-over bid rights) which results in the investment fund exceeding the limits of section 2.2(1)(a), the investment fund will be required to reduce its holdings of those securities as quickly as commercially reasonable and in any event, no later than 90 days after the acquisition, so that it does not hold securities exceeding the prescribed limits (NI 81-102 s. 2.2(2)).

(iv) Cannot invest in any person or company in which the investment fund, alone or with other related investment funds[17], is a substantial[18] securityholder (s. 111(2) of the *Securities Act* (Ontario) (the **OSA**; also see s. 6(2) of BC Instrument 81-513 *Self-Dealing* (**BCI 81-513**) and equivalent requirements in other jurisdictions).

(c) **Restriction on Investing in Debt-like Securities[19]**

(i) Cannot purchase a "debt-like security" (as defined in NI 81-102) with an option component for any purpose other than hedging, where, immediately after the purchase, more than 10% of the mutual fund's net asset value would consist of this type of security and/or purchased options (NI 81-102 s. 2.8(1)(a)).

(ii) Cannot open or maintain a long position in a debt-like security that has a component that is a long position in a forward contract where the mutual fund does not hold cash cover[20] in an amount that, together with margin on account for the specified derivative and the market value of the specified derivative, is more than, on a daily mark-to-market basis, the underlying market exposure of the specified derivative (NI 81-102 s. 2.8(1)(d)).

2. RESTRICTIONS ON SPECIFIC TYPES OF INVESTMENT

(a) **Illiquid Assets**

(i) Cannot purchase illiquid assets which, when aggregated with illiquid assets already held by the mutual fund, would result in more than 10% of the mutual fund's net asset value at the time of purchase being held in illiquid assets (NI 81-102 s. 2.4(1)).

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[16] Special warrants = a security that, by its terms or the terms of an accompanying contractual obligation, entitles or requires the holder to acquire another security without payment of material additional consideration and obliges the issuer of the special warrant or other security to undertake efforts to file a prospectus to qualify the distribution of the other security.

[17] Related investment funds are those managed by the same manager.

[18] That is, holds more than 20% of the securities of that entity (collectively with other related investment funds).

[19] These restrictions are not applicable to alternative mutual funds.

[20] Cash cover is prescribed by NI 81-102. Primarily cash, cash equivalents (equal to or less than 365 days to maturity) and includes money market mutual funds that are themselves subject to NI 81-102.

(ii) Cannot hold more than 15% of its net asset value in illiquid assets for a period of 90 days or more (NI 81-102 s. 2.4(2)). If more than 15% of the mutual fund's net asset value is made up of illiquid assets, the mutual fund must as quickly as is commercially reasonable, take all necessary steps to reduce the percentage of its net asset value invested in illiquid assets to 15% or less (NI 81-102 s. 2.4(3)).

(b) **Real Estate and Commodities**

(i) Cannot purchase real property (NI 81-102 s. 2.3(1)(a)) or invest in mortgages, other than guaranteed mortgages (NI 81-102 s. 2.3(1)(b)). Cannot purchase a guaranteed mortgage if after the purchase, more than 10% of the mutual fund's net asset value would consist of guaranteed mortgages (NI 81-102 s. 2.3(1)(c)). Special exceptions for mortgage mutual funds (NI 81-102 s. 20.4).

(ii) Cannot purchase a physical commodity other than permitted precious metal[21], permitted precious metal certificates[22] or specified derivatives of which the underlying interest is a permitted physical commodity, but only if immediately after the purchase such commodities do not exceed 10% of the mutual fund's net asset value (NI 81-102 s. 2.3(1)(d), (e) and (f)).[23]

(c) **Self-Dealing and Conflicts of Interest**

(i) Cannot invest in any person or company who is a substantial securityholder of the investment fund, its management company or distribution company (s. 111(2) of the OSA; also see s. 6(2) of BCI 81-513 and equivalent requirements in other jurisdictions).

(ii) Cannot invest in any issuer in which any officer or director of the investment fund, its management company or distribution company or an associate of any of them, or any person or company who is a substantial securityholder of the investment fund, its management company or distribution company, has a significant interest[24] (s. 111(2) of the OSA; also see s. 6(2) of BCI 81-513 and equivalent requirements in other jurisdictions).

(iii) Portfolio manager of an investment fund cannot cause the investment fund to:

(A) invest in any issuer in which a responsible person[25] or an associate of a responsible person is an officer or director unless the client is aware of the relationship and has consented in writing to the investment before the purchase;

(B) purchase or sell securities of any issuer from or to the account of a responsible person, any associate of a responsible person or the portfolio manager[26]; or

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[21] "Permitted precious metal" = gold, silver, platinum or palladium.

[22] "Permitted precious metal certificates" = certificates representing a permitted precious metal held in Canada in the form of bars or wafers and is (a) available for delivery, free of charge, in Canada, to the holder of the certificate; (b) of a minimum fineness of 995 parts per 1000 in the case of a certificate representing gold; (c) of a minimum fineness of 999 parts per 1000 in the case of a certificate representing silver, platinum or palladium; and (d) fully insured against loss and bankruptcy by a licensed insurance company if not purchased from an approved bank.

[23] These restrictions do not apply to an alternative mutual fund or a precious metals fund.

[24] "Significant interest" = more than 10% shareholdings.

[25] "responsible person" is a broadly defined term and includes the portfolio manager and its directors and officers and those who make decisions for the portfolio manager's accounts.

[26] The CSA intend this prohibition to mean that a portfolio manager cannot cross trades between two investment funds it manages.

(C) provide a guarantee or a loan to a responsible person or an associate of a responsible person (s. 13.5(2) of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**)).

(iv) An investment fund cannot pay a fee or compensation not disclosed in a prospectus to a related party in connection with an investment made by the investment fund (s. 115 of the OSA; also see s. 8 of BCI 81-513 and equivalent requirements in other jurisdictions).

(v) A "dealer managed investment fund" (as defined in NI 81-102) shall not knowingly make:

(A) an investment in a class of securities of an issuer of which a partner, director, officer or employee of the dealer manager of the investment fund, or a partner, director, officer or employee of an affiliate or associate of the dealer manager, is a partner, director or officer; or

(B) an investment in securities that have been underwritten by the related dealer during the first 60-days of the applicable distribution (NI 81-102 s. 4.1(1) and (2)).

(vi) Cannot purchase a security from, or sell a security to, any of the following persons or companies, if that person or company would be selling to the investment fund, or purchasing from the investment fund, as principal: (i) the manager, portfolio adviser or trustee of the investment fund or any a partner, director or officer thereof; (ii) an associate or affiliate of a person or company referred to in (i); or (iii) a person or company, having fewer than 100 securityholders of record, of which a partner, director or officer of the investment fund or a partner, director or officer of the manager or portfolio adviser of the investment fund is a partner, director, officer or securityholder (NI 81-102 s. 4.2(1)). An equity security can be purchased, notwithstanding this prohibition, if the price payable for the security is: (i) not more than the ask price of the security as reported by any available public quotation in common use, in the case of a purchase by the investment fund; or (ii) not less than the bid price of the security as reported by any available public quotation in common use, in the case of a sale by the investment fund (NI 81-102 s. 4.3(1)).

(d) **Derivatives (Generally)**

(i) Cannot purchase, sell or use derivatives other than derivatives as permitted in NI 81-102 and in accordance with the simplified prospectus (NI 81-102 s. 2.3(g)). Different treatment depending on whether derivatives are being used for hedging or non-hedging purposes (most of the restrictions set out below are in respect of using these derivatives for non-hedging purposes). Leverage is not generally permitted.

(e) **Investments in Other Investment Funds**

(i) Cannot purchase or hold securities of another investment fund unless the other investment fund (a) is an mutual fund, other than an alternative mutual fund, that is also subject to NI 81-102, (b) is an alternative mutual fund or a non-redeemable investment fund that is also subject to NI 81-102 and, at the time of the purchase of that security, the investment fund holds no more than 10% of its net asset value in securities of alternative mutual funds and non-redeemable investment funds, (c) is issuing index participation units, or (d) is established with the approval of the government of a foreign jurisdiction and the only means by which the foreign jurisdiction permits investment in the securities of issuers of that foreign jurisdiction is through that type of investment fund. Specified conditions to purchasing an investment fund must be followed (NI 81-102 s. 2.5).

(f) **Securities Lending, Repurchase Transactions and Reverse Repurchase Transactions**

(i) Cannot enter into a securities lending transaction, repurchase transaction or reverse repurchase transaction except as otherwise permitted in NI 81-102 s. 2.12 (securities lending), NI 81-102 s. 2.13 (repurchase transaction) and NI 81-102 s. 2.14 (reverse repurchase transaction) (refer generally to NI 81-102 ss. 2.12 to 2.17).

3. BORROWING AND LENDING

(a) Borrowing and Encumbrances on Assets

(i) Cannot borrow money or provide a security interest over any of its portfolio assets. Temporary borrowings to facilitate redemptions are permitted only up to 5% of net asset value of the investment fund at the time of the borrowing (NI 81-102 s. 2.6(1)(a)).

(b) Lending Money and Portfolio Assets

(ii) Cannot lend cash or portfolio assets other than cash, except pursuant to specified securities lending transactions (as above) (NI 81-102 s. 2.6(1)(f)).

(iii) Cannot make a loan to any officer or director of the investment fund, its management company or distribution company or an associate of any of them (s. 111(1) of the OSA; also see section 6(1) of BCI 81-513 and equivalent requirements in other jurisdictions).

(iv) Cannot make a loan to any individual if the individual or an associate of the individual is a substantial security holder of the investment fund, its management company or distribution company (s. 111(1) of the OSA; also see section 6(1) of BCI 81-513 and equivalent requirements in other jurisdictions).

(v) Portfolio manager cannot cause the investment fund to make a loan to a responsible person or an associate of a responsible person (NI 31-103, s. 13.5(2)(c)).

(c) Interests in Loans

(i) Cannot purchase an interest in a loan syndication or loan participation where the purchase requires the investment fund to assume responsibilities in administering the loan in relation to the borrower (NI 81-102 s. 2.3(1)(i)).

4. MISCELLANEOUS

(a) Purchases on Margin

(i) Cannot purchase securities on margin except for transactions in permitted derivatives (NI 81-102 s. 2.6(1)(b)).

(b) Underwriting and Marketing Activities

(i) Cannot underwrite or market securities of any other issuer (NI 81-102 s. 2.6(1)(e)).

(c) Guarantees

(i) Cannot guarantee the securities or obligations of any other person or company (NI 81-102 s. 2.6(1)(g)).

(d) **Purchases Other Than Through Normal Market Facilities**

(i) Cannot purchase securities other than through normal market facilities where the purchase price does not approximate the prevailing market price or the parties are not at arm's length in connection with the transaction (NI 81-102 s. 2.6(1)(h)).

(e) **Short Selling**

(i) Cannot sell securities short other than for transactions in permitted derivatives (NI 81-102 s. 2.6(1)(c)) and other than set out in NI 81-102, which permits short selling in limited circumstances (NI 81-102 s. 2.6.1).

(f) **Additional Contributions**

(i) Cannot purchase securities, except derivatives as permitted under NI 81-102, which may require a contribution in addition to the payment of the purchase price (NI 81-102 s. 2.6(1)(d)).