Date: July 27, 2022

To: Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office of the Superintendent of Securities
Newfoundland and Labrador Ontario Securities Commission
Office of the Superintendent of Securities Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

And To: Me Philippe Lebel Corporate Secretary and Executive Director, Legal Affairs
Autorité des marchés financiers
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The Secretary
Ontario Securities Commission
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comments@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: Response to CSA and CCIR Joint Notice and Request for Comment – *Proposed Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations, and to Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations, and Proposed CCIR Individual Variable Insurance Contract Ongoing Disclosure Guidance – Total Cost Reporting for Investment Funds and Segregated Funds* (the "Proposed Amendments")

The Private Capital Markets Association of Canada ("**PCMA"**) is pleased to provide our comments in connection with the Proposed Amendments, as set out below.

A. About the PCMA

The PCMA is a not-for-profit association founded in 2002 as the national voice of the exempt market dealers ("**EMDs**"), issuers and industry professionals in the private capital markets across Canada.

The PCMA plays a critical role in the private capital markets by:

- assisting hundreds of dealers and issuer member firms and individual dealing representatives to understand and implement their regulatory responsibilities;
- providing high-quality and in-depth educational opportunities to the private capital markets professionals;
- encouraging the highest standards of business conduct amongst its membership across Canada.
- increasing public and industry awareness of private capital markets in Canada;
- being the voice of the private capital markets to securities regulators, government agencies and other industry associations and public capital markets;
- providing valuable services and cost-saving opportunities to its member firms and individual dealing representatives; and
- connecting its members across Canada for business and professional networking.

Additional information about the PCMA is available on our website at www.pcmacanada.com.

B. General Support

Overall, the PCMA generally supports providing additional reporting to help investors better understand their investments, as intended in the Proposed Amendments.

Many EMD dealing representatives are also licensed insurance agents that sell segregated funds. Accordingly, the PCMA generally supports having the same/similar reporting requirements imposed on investment funds and segregated funds which helps reduce regulatory arbitrage, subject to our comments below.

C. Implementation Issues

Many EMDs sell investment funds to accredited investors under the Accredited Investor Exemption and have concerns on the application of a cost and performance reporting regime for prospectus offered investment funds, such as conventional mutual funds, being imposed on prospectus-exempt investment funds, such as non-redeemable investment funds.

Many investment fund managers ("**IFMs**") of prospectus-exempt investment funds do not typically calculate a "**fund expense ratio**" consisting of an investment fund's management expense ratio and trading expense ratio expressed as a percentage since it is not required under National Instrument 81-106 – *Investment Fund Continuous Disclosure*.

Prospectus-exempt investment funds also do not have publicly available information that would allow an EMD to calculate a fund expense ratio or determine if an IFM's reported fund expense ratio is misleading. Therefore, if an IFM does provide an EMD with a fund expense ratio, an EMD should be able to rely on such information for reporting to its clients.

We note that the underlying portfolio of an investment fund may be illiquid so the calculation of net asset value or its equivalency may be based on stale-dated or unaudited financial information (in circumstances where an investment fund holds investments where an investee is not required to provide the investment fund with audited annual financial statements). For purposes hereof, "**stale-dated**" means financial information that is over 30 days old. Investment funds with illiquid assets generally do not publish net asset values on a daily basis (they can be monthly, quarterly or annually) and there is also no standard valuation frequency as it is product dependant and the frequency is set out in an investment fund's offering documents.

Therefore, if an IFM does not provide an EMD with fund expense ratio information for an investment fund that meets the requirements of the Proposed Amendments, then *it will be the norm and not the exception* that an EMD's client account statements will report that such information is unavailable and not being reported (as required and permitted by proposed section 14.17.1(4) *Reporting of fund expenses and direct investment fund charges).* The PCMA submits that the Canadian Securities Administrators (the "**CSA**") should further consider whether the cost reporting changes, as outlined in the Proposed Amendments, should have a carve-out for prospectus-exempt funds.

D. A Registrant Should Be Able To Rely On Another Registrant

The PCMA submits that an EMD should be able to rely on information provided by an IFM in connection with its cost reporting obligations under the Proposed Amendments.

An IFM is a registrant and has certain duties and responsibilities under applicable securities law. It is concerning that if an IFM fails to provide an EMD with the information required under the Proposed Amendments and more importantly, if an EMD reasonably believes the information is incomplete or in relying on such information is misleading, then an EMD would have to resort to other measures to provide such information, if at all.

EMDs do not necessarily have the proficiency to prepare the required financial information as required under the Proposed Amendments, let alone have access to such information since, as discussed above, it is not publicly available. Simply, we respectfully submit that a registrant, such as an EMD, should not be the surrogate of providing or verifying such information.

E. Performance Reporting Should Be Included With Cost Reporting

The PCMA submits that costs should not be viewed in isolation, rather investors should see costs *and* performance information in their client account statements and reports so they have a better overall understanding of their investment. In the PCMA's view, costs without any connection to performance information are misleading since they are not presented in the context of an investor's overall investment.

The PCMA also believes that linking costs and performance avoid any possible debate that investment funds with high fund expense ratios have better or worse performance than those investment funds

with lower fund expense ratios. It would also provide a better comparison of costs and performance *among and between* prospectus offered investment funds and prospectus-exempt investment funds. For example, certain prospectus-exempt investment funds that provide for a carried interest or performance fee to be paid and shared with a manager/promoter would be higher relative to conventional mutual funds. However, these costs, reflected in a fund expense ratio, need to be linked to performance among prospectus offered versus prospectus-exempt investment funds.

Currently, performance disclosure is only required on an annual basis and is based on the performance of the investment fund within a client's account at a dealer. If costs are to be included in ongoing account statements, as proposed, this should also require performance to be included. As discussed above, prospectus-exempt funds may not publish net asset values on the same frequency as prospectus offered investment funds. Accordingly with different frequencies in reporting, ongoing performance reporting for prospectus-exempt investment funds may be problematic.

Lastly, registrants have know-your client and know-your-product obligations under applicable securities law in order to assess suitability, therefore registrants look at *both* cost and performance information to assess the potential value of an investment before making a product recommendation. Accordingly, clients should receive both cost and performance information to assess their investment.

F. Alberta-Based MICs That Are IFMs Should Be Excluded From The Proposed Amendments

The PCMA has a number of Alberta-based mortgage investment corporations ("**MICs**") and dealers that distribute securities of Alberta-based MICs.

The PCMA is concerned that certain mortgage investment entities ("**MIEs**"), including "*mortgage investment corporations*" (as defined in the *Income Tax Act (Canada)*) and mutual fund trusts operating as mortgage lenders, will be unduly prejudiced by the Proposed Amendments due to jurisdiction-specific interpretations as to whether or not they qualify as *investment funds* under local legislation.

As set out in CSA Staff Notice 31-323 *Guidance Relating to the Registration Obligations of Mortgage Investment Entities* ("**SN 31-323**"), an MIE is defined as a person or company whose purpose is to directly or indirectly invest substantially all of its assets in debts owing to it that are secured by real property (including mortgages) and whose other assets are limited to deposits, cash, debt securities, real property and risk-hedging instruments.

SN 31-323 states, among other things, that the applicability of the IFM registration requirement for a "**Pooled MIE**" (*i.e.,* an MIE that manages a portfolio of mortgages) varies in the different CSA jurisdictions. In all jurisdictions other than Alberta, a Pooled MIE *is not considered an investment fund* if its primary activity is managing an investment portfolio that includes mortgages. More specifically, a Pooled MIE in jurisdictions other than Alberta is not considered an investment fund if the Pooled MIE (a) originates its own mortgages, (b) funds its own mortgages, (c) acts as mortgagee and (d) administers the mortgages directly or through an agent.

Conversely, SN 31-323 further states that for a Pooled MIE whose principal jurisdiction is Alberta, this analysis does not apply. Instead, the definitions of "mutual fund" and "non-redeemable investment fund" pursuant to the *Securities Act* (Alberta) apply. In this case, the view that a mortgage is a security creates a scenario where an Alberta-based Pooled MIE is an investment fund because, irrespective of

redeemability provisions, the primary purpose of the entity is to invest money provided by its security-holders in mortgages.

As a result of SN 31-323, Pooled MIEs whose principal jurisdiction is Alberta will be required to comply with the Proposed Amendments while all other operational Pooled MIEs in jurisdictions outside of Alberta will not. This further fractures the issuer regulatory environment in Canada and encourages Pooled MIEs to jurisdiction-shop in order to remain competitive with their regulatory burdens.

ASC Staff Notice 81-701 *Mortgage Investment Entities and Rules Applicable to Investment Funds* ("**ASN 81-701**") expands upon the applicability of the investment fund concept to MIEs by introducing the concept of an "**Operational MIE**" (which aligns closely with other CSA jurisdiction analysis for non-investment fund MIEs) and introduces the precedent of excluding Operational MIEs from certain investment fund regulatory requirements. Unfortunately, the accompanying designation order (*Certain mortgage investment entities designated not to be non-redeemable investment funds (except for registration), 2014 ABASC 370)* only addresses non-redeemable investment funds. It is unclear why private Operational MIEs that raise capital in the exempt market, but utilize redeemability at net asset value (a hallmark of the definition of a "mutual fund" under applicable securities law), were not included in this designation order.

The PCMA submits that the guidance of ASN 81-701 should be expanded and incorporated into the Proposed Amendments to establish that an Operational MIE in Alberta is not an investment fund except for the purposes of registration. This will reduce regulatory drift by Alberta away from other jurisdictions in Canada and facilitate a more equitable deployment of the Proposed Amendments.

Simply, an Operational MIE should not be subject to the Proposed Amendments solely because its principal jurisdiction is Alberta, nor should the registered firms that sell these funds and who inevitably have a reporting obligation to their clients.

G. Timelines

The CSA states that it would like the final Proposed Amendments to become effective in September 2024 *assuming* that final publication would occur and ministerial approvals are obtained during the second quarter of 2023.

The PCMA believes that all registrants should have sufficient time to implement any final version of the Proposed Amendments. The PCMA does not believe it is in the public interest, nor fair to registrants, for the CSA to assume an implementation date when the rules are not final. Accordingly, the PCMA is against a shortened transition period and advocates for a reasonable implementation period post final approval as is typically done with other CSA initiatives.

Lastly, the PCMA believes the CSA should have more direct communications with IFMs of prospectus-exempt investment funds and determine what other disclosure challenges need to be considered or added to the final rule since there is little to no information in the Proposed Amendments that deal with the unique nature of prospectus-exempt investment funds.

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We thank the CSA for the opportunity to provide you with our comments and would be pleased to discuss them with you at your earliest convenience.

Yours truly,

PCMA Comment Letter Committee Members*

"*Brian Koscak*"
PCMA Chair of Advocacy Committee &
Executive Committee Member

"*Nadine Milne*"
PCMA Executive Committee Member and
Co-Chair of the Compliance Committee

"*Phil du Heaume*"
Executive Committee Member

**The views expressed herein are those of the above individuals in their role as members of the PCMA and not necessarily those of the organizations of which they are employed or affiliated.*

cc: PCMA Board of Directors