FREQUENTLY ASKED QUESTIONS ON REGULATION 81-106 RESPECTING INVESTMENT FUND CONTINUOUS DISCLOSURE - CANADIAN SECURITIES ADMINISTRATORS STAFF NOTICE 81-315

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Background

On June 1, 2005, Regulation 81-106 respecting Investment Fund Continuous Disclosure (Regulation 81-106) came into force. In order to assist issuers subject to Regulation 81-106, we have compiled a list of frequently asked questions (FAQs) and staff's response to those questions.

FAQs

After reviewing Regulation 81-106, some readers have questions regarding its application and interpretation. This list of FAQs is not exhaustive, but represents the types of inquiries we have received.

We have divided the FAQs into the following subject categories:

A. Definitions, Application and Transition Issues
B. Financial Statements
C. Management Reports of Fund Performance (MRFPs)
D. Delivery of Continuous Disclosure Documents to Securityholders
E. Binding and Presentation
F. Quarterly Portfolio Disclosure
G. Proxy Voting Disclosure

A. Definitions, Application and Transition Issues

A-1 **Q:** Sections 18.3 and 18.4 of Regulation 81-106 provide a transition year for the filing of annual financial statements and annual information forms. Does this transition year only apply to investment funds in existence on June 1, 2005?

A: Yes, these transition provisions only apply to investment funds that were in existence on June 1, 2005. Investment funds created after that date do not require a "transition" year and must comply with the 90 day annual and 60 day interim filing deadlines.

A-2 **Q:** The decisions of some regulators granting pooled funds relief from publicly filing their financial statements contain a sunset clause stating that the exemption expires on the date that Regulation 81-106 comes into force, which was June 1, 2005. However, pursuant to the transition provisions, pooled funds are only obligated to comply with Regulation 81-106 for financial years ending on or after June 30, 2005. Can pooled funds that previously received relief from filing their financial statements continue to rely on that exemption for interim financial statements relating to periods prior to the application of Regulation 81-106?

A: Yes. In the jurisdictions where this relief was granted, we did not intend to create a gap between the application of the exemptive relief orders and the application of Regulation 81-106. Pooled funds that were granted an exemption from filing financial statements can continue to rely on that exemption up until the time when they must begin complying with Regulation 81-106. Regulation 81-106 also grants pooled funds an exemption from filing their financial statements, subject to certain conditions.

A-3 **Q:** Does OSC Rule 51-501 still apply to non-redeemable investment funds?

A: The Ontario Securities Commission extended the revocation date of OSC Rule 51-501 to May 30, 2006 (see (2005) 28 OSCB 4559). Investment funds subject to OSC Rule 51-501 must continue to comply with that rule, up until such time as they are required to begin complying with Regulation 81-106.

A-4 **Q:** Must commodity pools subject to Regulation 81-104 file quarterly financial statements for interim periods ending prior to their first annual period to which Regulation 81-106 applies?

A: No, we amended Regulation 81-104 to delete this requirement effective June 1, 2005.

A-5 **Q:** Must mutual funds subject to Regulation 81-101 comply with Part 9 (Annual Information Form) of Regulation 81-106?

A: If a mutual fund has a current simplified prospectus and annual information form as required by Regulation 81-101, it does not have to file an annual information form in accordance with Regulation 81-106. Other investment funds that are in continuous distribution and renew their prospectus annually also do not have to file an annual information form in accordance with Part 9 of Regulation 81-106. Only investment funds without a current prospectus are required to file an annual information form in accordance with Regulation 81-106.

A-6 **Q:** Do mutual funds have to include past performance and financial highlights in their simplified prospectus this year?

A: We amended Regulation 81-101 to indicate that a mutual fund may remove past performance and financial highlights from its simplified prospectus only after the mutual fund has filed its first annual MRFP.

A-7 **Q:** Some investment funds have received exemptive relief (for example, from the requirement to report transactions between a mutual fund and a related person) on the condition that certain disclosure is provided in the statement of portfolio transactions. However, this statement is no longer required. What happens to the exemptive relief?

A: Investment funds should not rely on this exemptive relief because they cannot comply with the condition requiring disclosure in the statement of portfolio transactions. Investment funds in this situation should contact their principal regulator if they still require the exemptive relief.

B. Financial Statements

B-1 **Q:** Is the requirement to disclose that the auditor has not reviewed the interim financial statements fulfilled by clearly marking the interim statements as “unaudited”?

A: No, if the interim statements are not reviewed by the auditor, they must be accompanied by a separate notice as required by section 2.12 of Regulation 81-106 and as described in section 3.4 of Policy Statement to Regulation 81-106.

B-2 **Q:** What should be included in “securityholder reporting costs” (statement of operations, line item 11)?

A: While an investment fund must assess in its own circumstances what securityholder reporting costs it has incurred, examples would include the costs associated with the printing and mailing of the financial statements, MRFPs and any other required securityholder document.

B-3 **Q:** Line item 18 of the statement of operations is “increase or decrease in net assets from operations, and, if applicable, for each class or series”. Please clarify how the overall net increase or decrease in net assets should be allocated to each class or series.

A: Investment funds with more than one class or series are currently allocating income and net assets between classes and series, and should generally continue to use the same method.

B-4 **Q:** Can line item 19 of the statement of operations be called “earnings per share” instead?

A: To provide comparability between investment funds, the prescribed wording for item 19 should be used.

B-5 **Q:** The notes to the financial statements must disclose the total commissions paid to dealers for portfolio transactions. To the extent the amount is ascertainable, the soft-dollar portion (the amount paid for goods and services other than order execution) of these payments must also be disclosed. What does “to the extent the amount is ascertainable” mean? If an investment fund does not have this information, what must it disclose?

A: Investment funds should make reasonable efforts to determine the soft-dollar portion of commissions paid on portfolio transactions. For mutual funds, Form 81-101F2 already requires funds to disclose the names of entities that provided investment decision-making services to the fund if those services were paid for through brokerage transactions executed on the fund's behalf. To the extent an investment fund can assess the value of these services (either through its own valuation process using reasonable estimates or the entities' pricing), Regulation 81-106 requires the fund to disclose this amount in the notes to the financial statements. In cases where the investment fund cannot ascertain the value of the soft dollar portion, a statement should be included in the notes that the soft dollar portion is unascertainable.

B-6 **Q:** Given that mutual funds are subject to Regulation 81-105, what should be included in the "total cost of distribution of the investment fund's securities recorded in the statement of changes in net assets" required in the notes to the financial statements?

A: This item only applies to investment funds that are permitted to pay distribution costs (for example, funds that are not subject to Regulation 81-105 or have received an exemption from Regulation 81-105). If distribution costs are paid out of management fees, they do not have to be disclosed separately in the notes (but may be disclosed in the management fee breakdown provided in the MRFP).

B-7 **Q:** Subsection 15.1(1) of Regulation 81-106 requires the numerator of the management expense ratio to include total expenses before income taxes as shown on an investment fund's statement of operations, and any other fee, charge or expense of the investment fund that has the effect of reducing the investment fund's net asset value. Does the management expense ratio have to include sales commissions paid by an investment fund in connection with the offering of its securities (including one-time commissions) and other offering costs paid by the investment fund?

A: Yes, offering costs paid by an investment fund must be included in its management expense ratio. Offering costs are charges that have the effect of reducing the investment fund's net asset value,

and the management expense ratio is not limited to recurring charges only. Additional disclosure may be added by the investment fund explaining why the management expense ratio is higher for the year that the investment fund did an offering.

C. Management Reports of Fund Performance

C-1 **Q:** Do the MRFPs have to include information about classes or series of securities that are not publicly offered?

A: Yes. Part 7 of Regulation 81-106 requires an investment fund with more than one class or series of securities outstanding referable to a single portfolio to prepare financial statements and MRFPs that contain information concerning all of the classes or series.

C-2 **Q:** Can the MRFP be tailored to include only information that is specific to the series or class of a fund that an investor owns?

A: No, the MRFP must contain information concerning all of an investment fund's classes or series. We encourage investment funds to clearly distinguish the information for each class or series.

Form 81-106F1 – Item 3 – Financial Highlights

C-3 **Q:** The trading expense ratio must be calculated using the total commissions and other portfolio transaction costs disclosed in the notes to the financial statements. What should be included in "other portfolio transaction costs"?

A: The trading expense ratio must be calculated using the number disclosed in the notes to the financial statements in response to item 3(a) of s. 3.6(1) of Regulation 81-106.

C-4 **Q:** The trading expense ratio is to be calculated using the same denominator as the management expense ratio. Given that portfolio transactions occur at a fund level, can the trading expense ratio be calculated using fund average net assets (rather than assets at the class or series level)?

A: Yes, the denominator used in calculating the trading expense ratio can be the average net assets of the fund as a whole. The trading expense ratio does not have to be calculated at the class or series level.

C-5 **Q:** As the financial highlights tables present historical information for the past five years, does the trading expense ratio have to be calculated for years prior to the implementation of Regulation 81-106?

A: No, you do not have to go back and calculate the trading expense ratio for financial periods ending prior to the implementation of Regulation 81-106. A footnote may be added to the financial highlights table explaining that the trading expense ratio is a new requirement.

C-6 **Q:** As there is a new instruction regarding the calculation of the portfolio turnover rate following a purchase-of-assets transaction between two investment funds, does the portfolio turnover rate have to be recalculated for prior years?

A: No, you do not have to recalculate the portfolio turnover rate for prior years. If applicable, the difference in the portfolio turnover rate calculation can be explained in a footnote.

C-7 **Q:** The financial highlights tables in the MRFPs are slightly different from the statement of financial highlights previously prepared. Can the new tables be constructed using the audited numbers from past statements of financial highlights? Do the numbers have to be recalculated or can a footnote explaining that prior years have not been recalculated be added to the financial highlights tables in the MRFPs?

A: For the financial highlights tables, investment funds should use the audited numbers previously published in their financial statements. Information for prior years does not have to be recalculated.

Form 81-106F1 – Item 3 – Management Fees

C-8 **Q:** For the breakdown of management fees required by item 3.3 of Form 81-106F1, given that certain information may be commercially sensitive, can services be grouped into categories? Does the breakdown have to add up to 100% of the management fees?

A: The requirement to breakdown management fees is intended to show investors what is included in the fee. The objective of this requirement is to show what portion goes to the distribution channel by way of trailing commissions, etc. This requirement does not necessitate disclosure of commercially sensitive information (such as the specific compensation paid to portfolio advisers or the manager's profit). Services can be grouped together – for example, "general administration, investment advice and profit" could be one category for which a percentage is given.

The breakdown of management fees does not have to add to 100%, as the item requires disclosure of the *major* services paid for out of the management fee, not a complete accounting.

C-9 **Q:** Does the breakdown of management fees have to be shown separately by series for a multi-class fund?

A: Any differences between classes or series must be disclosed.

C-10 **Q:** Is it acceptable for the breakdown of management fees to include the percentage of management fees representing waived or absorbed expenses if the manager paid for fund expenses on the securityholders' behalf?

A: Yes, the breakdown of management fees can include the percentage representing waived or absorbed expenses.

Form 81-106F1 – Item 4 – Past Performance

C-11 **Q:** How should the return on the short portfolio be calculated?

A: Regulation 81-106 does not set out how to calculate the return on the short portfolio. Generally, we are of the view that it is possible to calculate the return on the long and short portfolio separately, on a dollar-weighted basis. Investment funds may make reasonable

assumptions and estimates in order to calculate the return on the short portfolio, as long as these are explained in the MRFP (for example, with note disclosure under the bar chart).

C-12 **Q:** Can a fund in existence for less than twelve months show past performance?

A: Yes, a young fund can show past performance, if it has completed a financial year (it has audited annual financial statements) and was a reporting issuer at all times during the period for which the performance data is provided. The fund should clearly indicate that the performance shown is for a period of less than one year.

For mutual funds subject to Regulation 81-102, the "young fund rule" continues to apply to sales communications pursuant to subsection 15.6(a) of Regulation 81-102.

Form 81-106F1 – Item 5 – Summary of Investment Portfolio

C-13 **Q:** If an investment fund invests in multiple underlying funds, should the summary of investment portfolio list the underlying funds, or does the investment fund have to "look through" to the portfolio of the underlying funds?

A: An investment fund does not have to "look through" to the portfolio of underlying funds. The "look through" only applies when the investment fund invests substantially all of its assets in one underlying fund.

C-14 **Q:** Part 8 of Regulation 81-106 exempts a labour sponsored or venture capital fund from the requirement to disclose the current value of a venture investment, subject to certain conditions. Does this exemption extend to the summary of investment portfolio in the MRFP?

A: Yes, if a labour sponsored or venture capital fund complies with the conditions in Part 8 of Regulation 81-106 in order to be exempt from disclosing the individual current values of venture investments, this exemption extends to the summary of investment portfolio.

D. Delivery of Continuous Disclosure Documents to Securityholders

D-1 **Q:** Can an investment fund use standing instructions for one group of securityholders, annual instructions for another group of securityholders, and choose to deliver the disclosure documents to a third group of securityholders?

A: Yes, an investment fund can use any combination of the delivery options available in Part 5 of Regulation 81-106. However, if the fund has obtained standing instructions from a securityholder, it cannot obtain annual instructions from that securityholder.

D-2 **Q:** If an investment fund obtains standing instructions with respect to the delivery of financial statements and MRFPs, can the dealers provide annual generic reminders to clients that they have provided instructions to the investment fund which can be changed by contacting the fund?

A: If an investment fund obtains standing instructions, it is obligated to advise securityholders annually of the documents they are entitled to receive and of how their delivery instructions can be changed. Regulation 81-106 does not place this obligation on the dealer, but if the investment fund can send the required annual reminder through its dealers, it may do so.

D-3 **Q:** If an investment fund has information about some, but not all, of its beneficial owners, can it communicate directly with the beneficial owners for which it does have information and rely on Regulation 54-101 to communicate with its other beneficial owners?

A: Yes, if an investment fund has the necessary information to communicate directly with one or more beneficial owners of its securities, it can do so, even though it may need to rely on Regulation 54-101 to communicate with other beneficial owners of its securities.

D-4 **Q:** Do investment funds have to solicit new delivery instructions from securityholders who provided standing instructions prior to Regulation 81-106 coming into force?

A: Regulation 81-106 requires investment funds to obtain delivery instructions for each document listed in subsection 5.1(2). It will be necessary to obtain delivery instructions for MRFPs (prior instructions would not have contemplated MRFPs).

D-5 **Q:** Regulation 81-106 requires an investment fund to post certain documents on its website. For how long must these documents remain on the website?

A: Regulation 81-106 does not specify the length of time that continuous disclosure documents must remain on an investment fund's website. In our view, the documents should stay on the website for a reasonable length of time, and at least until they are replaced by updated versions.

E. Binding and Presentation

E-1 **Q:** As the financial statements for more than one investment fund can be bound together, can the MRFP for one investment fund be bound with a set of financial statements that includes the statements for the relevant fund as well as the statements for other investment funds?

A: Yes. If the financial statements for a group of investment funds are bound together, this document can be bound to the MRFP for one of the investment funds included in the group.

E-2 **Q:** How should the MRFPs be filed on SEDAR – individually or as a group?

A: Each MRFP should be filed on SEDAR only under the individual investment fund to which it pertains (and not under a group profile).

F. Quarterly Portfolio Disclosure

F-1 **Q:** Does an investment fund with a December 31 year end have to prepare quarterly portfolio disclosure for the period ending June 30?

A: No, the quarterly portfolio disclosure only has to be prepared for the first and third quarters. (An interim MRFP must be prepared and filed for the period ending June 30.)

G. Proxy Voting Disclosure

G-1 **Q:** Does an investment fund's proxy voting record only have to report how the fund voted at meetings of Canadian public issuers, or must it include meetings of all publicly traded issuers, Canadian and foreign?

A: The proxy voting record should provide disclosure of all proxies received in connection with meetings of public issuers, both Canadian and foreign.

G-2 **Q:** If an investment fund delegates proxy voting to a third party portfolio adviser, can it rely on the proxy voting policies of the portfolio adviser?

A: Yes, but the investment fund is still responsible for ensuring that its proxy voting policies and procedures meet the requirements in section 10.2 of Regulation 81-106.

G-3 **Q:** How will securityholders know that the proxy voting record and the proxy voting policies and procedures are available to them?

A: The MRFPs must state on the first page that this disclosure is available (see Part B, Item 1 and Part C, Item 1 of Form 81-106F1). Investment funds are obligated to send their first annual MRFP to every securityholder, including an explanation of the new requirements and the availability of quarterly portfolio disclosure and proxy voting disclosure (see section 18.5 of Regulation 81-106). We also amended the annual information form to require this disclosure (see Item 12 of Form 81-101F2).

G-4 **Q:** When can securityholders request proxy voting policies and procedures?

A: Securityholders can request a copy of the proxy voting policies and procedures at any time. The transition provision in section 18.2 of Regulation 81-106 only applies to the proxy voting record.

Questions

Please refer your questions to:

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