CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

CSA Multilateral Staff Notice 81-337

Targeted Continuous Disclosure Review and Guidance for *Independent Review Committees for Investment Funds*

March 21, 2024

Introduction

Staff of the Ontario Securities Commission (**OSC**) and the Autorité des marchés financiers (**Staff, we** or **our**) have completed a continuous disclosure review (the **CD Review**) related to *Regulation 81-107 respecting Independent Review Committee for Investment Funds*.

In Quebec, *Regulation 81-107 respecting Independent Review Committee for Investment Funds* is a Regulation, and in Ontario, a Rule. Noting this, in this Notice, we refer to *Regulation 81-107 respecting Independent Review Committee for Investment Funds* as **Regulation 81-107** or **the Regulation**.

Substance and Purpose

This Notice includes regulatory views on Independent Review Committee (**IRC**) Authority, summarizes our findings and general observations in specific areas of inquiry and provides regulatory views and guidance on each area of inquiry.

The CD Review covered the following topics:

- IRC Term Limits
- Skills, Competencies and Recruitment
- Size and Diversity
- Compensation
- Expanded Scope of IRC Review
- Disclosure to Demonstrate IRC Impact.

1. BACKGROUND

1.1 Regulation 81-107

Regulation 81-107 requires an Investment Fund Manager (**IFM**) to identify and refer an actual or perceived conflict of interest matter to the IRC for its approval or recommendation as required by the Rule.

The Regulation also requires every investment fund that is a reporting issuer in Canada to have a fully independent body, the IRC, whose role is to review all decisions involving an actual or perceived conflict of interest faced by the IFM in the operation of the fund.

The structure of the fund industry - where the investor's ownership of the fund is separate from the IFM's management and control of the fund – creates the potential for the interests of fund investors to diverge from the financial interests of the IFM. This structure has the potential risk of causing an IFM to act contrary to its fiduciary duty to the investment fund and ultimately, to investors. Regulation 81-107 came into force in November 2006 and imposed a minimum, consistent standard of independent review for all publicly offered investment funds in each of the jurisdictions represented by the Canadian Securities Administrators (the **CSA**).

The Regulation captures two types of conflicts that arise in the operation of an investment fund: (i) 'business' or 'operational' conflicts, i.e. those relating to the operation by the IFM of its funds that are not specifically regulated under securities legislation, except through the general duties of loyalty and care imposed on the IFM; and (ii) 'structural' conflicts, i.e. those resulting from proposed transactions by the IFM with its related entities, fund or portfolio manager, currently prohibited or restricted by securities legislation.

The Regulation requires that the IFM establish written policies and procedures that it must follow when making a decision involving a conflict of interest matter and must refer the matter to the IRC for its recommendation or approval, as appropriate, before proceeding.

A decision by the IFM to engage in certain transactions that comprise 'structural' conflicts must be approved by the IRC before the transaction may proceed. Approval by the IRC of each transaction may be provided on a case-by-case basis or take the form of a standing instruction. Prior to the Regulation, investment funds seeking to engage in proposed transactions by the IFM with its related entities, fund or portfolio manager, prohibited or restricted by securities legislation (i.e. 'structural conflicts'), required regulatory approval in the form of an exemptive relief decision to proceed. As a result of the Regulation, IRC approval of structural conflicts is one of several key conditions set by securities regulatory authorities to be met for certain related party transactions to proceed. In such context, IRC review of an IFM's approach to mitigating conflict of interest matters is intended to contribute to enhanced investor protection.

For any other course of action not restricted by securities legislation but which raises an actual or perceived conflict of interest for the IFM, the IFM is required to refer the conflict of interest matter to the IRC, which must then provide the IFM with a recommendation that it

must consider before proceeding. IRC review of the IFM's approach to mitigating such 'operational conflicts' similarly remains relevant to enhanced investor protection.

Since 2006, the investment management industry has experienced several new developments[1] which have informed and challenged existing governance practices and raised new considerations concerning conflicts of interest. In this evolving environment, staff sought to assess the IRC framework in the context of a targeted CD Review.

2. IRC AUTHORITY

The IRC is not intended to replace the IFM's management of its funds.

Consistent with its purpose, the IRC is intended to support the IFM and review its handling of conflicts of interest as they arise in the management and operation of the investment fund. If few or no conflict of interest matters are brought to the IRC for review, IRC members should consider whether that is reasonable, whether there is actual compliance with Regulation 81-107, or with securities legislation more generally. The IRC has authority to request information it determines useful or necessary from the manager and its officers to
carry out its duties[2]. Moreover, the IRC is reminded of its authority under paragraph 3.11(1)(b) of Regulation 81-107 to engage independent counsel and other advisors it determines useful or necessary to carry out its duties.

In this context, staff have become aware that in certain cases there may be instances of disagreement between an IRC and an IFM on what constitutes a 'conflict of interest matter' under Regulation 81-107, particularly with respect to 'operational conflicts' that are not prohibited by securities legislation, i.e. an IRC may be of the view that a particular matter or fact pattern should be referred to the IRC as a 'conflict of interest matter' for its recommendation or approval where required. Staff recognize that the process of identifying a conflict of interest matter may be challenging in certain instances.

Our response to such instances is to reiterate that under Regulation 81-107, responsibility for the identification and mitigation of conflicts of interest of the investment fund ultimately rests with the IFM not the IRC. The process of identifying an operational conflict of interest matter should be informed by the view of a 'reasonable person' [3]applied to a set of facts. In this context, IFMs are encouraged to take a broad view of what constitutes a 'conflict of interest matter' and to err on the side of caution when identifying and referring an actual or perceived conflict of interest matter to the IRC for approval or recommendation.

Staff are also aware that there may be instances where it is appropriate for the IRC to contact the regulator to discuss any matter in connection with the subject funds. IRCs are reminded

[1] Examples include Environmental, Social and Governance, Cryptocurrency, Alternative Funds and the expansion of certain exemptions in NI 81-107 to include non-reporting issuer investment funds, among other new developments.
[2] Paragraph 3.11(1)(a) of NI 81-107.
[3] Paragraph 1.2(a) of NI 81-107.

of their ability under subsection 3.11(3) of Regulation 81-107 to talk to the regulator about any matter, including whether the IRC has found, or has reasonable grounds to suspect, that a breach of securities legislation has occurred.[4] This permissive ability does not extend to inconsequential matters, however, and should be used when appropriate.

IRCs should ensure that they understand, at all times, what is being asked of the IRC by the IFM, e.g. is the IFM asking for an approval or a recommendation? Is what is being asked consistent with the scope of duties and responsibilities of the IRC, as an independent committee and as outlined in its Charter? Has the IRC ensured proper documentation of the details of any conversations with the IFM? Upon referral of a conflict of interest matter to the IRC for an approval or recommendation, does the IRC need further information or to review specific documents (e.g. fund disclosure documents) to get comfortable with the IFM's proposed approach to mitigating the conflict of interest?

Minutes of the IRC meetings should be fulsome and clearly demonstrate the deliberations of the IRC members and the considerations that factor into any decision made by the IRC when asked for a recommendation or approval on a conflict of interest matter.

3. CONTINUOUS DISCLOSURE REVIEW

Staff completed a review of Regulation 81-107-related disclosure of investment funds managed by twenty-four different IFMs for which the OSC or the AMF is the principal regulator. The following were reviewed: (a) the prospectus (long form or simplified prospectus as applicable to the fund), (b) the annual information form (**AIF**), where available, (c) the IRC Report to Securityholders and (d) the website of the IFM or funds as applicable.

IFMs reviewed were selected based on criteria designed to reflect a fair representation of fund family size and fund type. Of the 24 IFMs reviewed,

- four had assets under management (**AUM**) of less than $1 billion;
- eleven had AUM of between $1 billion and $50 billion;
- two had AUM of between $50 billion and $100 billion; and
- seven had AUM of over $100 billion.

Investment funds managed by the IFMs included conventional mutual funds, exchange-traded funds, scholarship plans and alternative funds.

4. FINDINGS, COMMENTS and REGULATORY VIEWS

Overall, staff have reached the following conclusions based on the CD Review:

- Several IRCs have members with terms longer than 6 years, however, IRCs are encouraged to strive for ongoing turnover and fresh perspectives on conflicts of

[4] Commentary 3 to section 3.11 of NI 81-107.

interest by limiting IRC terms to a maximum of 6 years, except in limited circumstances;
- IFMs are encouraged to take a broad view of what constitutes a 'conflict of interest matter' and to err on the side of caution to refer an actual or perceived conflict of interest matter to the IRC; and
- Diversity in IRC membership beyond 'skill-set' may lead to better decision-making and good governance.

4.1 IRC Term Limits

Section 3.4 of Regulation 81-107 specifies that the term of a member of the IRC must not be less than 1 year and not more than 3 years. Subsection 3.3(4) of Regulation 81-107, however, sets a maximum term of 6 years for an IRC member that may be extended only with the agreement of the IFM.

The maximum 6-year term limit for IRC members was intended to enhance the independence and effectiveness of the IRC and to encourage regular turnover of IRC membership, new insights and varied perspectives on how conflict of interest matters of an investment fund should be viewed and mitigated by the IFM.

Some IRCs indicated that membership longer than 6 years was beneficial to the functioning of the IRC. While most IRCs we reviewed appoint their members for initial terms of 1, 2 or 3 years, the majority of IRCs reviewed had at least one IRC member with a term longer than 6 years. IRC membership for most IRCs we reviewed ranged between 3 years and 6 years, however, we came across a few IRC members serving up to 8 years or longer and in limited instances, we observed IRC members who had served longer than 14 years.

Long-standing membership is valued by IRCs because it is conducive to stability and beneficial to the IRC's understanding and ongoing familiarity with the IFM's operations and framework for mitigating conflicts of interest. Specific factors cited by IFMs in the CD Review in favor of long-standing IRC membership beyond 6 years include the following:

- specialized skill sets, experience or proficiency of IRC members which make specific members hard to replace;
- the need for continuity of knowledge of IRC members, particularly during periods of change in the funds (e.g. fund mergers) or in the IFM's business (e.g. acquisition of new corporate entities);
- the pandemic introduced periods of uncertainty during which IRC continuity was necessary;
- a need for IRC members to have sufficient time to get up to speed and to become familiar with the IFM's operations and its funds; and
- overall knowledge and efficiency of the IRC.

Most IRCs continue to use staggered terms of IRC members to ensure appropriate succession planning. We observed the use of a hard limit of not more than two three-year terms for IRC members, as well as use of a limit on IRC membership to two three-year

terms unless the circumstances of business operations specifically required extension of the 6 year maximum limit referenced in Regulation 81-107[5].

Regulatory Views

IRCs should continue to strive for fresh, ongoing turnover in IRC membership and compliance with the 3-year to 6-year requirement to encourage new insights into how conflicts of interest are reviewed and to avoid static or repetitive approaches to reviewing conflict of interest matters.

Staff are of the view that IRC members should not remain on IRCs indefinitely nor for periods that span excessively beyond 6 years. IRCs should consider implementing firm term limits for the role of IRC Chair to encourage regular changes in leadership. The intent of the Regulation is to provide "independent insights" to the IFM concerning investment fund conflict of interest matters. Staff are of the view that such independent insights may be challenged or compromised by an extensive IRC term which could be perceived as a lack of independence of the IRC member.

Staff are of the view that IRC terms beyond 6 years should be viewed as exceptions to the Regulation in limited circumstances where appropriate, and should not become common practice.

4.2 Skills, Competencies and Recruitment of IRC Members

Section 3.5 of Regulation 81-107 specifies the considerations an IFM and/or IRC must give to nominating criteria before appointing an IRC member. While conflicts of interest remain the primary purpose for an IRC, a variety of competencies and skills are typically required to fulfill the IRC's mandate under Regulation 81-107.

Staff observed that the occupations of the majority of IRC members evidenced familiarity and experience within the investment management industry. IRC members were accountants, lawyers, financial services and regulatory compliance consultants, investment professionals, retired professors, former regulators, former individual asset managers and former executives in various related industries.

The occupations of IRC members were clearly disclosed in either the funds' prospectus or AIF where available, and in some instances, the IRC Report to Securityholders. While not a requirement under section 4.4 of Regulation 81-107, staff noted that nearly half of the IRC Reports to Securityholders reviewed specifically disclosed the occupation of the IRC member.

Staff noted that all IRCs reviewed had identified key criteria necessary for IRC members to perform their function as an oversight body. These criteria include the following:

- knowledge of the financial, securities and investment fund industry;
- soft skills, such as interpersonal and strong communication skills;

[5] Subsection 3.3(4) of NI 81-107.

- leadership, management and industry experience;
- professionalism, collegiality, analytical skills and discretion;
- an ability to align with the investor's perspective while providing different thoughts or perspectives; and
- time available to act as an IRC member, along with interest in doing so.

We observed the use of a matrix to assess existing IRC competencies against the competencies/skills of a new or prospective IRC member. The matrix is used to identify gaps in IRC experience or skills and to inform the recruitment process when seeking new IRC members in assessing the competencies of potential candidates. None of the disclosure reviewed indicated a lack of independence of IRC members.

Staff were informed that IRC members are generally recruited from professional and social networks of existing IRC members or those of the IFM and its executives. Staff noted that the recruitment process for new IRC members is one in which both the IRC and IFM generally participate, with the IFM in certain cases, providing lists of potential candidates for further consideration by the IRC.

Regulatory Views

All IRCs reviewed demonstrated knowledge, experience, competencies and relevant skill sets across IRC members. We continue to encourage IRCs and IFMs to strive for diverse skill sets which complement the IRC and which inform its ongoing perspective on how conflicts of interest are reviewed. Staff remind IFMs that, consistent with section 3.15 of Regulation 81-107, ongoing IRC orientation and education is necessary to enhance the skills and competencies for an effective IRC.

IRCs and IFMs should implement recruitment processes that are fair and transparent, and which encourage IRC membership from individuals with relevant knowledge and experience gained from various backgrounds.

Given the importance of independence for IRC members, IRCs should lead the recruitment process to fill vacancies and not place undue reliance on the IFM's preferred candidates for the IRC.

4.3 Size and Diversity

Section 3.7 of Regulation 81-107 specifies a three-person minimum requirement for the IRC with allowance for IFMs to ultimately determine the size of the IRC with a view to effective decision-making concerning the funds under its authority.

Our reviews showed full compliance with the three-person minimum IRC requirement and almost one-quarter of IRCs reviewed had four members. Turnover of IRC members was evidenced by nine of the 24 IRCs noting changes to their composition during the review period covered by the IRC Reports to Securityholders.

Staff noted that a number of individuals hold membership on several IRCs.

All IRCs indicated high satisfaction with the three-person minimum IRC requirement. We were informed that this size is conducive to IRC efficacy, diversity of thought, varied insight, effective voting and resolution of issues. Staff were informed that it is appropriate for the size of the IRC to vary based on the number and complexity of conflict of interest matters that are brought to the IRC while another IRC stated that an increase in the mandatory IRC minimum size would provide no benefit and would only serve to increase costs and administrative burden.

IRCs are not currently subject to any regulatory disclosure requirements concerning diversity in IRC membership nor a specific regulatory requirement to establish diversity policies. Noting this, staff considered the diversity of IRC members as part of the CD Review. The results received highlighted that a majority of IRCs have at least one or more women as IRC members. Representation in IRC membership by other diverse groups such as racialized persons, Indigenous peoples, persons with disabilities and LGBTQ2SI+ persons could not be determined.

All IRCs reviewed were supportive of diversity. This support was evidenced by an IRC which had included diversity considerations in its competency matrix. Further, another IRC had specified in its written Charter, the need for diversity in a manner representative of the fund, its securityholders and their communities.

We note that most IRCs highlighted the need for specialty and diversity of 'skill-set' as paramount to the efficacy of the IRC given its limited and targeted focus on conflicts of interest.

Regulatory Views

Staff's view is that diversity beyond skill set should be pursued and reflected in IRC membership.

Our general view is that diversity in IRC membership is likely to result in wider perspectives which may inform better decision-making concerning conflict of interest matters.

We understand that as the scope of the IRC is focused on conflict of interest matters, diversity of skill set is of key importance, however, staff are of the view that there are qualified candidates that could enhance the diversity of skill set of the IRC and more generally, enhance diversity in IRC membership. As such, staff encourage IRCs to pursue IRC membership reflective of all forms of diversity, in particular, those forms that are relevant to the fund and its securityholders.

4.4 Compensation

Section 3.8 of Regulation 81-107 notes that the IFM may set initial compensation of the IRC when first appointed and cites the IRC's responsibility to set its compensation thereafter. The results of the IRC's annual assessment along with the recommendations of the IFM, if any, must be considered in the setting of compensation by the IRC.

The compensation of IRC members varied amongst IFMs of different sizes with reference to AUM. Staff noted that IRC compensation is generally higher for IFMs with higher levels of AUM. Our specific findings concerning IRC compensation are summarized in Appendix A to this Notice.

One key observation from our review of compensation was that the disclosure in the IRC Report to Securityholders did not specify the basis on which IRC compensation was allocated across the funds. Although there is no requirement in section 4.4 of Regulation 81-107 to specify the basis for allocation of IRC costs across funds, we noted vague references and terminology to denote the basis of allocation of IRC costs. For example, common references for IRC costs include the following:

- on a *fair and equitable basis* or as *fair and reasonable;*
- *in a manner considered to be reasonable;*
- *in a manner considered by the Manager to be fair and reasonable;*
  or
- made *pro rata*, without further context provided on whether the pro rata share is based on total assets of the fund, its complexity of investment objectives or some other basis.

A minority of IRCs indicated that costs were allocated equally across their funds. Staff noted discrepancies between aggregate IRC compensation amounts cited in the IRC Report to Securityholders and the funds' AIF where available. Issuers explained these differences as a typographical error or the application of taxes or other expenses in one disclosure document and not the other, or due to timing differences in the presentation of the disclosure.

We noted a few instances where the compensation of individual IRC members was not broken down by individual amounts in the funds' AIF. We also noted one IRC Report to Securityholders which cited IRC compensation in U.S. dollars, whereas its other fund disclosure documents, including the financial statements, reported in Canadian dollars.

With reference to paragraph 4.4(1)(f) of Regulation 81-107, a majority of IRC Reports to Securityholders specified the basis on which IRC compensation is determined. Common criteria used to determine IRC compensation included the following:

- industry annual compensation reports;
- comparative industry IRC compensation;
- workload and time commitment of IRC members;
- complexity of issues faced by the IRC members;
- results of the IRC's annual self-assessment;
- nature and number of funds overseen by the IRC;
- inflation, economic conditions and market value of IRC members;
- number of meetings held or required by the IRC or IFM to address specific conflicts of interest; and,
- industry best practices.

Regulatory Views

Staff noted a wide variation in compensation levels across IFMs of different sizes. IRC compensation should be measured, justified based on the complexity and involvement of the IRC, and transparent concerning the basis for determination. Staff are of the view that IRC compensation should be transparent and clearly disclosed as it can be viewed as a measure of the IRC's independence.

Section 4.4 of Regulation 81-107 does not mandate disclosure in the IRC Report to Securityholders of the basis on which IRC costs are allocated across applicable funds. The regulatory view, however, is that such disclosure is beneficial to investors and that any description that is used to denote how such costs have been allocated should be informative, meaningful and not vague, e.g. a statement to the effect of the IRC fees and expenses being allocated across the funds in a 'fair and equitable manner' is not informative and raises questions as to whether, for example the reference to 'equitable' means 'equally' across funds. Ideally, an IRC Report to Securityholders is enhanced if the basis for allocation of IRC costs across funds is disclosed and if clear language specifying the basis for allocation is used, e.g. 'equally', 'proportionate based on the NAV or complexity of the fund', 'based on NAV of the fund', etc.

Staff also remind IFMs of the need for breakdown of individual IRC costs in the fund's prospectus going forward [6] and appropriate consistency in disclosure between the fund's prospectus and the IRC Report to Securityholders. Disclosure of IRC compensation in Canadian dollars, while not a requirement of Regulation 81-107, is preferred to enable appropriate comparisons of IRC compensation to be made across IRCs.

4.5 Expanded Scope of IRC Review

Section 3.6 of Regulation 81-107 requires an IRC to adopt a written charter setting out its mandate, responsibilities, functions and the policies and procedures it will follow when carrying out its functions. Commentary 4 to section 3.6 notes that the IFM and IRC may agree that the IRC will perform functions additional to those prescribed by Regulation 81-107 and elsewhere in securities legislation. Essentially, the IRC is required under Regulation 81-107 to review the IFM's handling of conflicts of interest as they arise in the operation of the investment fund but may be tasked with functions additional to the review of conflicts of interest, as agreed to with the IFM.

Staff noted a degree of commonality in terms of what IFMs consider to be a 'conflict of interest matter' necessitating referral to the IRC for its recommendation or approval. Most IFMs obtained standing instructions from their IRCs concerning the following subject matters:

- Proxy Voting
- Operating Costs / Expense Allocation

[6] See Form 81-101F1 *Contents of Simplified Prospectus* – Part A – Item 4.16(2), Form 81-101F2 *Contents of Annual Information Form* – Item 15(2) and Form 41-101F2 *Information Required in an Investment Fund Prospectus* – Item 19.1(12)

- Inter-Fund Trading
- Personal Trading
- Gifts, Gratuities and Business Entertainment
- Allocation of Investment Opportunities, Trade Allocation and Aggregation
- Unitholder Activity (large transactions; short-term trades, transactions-in-kind etc.)
- NAV Errors and Adjustments
- Soft Dollars Use
- Transactions in Securities of Related Issuers
- Fund Valuation
- Trade Errors and Modifications
- Fund of Funds
- Correcting Portfolio Pricing Errors
- Sub-Advisor Selection / Change
- Best Execution
- Seed Capital
- Fair Value Pricing
- Confidentiality & Code of Ethics
- Services Provided by Related Parties / Affiliates
- Portfolio / Investment Management & Change
- Purchases of Equity / Fixed Income Securities Underwritten by an Affiliate.

We also noted the standing instructions from a smaller number of IRCs concerning various themes but suggestive of the identification and concern for a similar type(s) of conflict of interest matter to those listed above. These standing instructions have been categorized in Appendix B to this Notice.

The focus of IRCs under Regulation 81-107 is conflicts of interest and review of the IFM's handling of conflicts of interest as they arise in the operation of the funds.

Noting this scope, we are also aware that investment funds and IFMs currently face growing areas of operational complexity. Therefore, we sought feedback on whether IRCs should be tasked with more mandatory responsibilities and subject areas of the investment fund to review beyond conflicts of interest.

All IRCs and IFMs shared the common view that the mandate of the IRC should not be expanded to areas beyond conflicts of interest. We were told that 'conflicts of interest' is a sufficiently broad enough area to justify the existence of the IRC and to derive benefit from the IRC's consideration of conflict of interest matters. Staff were informed that an expanded scope for the IRC is not needed, given the complexity, wide scope and implications of the conflict of interest matters referred to the IRC. Further, staff were informed that an expansion of the IRC mandate beyond conflicts of interest would impose additional costs with minimal to no benefit to fund securityholders, the fund or the IFM.

Regulatory Views

The Regulation places the highest onus on the IFM to identify conflicts of interest, to compose and evidence a plan of action based on its written policies and procedures to mitigate the conflict of interest, and to refer such conflicts to the IRC for its approval or recommendation, under subsections 5.2(2) or 5.3(1) of Regulation 81-107 respectively. In contrast, IRCs are expected to be reactive to an IFM's referral to the IRC of a conflict of interest matter. Once the matter has been referred, the IRC is within its authority under the Regulation to be proactive in its review function.

Given the onus on IFMs to identify conflicts of interest, staff encourage IFMs to take a broad and wide-ranging view of 'operational' conflicts of interest. Industry experience and disclosure under Regulation 81-107 has yielded a general list of common conflict of interest matters, crystallized into specific areas of conflict and adopted by several IFMs across the industry. This outcome is beneficial and encourages consistency between IFMs and IRCs, however, staff is of the view that the identification by IFMs of new, operational conflict of interest matters should be ongoing. Prohibitions in securities legislation on certain related party transactions dictate the existence of 'structural conflicts' for which IRC approval is required in order for the IFM to proceed with the transaction. However, concerning 'structural conflicts', IFMs are encouraged to be aware of when an IRC approval or exemptive relief from requirements in securities legislation is required in order to proceed with such transactions.

In this context, IFMs are encouraged to have a disciplined, established, organizational approach to identifying new, operational conflicts of interest which may not have been considered previously. A disciplined approach to identifying new operational conflicts of interest for example, may take the form of quarterly, or otherwise regular, organizational meetings across sectors of an organization aimed specifically at the identification of new conflicts of interest. The increasing complexity of investment fund management regulation and operations makes it appropriate for the IFM to have an ongoing and specific focus on the identification of new conflicts of interest and to refer those to the IRC for its recommendation or approval, as appropriate.

Staff encourage a broad interpretation of 'operational' conflicts of interest to derive maximum benefit from IRC review of how conflicts of interest are mitigated.

4.6 Disclosure to Demonstrate IRC Impact

Subsection 5.1(1) of Regulation 81-107 requires the IFM to determine, with reference to its duties under securities legislation and its written policies and procedures, what action it proposes to take in respect of a conflict of interest matter and to present its proposed action to the IRC for its approval or recommendation under subsections 5.2(2) and 5.3(1) as appropriate. In referring the matter to the IRC, the IFM is expected to inform the IRC

whether its proposed action follows the IFM's written policies and procedures on the matter.[7]

Under section 5.4 of Regulation 81-107, IRCs are permitted to issue standing instructions to the IFM to proceed on a given conflict of interest matter in accordance with its terms. Commentary 2 to section 5.4 of Regulation 81-107 states that the IRC may consider including in any standing instruction any terms or conditions in prior exemptive relief orders, waivers or approvals obtained from the securities regulatory authorities.

Staff queried whether a specific metric or additional disclosure should be used to assess the efficacy of the IRC and its impact on the IFM's handling of a conflict of interest matter. Staff were interested in whether there is a specific and measurable way to assess, quantify and determine the extent of IRC impact on the decisions of the IFM on how it chooses to mitigate conflicts of interest of the fund.

Most IRCs consider the current disclosure requirements in the annual IRC Report to Securityholders to adequately demonstrate the work and impact of the IRC. A few IRCs suggested that it could be beneficial to disclose discussions between the IRC and the IFM, however, they noted this would be difficult to demonstrate efficacy. An IFM suggested that a cover report by the IRC Chair summarizing the activities of the IRC may be beneficial for investors.

Another IFM suggested that the following measures may be beneficial in highlighting the activities and benefits of the IRC:

- citing a profile of each IRC member in the annual IRC Report to Securityholders;
- transparency into the components of any competency matrix used by the IRC to assess current skills and competencies of IRC members against those of prospective IRC members; or
- additional guidance from the regulators to enhance consistency in the qualitative disclosures of conflict of interest matters reviewed by the IRC across IFMs, given significant variances noted.

Regulatory Views

As the IRC Report to Securityholders is the disclosure document in which IRC activities are captured, IRCs should ensure that the disclosure in such documents is fulsome, substantive and informative and that it provides a clear picture of the scope of IRC activities and the impact of the IRC's involvement on how conflicts of interest of the funds have been mitigated. As an example, the IRC Report to Securityholders could provide insight into any enhanced procedures adopted by the IFM as a result of an IRC approval or recommendation.

Enhanced disclosure in the IRC Report to Securityholders on the activity and impact of the IRC can better inform stakeholders about the value, role and impact of the IRC.

[7] Commentary 3 to section 5.1 of NI 81-107.

NEXT STEPS

IFMs and IRCs are encouraged to use the guidance provided in this Notice to further enhance and support their roles under Regulation 81-107. Staff will continue to monitor disclosure in this area.

Questions

Please refer your questions to any of the following:

Autorité des marchés financiers

Louis-Martin Ouellet
Coordinator
Investment Products and Sustainable Finance
Phone: 514-395-0337, ext. 4496
Email: Louis-Martin.Ouellet@lautorite.qc.ca

Ontario Securities Commission

Susan Thomas
Senior Legal Counsel
Investment Funds and Structured Products
Phone: 416-593-8076
E-mail: sthomas@osc.gov.on.ca

Neeti Varma
Manager
Investment Funds and Structured Products
Phone: 416-593-8067
E-mail: nvarma@osc.gov.on.ca

Appendix A:

CD Review Findings on IRC Compensation

IFM Size	Range of Aggregate IRC Compensation	Range of IRC Compensation for Individual IRC Chairs	Range of IRC Compensation for Individual IRC Members (Non-IRC Chairs)
AUM < $1 Billion	$12,000 to $33,000	$4,000 to $13,000	$3,000 to $10,000
AUM between $1 Billion and less than $50 Billion	$20,160 to $154,603	$10,600 to $53,000	$8,100 to $48,000
AUM between $50 Billion and $100 Billion	$113,500 to $132,800	$41,500 to $50,000	$36,000 to $40,000
AUM > $100 Billion	$60,000 to $246,250	$24,000 to $88,750	$18,000 to $78,750

Appendix B:

Staff Categorization of Various IRC Standing Instructions

Observed from CD Review

THEMES				
Related Entities	***Unitholders***	***Service Providers and Oversight***	***Fund Operations, Allocation, Fees, Valuation and Performance***	***Employee Behaviour***
In Species Transactions Prohibited Investments Foreign Exchange Transactions with Related Party Transactions Through Related Dealer	Capacity Issues Showing Favoritism to Unitholders Complaints Handling Large Unitholders	Broker Selection Oversight of Service Providers Transition Management Services & Affiliated Brokerage Services Oversight of Sub-Advisor Compliance Referral Arrangements Reasonable Enquiries of Sub-Advisor COI Related Supplier Fees and Quality Monitoring Non-Audit Services Guidelines re Serving as Director Outsourcing to Third Parties	Management Fees NAV Calculation / Frequency of Calculation Performance Incentives Benchmark Indices Omnibus Redemption / Disposition for Investments in Funds Fund Gain / Loss Accounting Valuation of Illiquid & Private Placements Discretionary Trades in Securities where Selling Commission is Earned Distribution Issues Allocation of Income, Surpluses & Scholarships ETF / IPU Purchases for Retail Investment Funds Portfolio Holdings Release	Outside Business Activity Employee / Managers COIs

			Dissemination of Portfolio Info Transfer Agency Error Correction Auditor Custody Launching, Merging, Closing of Funds Underlying (Alternative) Fund Investment Mutual Fund Sales Flow-Through Limited Partnership Merging into Fund Supplements to Base Shelf Prospectus Short Term Trading Fees Market Timing Manual Pricing	