

STRUCTURED PRODUCTS BULLETIN

April 2005

IMPORTANT NEW FINANCIAL REPORTING AND CONTINUOUS DISCLOSURE REQUIREMENTS FOR INVESTMENT FUNDS

THE CSA RELEASES NATIONAL INSTRUMENT 81-106 INVESTMENT FUND CONTINUOUS DISCLOSURE

INTRODUCTION

The Canadian Securities Administrators (the “CSA”) have recently released National Instrument 81-106 *Investment Fund Continuous Disclosure* (the “Instrument”) and Companion Policy 81-106CP (the “Companion Policy”), along with Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance*. The Instrument sets out obligations for investment funds relating to financial statements, management reports of fund performance, delivery obligations, proxy voting disclosure, annual information forms and certain other disclosure related matters.

The Instrument and Companion Policy are expected to come into force on June 1, 2005.

The new regulatory regime heralded by the Instrument is intended to address the need of investors to receive more timely and useful ongoing information from the investment funds in which they invest. The form of financial disclosure prescribed by the Instrument is designed to permit investors to better assess an investment fund’s performance, position and future prospects and also assist advisers in selecting and recommending appropriate investment funds that are consistent with the goals of their clients.

WHO DOES THE INSTRUMENT APPLY TO?

The Instrument applies to reporting issuers and in some jurisdictions, including Ontario and Québec, non-reporting issuers. However, the Instrument provides specific relief to non-reporting issuers from the requirement to file financial statements on SEDAR. Highlights of this relief and other key features of the new Instrument are discussed below.

KEY FEATURES OF THE INSTRUMENT

Key features of the Instrument include the following:

- (i) the introduction of annual and interim management reports of fund performance for reporting issuers (akin to MD&A in the corporate world);
- (ii) updated requirements relating to the content of investment fund annual and interim financial statements;
- (iii) amendments to current filing and delivery requirements for annual and interim financial statements; and
- (iv) new requirements relating to quarterly portfolio disclosure and proxy voting for investment funds that are reporting issuers.

The new requirements will generally apply to (i) an investment fund that is a reporting issuer and (ii) a mutual fund that is organized under the laws of a local Canadian jurisdiction except in the case of Alberta, British Columbia, Manitoba, and Newfoundland and Labrador, where the Instrument does not apply to a mutual fund that is not a reporting issuer. An “investment fund” can be either a mutual fund or a non-redeemable investment fund. A “mutual fund” is generally a fund that is redeemable more than once a year by reference to net asset value. A “non-redeemable investment fund” is generally an issuer whose primary purpose is to invest money provided by its securityholders, 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 any issuer, and that is not a mutual fund (e.g., a pooled fund). Examples of funds affected by the Instrument would include open-ended mutual funds, labour sponsored investment funds, venture capital funds, exchange-traded funds, closed-end funds and scholarship plans. The Instrument does not apply to conventional income trusts (investment trusts that invest exclusively in an operating company), real estate investment trusts (REITS) or royalty trusts.

SUMMARY OF KEY FEATURES OF THE INSTRUMENT

(i) Requirement for Annual and Interim Management Reports of Fund Performance

To address concerns about timeliness and relevance of financial information provided by investment funds, the CSA has introduced a requirement for reporting issuers to prepare annual and interim management reports of fund performance (a “MRFP”) in the form required by the Instrument, to be filed on SEDAR at the same time as the investment fund’s annual financial statements and interim financial statements. Scholarship plans will not have to prepare or file interim MRFPs.

The MRFP is designed to provide analysis and explanation to complement and supplement an investment fund’s financial statements, and is the equivalent to the MD&A required for corporate reporting issuers with specific modifications for investment funds. The Instrument requires directors of corporate investment funds and trustees (or other authorized parties) of investment funds organized as trusts to approve the annual and interim MRFPs.

In addition, every investment fund that does not have a current prospectus must continue to prepare and file an annual information form no later than 90 days after each financial year-end.

(ii) Content of Financial Statements

All investment funds must prepare annual audited financial statements for the fund’s most recently completed financial year in the specified form, including all required line items. The financial statements must be prepared in accordance with Canadian GAAP as applicable to public enterprises. Financial statements that are required to be audited must be audited in accordance with Canadian GAAS. The statements must include a statement of investment portfolio as at the end of the year, and a statement of net assets, a statement of operations, and a statement of changes in net assets as at the end of the financial year and for the immediately preceding financial year. If required by Canadian GAAP, a statement of cashflows for that financial year and a statement of cashflows for the immediately preceding financial year are also required. Generally speaking, the same statements must also be filed on a semi-annual basis for the specified interim periods.

The Instrument requires directors of corporate investment funds and trustees (or other authorized parties) of investment funds organized as trusts to approve the annual and interim financial statements.

With respect to reporting issuers, if an auditor has not performed a review of the investment fund’s interim financial statements, the statements must be accompanied by a notice to such effect. If an auditor has been engaged but was unable to complete the review, the interim financial statements must be accompanied by a notice indicating that the auditor was unable to complete the review and the reasons why the review was not completed.

(iii) Delivery and Filing Requirements

The annual financial statements and MRFP must be filed on or before the 90th day after an investment fund's most recently completed financial year-end. The deadline represents a significant acceleration from the current filing deadline of 140 days after year-end. The deadline also has implications for fund-of-fund investment products where the underlying funds may not be subject to the same reporting requirements. The interim financial statements and MRFP must be filed on or before the 60th day after the end of the investment fund's most recent interim financial period, which is unchanged from the current filing deadline for interim financial statements.

All investment funds (including non-reporting issuers) must deliver annual and interim financial statements and MRFPs to investors on request by the later of the filing deadline and 10 calendar days after the request is received. Investment funds must comply with the delivery requirements of National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer*, unless the investment fund can communicate directly with the beneficial owner of the securities.

The Instrument exempts mutual funds that are not reporting issuers from the current requirement in some jurisdictions for such funds to file financial statements with the regulators on SEDAR. Financial statements will not have to be filed if the mutual fund:

- prepares the applicable financial statements in accordance with the Instrument;
- delivers the financial statements to its securityholders in accordance with the Instrument within the same time period as if the statements were required to be filed;
- has advised the applicable securities regulatory authority that it is relying on the exemption (which can be satisfied by a one-time notice); and
- has included a note in its financial statements that states that the fund is relying on this exemption not to file its financial statements.

Election of Investors to Receive / Not Receive Financial Statements and MRFPs

The Instrument also introduces the opportunity for securityholders of investment funds to elect whether or not they wish to receive any or all of the fund's financial statements and MRFPs, subject to any applicable corporate law requirements. Investment funds will be permitted to either rely on standing instructions or annual instructions from their securityholders with respect to the delivery of such documents. In order to rely on standing instructions, a fund must send out a document that explains the choice a securityholder has to receive the documents, solicits instructions about delivery, and explains that the instructions will continue to be followed until they are changed by the securityholder. At least annually, the investment fund must send out a reminder containing prescribed information. Alternatively, if a fund has never relied on standing instructions, a fund can request annual instructions from a securityholder by sending a request form and notice containing the prescribed information. When soliciting delivery instructions, a fund may deem a "no response" to be a request to receive some, none or all of the applicable documents. Investment funds should make clear, when soliciting delivery instructions, what the consequence of a "no response" will be.

Notwithstanding the above, a fund must send to each securityholder its first annual MRFP with an explanation of the new continuous disclosure requirements, including the availability of quarterly portfolio disclosure and proxy voting disclosure (discussed below).

Posting of Financial Information on Websites

A new requirement, applicable only to investment funds which are reporting issuers, is that each investment fund that has a website must post the financial statements and MRFPs no later than the date those documents are filed.

*(iv) Additional Requirements for Investment Funds that are Reporting Issuers***(1) Quarterly Portfolio Disclosure**

Investment funds that are reporting issuers (other than scholarship plans, labour sponsored funds, or venture capital funds) are now required to prepare quarterly portfolio disclosure that includes a summary of investment portfolio in the prescribed form as at the end of each period that ends three or nine months before the fund's financial year-end. The summary must also include the total net asset value of the investment fund as at the end of the specified periods. This information is required to be posted on the fund's website, if any, within 60 days of the end of the period to which the disclosure relates.

(2) Proxy Voting

The Instrument requires investment funds that are reporting issuers to establish policies and procedures for voting on matters for which the fund has received proxy materials. Investment funds that are reporting issuers will now be required to disclose in their annual information form (or prospectus if an AIF is not required to be prepared) a summary of their proxy voting policies and procedures. These policies must include standing policies for dealing with routine matters, the procedures by which the investment fund will determine how to vote or refrain from voting on non-routine matters, and procedures to ensure portfolio securities are voted in accordance with the instructions of the investment fund. In addition, an investment fund must prepare and maintain a proxy voting record on an annual basis for the period ending June 30 that includes prescribed information for each time the fund receives (as a securityholder) meeting materials relating to meetings of securityholders of reporting issuers. The information must include whether the investment fund voted, and if so, how it voted and whether the votes cast were for or against the recommendations of management of the issuer. If the investment fund has a website, the proxy voting record must be posted on the website by August 31 of each year.

(3) Other Requirements

The Instrument contains other requirements relating to independent valuations (applicable to labour sponsored investment funds), material change reports, proxy solicitation and change of auditor disclosure. The Instrument also prescribes requirements for the calculation of net asset value, and for both public and private funds, the MER calculation. Investment funds that are reporting issuers are also required to file reports on SEDAR relating to any matters submitted for a securityholder vote, as well as copies of any material contracts of the funds (or any amendments) at the time the final prospectus of the fund is filed or upon the execution of the material contract or any amendments.

IMPLEMENTATION OF THE INSTRUMENT

The timing of the implementation of the Instrument is as follows:

- the requirements for annual financial statements, annual MRFPs and annual information forms will commence for financial years ending on or after June 30, 2005;
- the requirements for interim financial statements and interim MRFPs will be required for interim periods ending after the investment fund's first year-end following June 30, 2005;
- the requirements for quarterly portfolio disclosure will apply for periods that end on or after June 1, 2005;

- the requirements for proxy voting records will apply for the annual period beginning July 1, 2005; and
- the requirements for proxy solicitation and information circulars will apply as of July 1, 2005.

The first annual financial statements, annual information forms and MRFPs must be filed on or before the 120th day after the end of the financial year to which they pertain. All other requirements are expected to apply as of June 1, 2005. As some of the new requirements represent a significant departure from the current rules relating to financial reporting, notably the accelerated filing deadlines for annual financial statements and, for investment funds that are reporting issuers, the preparation of MRFPs and quarterly portfolio disclosure, it is important that investment funds prepare for the implementation of the Instrument as soon as possible.

Written by Michael Burns, Kimberly Poster and David Hudson, Student-at-Law

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

© Copyright 2005 McMillan Binch LLP

The McMillan Binch Structured Products Group is one of the largest groups in Canada dedicated to specialty products and funds offered in the Canadian marketplace. From compliance issues to the creation and implementation of exchange listed structured funds, our Structured Products Group services the needs of a broad range of market participants including securities dealers, market intermediaries, hedge funds and other money managers.

For further information, please contact your McMillan Binch lawyer or one of the following team members listed below:

Tim Baron	416.865.7096	tim.baron@mcmillanbinch.com
Michael A. Burns	416.865.7261	michael.burns@mcmillanbinch.com
Michael Campbell	416.865.7114	michael.campbell@mcmillanbinch.com
Nicole Frew	416.865.7904	nicole.frew@mcmillanbinch.com
Mark Lobsinger	416.865.7107	mark.lobsinger@mcmillanbinch.com
Margaret C. McNee	416.865.7284	margaret.mcnee@mcmillanbinch.com
Gary K. Ostoich	416.865.7802	gary.ostoich@mcmillanbinch.com
Kimberly J. Poster	416.865.7890	kimberly.poster@mcmillanbinch.com
Michael Ward	416.865.7176	michael.ward@mcmillanbinch.com
David Wentzell	416.865.7036	david.wentzell@mcmillanbinch.com

MCMILLAN BINCH LLP

TELEPHONE: 416.865.7000
 FACSIMILE: 416.865.7048
 WEB: WWW.MCMILLANBINCH.COM