AUM Law Leap Year Bulletin

Did you know… Julius Caesar introduced the idea of a leap year when he ordered his astronomer, Sosigenes, to simplify the existing calendar. Sosigenes opted for a 365-day year, adding a day every four years to account for the extra hours gained by the earth's orbit.

At AUM Law, we know that you have plenty to do with your "extra hours" – please call us if we can be of assistance!

In this bulletin

In Brief: MIE Business Trigger ● Recent Business Trigger Decisions ● CSA Enforcement Report

1. New Exempt Market Filing Requirements

Hang on tight! As of May 24, 2016, certain exempt market filing procedures will be changing in all provinces and territories other than Ontario and British Columbia. In order to understand why the changes to the filing process are occurring, it is helpful to have some background knowledge on how exempt market filings operate across Canada.

In Ontario, exempt market filings are made electronically through the OSC's Electronic Filing Portal. In British Columbia, exempt market filings are made electronically through the BCSC eServices. In all other provinces and territories, exempt market filings are completed in paper form, which is more costly and is less efficient during the review process. The amendments to National Instrument 13-101 System for Electronic Document Analysis and Retrieval (SEDAR) (NI 13-101) and to Multilateral Instrument 13-102 System Fees for SEDAR and NRD (MI 13-102) are intended to address these issues and streamline the filing process.

The amendments will not alter the filing landscape in Ontario and British Columbia, since they have pre-existing electronic filing tools. However, for the rest of Canada, as of May 24, 2016, certain regulatory filings relating to exempt market activities will need to be filed electronically through SEDAR and will come with a fee of $25 per filing, in addition to the filing fees in the applicable jurisdictions. These filings include, among others, Form 45-106F1 Report of Exempt Distribution and an offering memorandum under the offering memorandum exemption.

In Brief

The Ontario Securities Commission (OSC) has recently reminded **mortgage investment entities** (MIEs) to consider whether they, in addition to registration with the Financial Services Commission of Ontario (FSCO), **may also require registration** with the OSC. Generally, registration may be triggered if a business involves trading in securities, such as units or common shares of a MIE. Both the OSC and the Canadian Securities Administrators (CSA) have previously released guidance on how registration requirements affect MIEs. In addition to reviewing this guidance, the OSC is recommending that MIEs seek the advice of legal counsel. If you are unsure of whether your business may require additional registration, please contact Erez Blumberger, Chief Regulatory Counsel.

Not all filings will need to be made electronically; some will still need to be made in paper format, including offering memorandums when used in reliance on exemptions other than the offering memorandum exemptions in Saskatchewan, New Brunswick and Nova Scotia.

From December 7, 2015, to the implementation of the amendments on May 24, issuers can voluntarily submit these exempt market filings electronically on SEDAR without paying the system fee.

The existence of three separate electronic filing systems is intended to be temporary, with the ultimate goal being to have a uniform national electronic filing system.

For more information, please refer to Multilateral CSA Notice of Amendments to NI 13-101 and MI 13-102. Remember, we are here to help. Please contact a member of our Regulatory Compliance Group.

2. Bond Fund Liquidity

Managers should remain aware that fund liquidity continues to be an ongoing concern for regulators, both in Canada and south of the border. In Canada, a mutual fund must invest primarily in liquid investments in accordance with National Instrument 81-102 - *Investment Funds* (NI 81-102). In June, 2014, the OSC commenced a series of targeted reviews of mutual fund practices relating to liquidity assessments of fund holdings, liquidity stress testing and liquidity valuation considerations. A notice summarizing the OSC's findings was released in June, 2015. Please see our July 2015 bulletin detailing this notice.

Some of the key recommendations made by the OSC are as follows:

- Funds should have robust **written policies and procedures** regarding how they make liquidity assessments both at the time of an investment purchase and on an ongoing basis. Some key metrics useful in making liquidity assessments include: volume metrics, bid-ask spreads, numbers of participants making a market for the holding and outstanding issue size. Further, it is advisable to have an assessment or review committee to determine whether a security is illiquid.
- In Staff's view, being listed on a stock exchange is not generally sufficient to conclude that a particular holding is liquid. Managers should consider whether or not a fund's investment holdings can be readily disposed of in 3 business days without a significant adverse impact to the portfolio.
- It is important to engage in stress testing on an ongoing basis to have a solid grasp of a fund's ability to meet unexpected large redemptions, both at historical and higher than historical levels, together with market stress. Both a **stress testing policy and a procedure should be in place** to deal with such scenarios. A fund with a higher exposure to potentially illiquid assets should provide additional disclosure to its investors and ongoing discussion of the risk management policies and investment restrictions in place designed to mitigate liquidity risk.
- Finally, Staff considered valuation practices and referred funds to International Financial Reporting Standards 13 (IFRS 13) “Fair Value Measurements” which sets out guidance for determining fair value, as well as the accompanying disclosure requirements. Managers should obtain standing instructions from the funds' IRC in regard to their valuation policies and procedures.

The Securities Exchange Commission (SEC) continues to be concerned with liquidity in the fixed income markets generally and in open end mutual funds and

Valt.X Holdings Inc.
A technology company relying on the accredited investor exemption was found to not be engaging in “activities similar to those of a registrant” (such as promoting or selling securities other than its own) and thus was found not to have tripped the registration business trigger. Read the full case here.

Liahona Mortgage Investment Corp, et al.
was found to have engaged in the business of trading in securities without being registered or able to rely on a registration exemption. The corporation had also distributed its shares to investors who did not qualify for prospectus-exempt distributions. The business trigger finding is not surprising considering that, among other things, approximately $20 million worth of LMIC shares were sold to 95 investors. What is somewhat surprising is the statement in the Settlement Agreement that an investment comprising over 10% of each investor’s financial assets *de facto* results in an investor’s portfolio being over-concentrated and hence unsuitable. It is not clear whether this statement was based on the particular risk and other attributes of the investors in this case, or is now a stand-alone Commission position. While there is Staff notice guidance that holdings over 10% in one issuer *may* be a suitability “concern”, we are not aware of the legal authority for a stand-alone 10% position.

ETFs in particular. Under proposed reforms, mutual funds and ETFs would be required to implement liquidity risk management programs and enhance disclosure regarding fund liquidity and redemption practices.

The SEC's proposed reforms would require a fund's liquidity risk management program to address: classification of the liquidity of fund portfolio assets based on the amount of time required to convert an asset to cash without market impact; assessment, periodic review and management of a fund's liquidity risk; establishment of a fund's three-day liquid asset minimum; and board approval and review. It would also codify the 15 percent limit on illiquid assets including in current SEC guidelines.

The proposed reforms also provide a framework under which mutual funds could elect to use "swing pricing" to pass on the costs stemming from shareholder purchase or redemption activity to the shareholders associated with that activity. These proposals would enable mutual funds, subject to board approval and oversight, to reflect in a fund's NAV costs associated with shareholders' trading activity.

Please contact us to further discuss this topic, and potential updates to your policies and procedures manual.

The CSA recently released its 2015 Enforcement Report highlighting the year's enforcement actions across the country. Among other enforcement actions, the report discusses several cases of misconduct by registrants in Ontario, British Columbia, Québec and Nova Scotia.

3. Amendments to Canada's Early Warning Reporting System and Take-Over Bid Regime

The CSA recently released final amendments to the early warning reporting system (Early Warning Amendments) and takeover bid regime (Takeover Amendments) to take effect May 9, 2016. The harmonized National Instrument 62-103 – *The Early Warning System and Related Takeover Bid and Insider Reporting Issues* includes the following amendments:

Takeover Amendments

- Current 35-day minimum bid period will be extended to 105 days.
- Bids will be subject to a mandatory tender requirement of a minimum 51%, after which, once met (along with all other conditions), the bid will be extended for a minimum 10-day period.

Early Warning Amendments

- A decrease in (a) a securityholder's ownership, control or direction of securities by 2% or more, or (b) a decrease below the 10% reporting threshold, will require disclosure.
- In specific circumstances, for the purpose of determining early warning reporting obligations, certain borrowers and lenders will be exempt from including securities they borrow or lend, respectively.
- Enhanced disclosure in early warning reports is required in certain circumstances, including with respect to purpose and intention of investors, and with respect to certain financial instruments, including, equity derivatives.
- Early warning news releases must be issued and filed no later than the opening of trading on the next business day.
- The alternative monthly reporting system will be unavailable to eligible institutional investors who solicit proxies from securityholders in certain circumstances.

For more information on this topic, including updating your policies and procedures manual, please contact us.

4. Derivative Scope and Trade Reporting Rules Proposed in Other Provinces

On January 22, 2016, Alberta, British Columbia, New Brunswick, Newfoundland and Labrador, Saskatchewan, the Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island and Yukon have proposed the adoption of derivative scope and trade reporting rules already similarly in effect in Ontario, Manitoba and Quebec. Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting*

and the related Companion Policy (the TR Rule) requires that all over-the-counter derivative transactions involving a local counterparty be reported to a designated trade repository. Multilateral Instrument 91-101 *Derivatives: Product Determination* and the related Companion Policy outlines the products that are considered derivatives and therefore subject to the TR Rule.

For background on the initial adoption of the TR Rule, see our nutshell on this topic.

AUM Law News

- We are pleased to announce that **Alan Sinclair** will be joining AUM Law in early April as the firm's Deputy Chief Regulatory Counsel. Alan brings a wealth of experience to the role and is a very welcome addition to our Regulatory Compliance team.
- **Susan Han** will be speaking at the CFA Society of Toronto's *Be Prepared: Exempt Product is Going Mainstream* seminar on March 2. For more details and to register, please visit the event page.
- **Erez Blumberger** will be chairing a panel at this year's National Society of Compliance Professional's (NSCP) *Canadian Conference – Stickhandling Compliance Challenges*, taking place on April 4. Erez will be speaking from his unique perspective as an ex-regulator – offering guidance on the implementation of new rules and tips for interacting with regulators – among other topics. Visit the conference page for more details, or to register.

Recent Publications

Mortgage Investment Corporations and Syndicated Mortgages

If you missed our recent *In a Nutshell* piece summarizing mortgage investment corporations and syndicated mortgages, you can read it here.