## And the Winner is…

The suspense is over – the votes have been tallied and the High Park Zoo's capybara babies have been named Alex, Geddy and Neil, after legendary rock band and proclaimed AUM Law favorite, Rush. Geddy Lee gave "thanks to all who voted to give us this special honour," adding "by the way, which one is me? In the picture I saw none of them were wearing glasses."

The babies' parents, the infamous capybaras Bonnie and Clyde, became media sensations last May when they escaped the High Park Zoo and evaded capture for weeks, sparking bigfoot-like sightings and searches.

Unfortunately, reporting financial institutions will not be able to escape or evade the new CRS reporting requirements as of July 1st. We will look at this and many other developments in this month's AUM Law Bulletin.

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### 1. Are You Ready For CRS?

A friendly reminder that Part XIX of the *Income Tax Act* (Canada), which implements the OECD's reporting and due diligence standards of the Common Reporting Standard (CRS), comes into force on July 1, 2017. Entities that are reporting financial institutions for CRS purposes (which can include asset managers, dealers and investment vehicles) need to have policies and procedures in place to begin identifying relevant accounts.

If you have any questions about CRS or would like assistance with updating your policies and account opening documents please contact us.

## In Brief

**OSC Roundtable on Discontinuing Embedded Commissions**

The OSC will host a roundtable on September 18 to discuss the results of the consultation period on the banning of embedded commissions. Other regulators will also be holding roundtables to discuss the proposed ban. A final decision on banning of embedded commissions is expected by end of year. Hmmm.

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**No Contest – Another OSC Settlement**

Three RBC firms have entered into the latest no-contest settlement with the OSC, paying $21.8

## 2. Changing Expectations of Ontario Securities Commission for Fund-of-Fund Relief

### 81-106 to Apply to All Underlying Funds

The OSC recently indicated that they will be imposing new conditions for investment fund managers seeking fund-of-fund relief from the prohibited investment provisions applicable to investment funds in s.111 of the *Securities Act* (Ontario) (the "OSA"). Fund-of-fund relief is obtained from the OSC in relation to provisions that prohibit certain investments by investment funds, including the prohibition against an investment fund owning 20% or more of another investment fund.

One key new condition establishes that "a Top Fund will not invest in an Underlying Fund, unless the Underlying Fund complies with the provisions of NI 81-106 that apply to a "mutual fund in Ontario" as defined in the OSA".

Going forward, this condition will require that all underlying funds for structures where fund-of-fund relief is obtained comply with the rules around the preparation of annual audited and interim financial statements in NI 81-106. Previous to this new condition, if the local jurisdiction of an underlying fund did not require audited annual financial statements as required by NI 81-106, there was no obligation to prepare them.

There has been no indication regarding how the OSC will deal with existing fund-of-fund structures where relief was granted by the OSC in the past and did not impose the new conditions. We will be watching for developments very closely.

### Custodial Considerations for Fund on Fund Structures

In order for a firm to act as its own trustee of a fund, it will often need to apply for an approval under the Loan and Trust Corporations Act (Ontario). In recent OSC audits, we have seen OSC Staff take the view that the commonly used wording in the LTCA approval setting out that assets must be custodied with an appropriate custodian includes assets such as a book based share registry.

This view has implications for fund-of-fund structures, where often the only "asset" of a top fund is a book based register of investors who ultimately invest in a bottom fund (that holds all the investment assets). Some firms consider retaining a custodian only for the bottom fund that contains the investment assets. The view we have seen expressed by OSC Staff would mean that the book based share registry must also be custodied and thus the top fund must also retain a custodian for that purpose. This could have practical not to mention cost considerations.

If you would like to discuss the implications of these changing OSC expectations and their implications please contact our [Investment Funds Group]

***In Brief cont'd***

million in compensation to clients and $925,000 to the OSC in response to allegations of overcharging with respect to certain fee-based accounts and mutual funds. RBC also agreed to undertake enhanced compliance measures to prevent overcharging going forward.

It is clear the OSC continues to see its no-contest settlement program as a key tool in its consumer protection arsenal. Firms must ensure they have effective compliance systems in place or face the consequences…

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**Final CASL Reminder**

As noted in our previous Bulletins, CASL consent rules are becoming more restrictive as of July 1. Please call us if you wish to discuss further.

## 3. Reports of Exempt Distribution: Fine Tuning the Fine Print or More?

The Canadian Securities Administrators (CSA), with exception to the British Columbia Securities Commission, published for comment proposed amendments to *Form 45-106F1 Report of Exemption Distribution* ("Form 45-106F1").

As we know, Form 45-106F1 is a filing requirement for issuers and underwriters who distribute securities pursuant to one or more prospectus exemptions. Although Form 45-106F1 was only recently amended in June 2016, the CSA has proposed more fine tuning to provide comfort to issuers and underwriters and relieve some headache surrounding the filing of Form 45-106F1. In the CSA's view, the proposed

amendments, although beneficial to all filers, are intended to address concerns that institutional investors are excluded from offerings by foreign dealers as a result of the information and certification requirements prescribed in Form 45-106F1 applicable to these dealers.

Generally, the proposed amendments to Form 45-106F1 relate to (i) certification requirements and (ii) information requirements.

First, the proposed amendment to the certification requirements would permit agents to certify on behalf of issuers and underwriters in order to reflect the practical reality that law firms usually file Form 45-106F1 on behalf of their clients. Further, the certification language proposed now includes a due diligence qualifier that allows the filer or their agent to certify based on their knowledge, having exercised reasonable diligence, the information provided is true, and to the extent required, complete. In addition, Form 45-106F1 now clarifies that the person certifying is doing so on behalf of the issuer using a corporate-style signature block and not certifying on an individual level.

Second, the proposed amendments relate to information requirements. Specifically, the CSA proposes that in filing Form 45-106F1, filers will no longer need to include all the exchanges where shares of the issuer trade, but rather list only the primary exchange where the shares trade. Further, the filer is not required to do analysis regarding all the categories that may apply to an issuer when relying on the exemption under Item 9 for disclosure of information of directors, executive officers and promoters of the issuer. The proposed amendments indicate that it is sufficient to select only one category that applies to the issuer under Item 9 of the form.

Finally, the proposed amendments also alleviate the need to select the applicable paragraph number in Schedule 1 under the definition of "accredited investor" when distributing securities to non-individual permitted clients.

In sum, the proposed amendments regarding both the certification and information requirements will likely ease the burden in completing Form 45-106F1 and the due diligence language may also provide some comfort to persons certifying the form.

Please contact us if you would like assistance with filing Form 45-106F1 or to discuss the proposed amendments.

## 4. Restrictive Covenants in Employment Contracts – How Restrictive is Too Restrictive?

Employers regularly use restrictive covenants in their employment contracts to minimize the harm that can be inflicted by former employees upon departure. The most common restrictive covenants are non-competition clauses (which restrict former employees from competing with former employers for a certain period of time) and non-solicitation clauses (which restrict former employees from soliciting customers, employees or suppliers of the former employer for a certain period of time).

Canadian courts have long held that restrictive covenants are a restraint of trade and contrary to public policy. As a restrictive covenant is presumed void, such clauses will only be upheld if they are drafted narrowly and go no further than necessary to protect the employer's legitimate business interests. This includes the use of reasonable limits in terms of duration and scope (geographic, etc.), amongst other factors. For this reason, a non-competition clause will only be enforced in rare circumstances.

Properly drafted non-solicitation clauses are a useful tool for employers and are much more commonly upheld by the courts. It is still important to ensure that a non-solicitation clause is sufficiently narrow and does not accidentally move into non-competition territory, however, as the Ontario Court of Appeal case, *Donaldson Travel Inc. v. Murphy*, 2016 ONCA 649, illustrates.

In this case, the non-solicitation clause at issue stated that the employee:

> …agrees that in the event of termination or resignation that she will not solicit **or accept business** from any corporate accounts or customers that are serviced by the employee], directly or indirectly. [emphasis added]

The Court of Appeal upheld that the phrase "or accept business" turned the non-solicitation clause into a non-competition clause and was unreasonable and unenforceable.

This decision serves as an important reminder that overbroad restrictive covenants will not be upheld by the courts. If you wish to use such clauses in your employment contracts it is important to have such clauses vetted by legal counsel beforehand.

Please contact us if you would like assistance in drafting your employment contracts or have general employment law questions.

## 5. What Are the Prohibited Investment Rules?

Over the years, we have received many questions from clients on the prohibited investment rules for registered plans. As this area has proven to be one of common confusion, we asked Ryan Morris, co-chair of the Tax Group at Weir Foulds LLP, to provide some illumination on this area. The following is Ryan's explanation.

It is well known that registered plans such as RRSPs, RRIFs and TFSAs may only invest in property that is a "qualified investment" for tax purposes. Further, under the *Income Tax Act* (Canada), such plans must not hold property that is a prohibited investment of the particular plan, even if such investment is a qualified investment. The 2017 federal budget, released on March 22, 2017, proposes to extend the prohibited investment rules to RESPs and RDSPs (collectively, with RRSPs, RRIFs and TFSAs, "Registered Plans").

The holder or annuitant of a Registered Plan that holds a prohibited investment can be subject to a 50% penalty tax on the value of the investment (which is refundable in certain circumstances) and a 100% penalty tax on any income or capital gain derived from the investment.

Generally, a prohibited investment includes (but is not limited to) an investment in a corporation, trust or partnership in which the controlling individual of the Registered Plan has (i) a "significant interest" or (ii) with which the controlling individual does not deal at arm's length.

### What is a significant interest?

Generally, an individual has a "significant interest" in a corporation if the individual owns, directly or indirectly, 10% or more of the issued shares of any class or series of the corporation or a related corporation. An individual has a "significant interest" in a partnership or trust if the individual's interests in the partnership or trust have a fair market value of 10% or more of the fair market value of all such interests in the partnership or trust, as applicable. It is important to note that the holdings of the individual together with those of persons and partnerships not dealing at arm's length with the individual must be aggregated for the purposes of determining whether the 10% thresholds above are met.

### How do I know if I am arm's length with the issuer?

Assuming the individual is not related to the issuer, one must determine whether the individual, as a factual matter, does not deal at arm's length with the issuer. In making such determinations, the jurisprudence generally considers whether one party has factual control over the other. However, it is unclear how the tests used by the courts would apply to the prohibited investment rules in certain situations such as when a holder or annuitant of a Registered Plan is an officer or director of a corporate issuer or a controlling shareholder of the manager of an investment fund.

Certain property is specifically excluded from the application of the prohibited investment rules including shares or units of a mutual fund corporation or mutual fund trust that either is subject to National Instrument 81-102 – Mutual Funds or follows a reasonable diversification policy. However, this exclusion applies only for the 24 month period on start-up and wind-up of the fund and is subject to certain anti-avoidance rules.

Compliance with the prohibited investment rules often presents challenges to taxpayers and their advisors. Falling offside the rules can result in material adverse consequences, particularly if correcting measures are not quickly implemented. Taxpayers should consult with a tax advisor on a timely basis if there is a risk that a particular investment or holding is, or could become, a prohibited investment for their Registered Plans.

If you have managed to read up to this point, please note that we work with certain key tax advisors, including Ryan Morris, in the course of providing you full service advice. If you have any further questions

regarding prohibited investments or any other tax related issues contact us and we can provide you with the answers you seek!

### 6. Quebec Complaint Reporting System filing due July 30, 2017

Firms registered as advisers or dealers with the Autorité des marchés financiers (AMF) in Quebec are required to send the AMF their semi-annual report no later than July 30, 2017 regarding any complaints they received between January 1 and June 30, 2017.

The AMF imposes administrative penalties on firms that fail to comply with this obligation. Firms that have not received any complaints must still file a report.

Reports must be filed via the AMF's Complaint Reporting System (CRS) at http://www.srp-crs.ca. Firms filing a report will require a user ID and password assigned by the AMF. Firms without a user ID and password should contact the following:

- their agent for service in Quebec, or
- an AMF Information Centre agent at:

Quebec: 418 525 0337

Montréal: 514 395 0337

Toll free: 1 877 525-0337

CRS email : rapportdeplaintes@lautorite.qc.ca

### Dépôt semestriel au système de rapport de plaintes du Québec pour le 30 juillet 2017

Les sociétés inscrites comme conseillers ou courtiers auprès de l'Autorité des marchés financiers (AMF) au Québec doivent préparer et envoyer à l'AMF au plus tard le 30 juillet 2017 leur rapport semestriel concernant toutes les plaintes qu'elles ont reçues entre le 1er janvier et le 30 juin 2017.

L'AMF impose des sanctions administratives aux sociétés qui ne se conforment pas à cette obligation. Les sociétés n'ayant pas reçu de plaintes doivent quand même transmettre une déclaration.

Le rapport doit être déposé via le système de rapport de plaintes (SRP) de l'AMF (http://www.srp-crs.ca). À cette fin, la société doit avoir un code d'accès et un mot de passe, attribués par l'AMF. Les sociétés sans code d'accès ni mot de passe doivent contacter les personnes suivantes :

leur fondé de pouvoirs au Québec, ou

un agent du Centre d'information de l'Autorité au

Québec : 418 525 0337

Montréal : 514 395 0337

Sans frais :1 877 525-0337

Courriel pour le SRP : rapportdeplaintes@lautorite.qc.ca

## Frequently Asked Questions

> If you change the trustee of an investment fund, is the trust maintained?

The trust can be maintained upon changing the trustee of the fund by conveyancing the trust property contractually between trustees and following certain steps:

1. check (and follow) the requirements of the existing trust deed for the replacement of a trustee, including the timing and notification requirements;

2. a new trust deed should be prepared that contemplates replacing the original trust deed. It should not terminate the original trust deed, but rather amend it in its entirety. A preliminary caution should be added that despite the

replacement of the trustee, the trust is continuing in force. The terms of the original trust deed respecting amendments must be taken into consideration, with appropriate notices to unitholders advising of the material changes resulting to the trust and to their unitholder rights; and

3. there should be a conveyancing agreement between the two trustees to transfer the trusteed property from one to the other, providing for liability for actions prior to the conveyance remaining with the original trustee and acknowledging that the new trustee will have legal title to the trusteed property without termination of the trust.

Don't try this at home – call us!

## News & Events

Please note we will be taking a summer hiatus and the Bulletin will return in the Fall.

AUM Law primarily serves the asset management sector, with specific expertise in the regulatory and investment fund space. We strive to provide the most practical, forward-thinking advice and services, using a business model geared to efficiency, responsiveness and client service excellence. We are pleased to send you this summary of recent developments that may affect your business.

This bulletin is an overview only and it does not constitute legal advice. It is not intended to be a complete statement of the law or an opinion on any matter. No one should act upon the information in this bulletin without a thorough examination of the law as applied to the facts of a specific situation.