

OSC issues new summary report with guidance for investment fund and structured product issuers

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The Ontario Securities Commission (OSC) Investment Funds and Structured Products branch (IFSP) recently released their [Summary Report for Investment Fund and Structured Product Issuers](#) (The Report) for fiscal 2023.

This bulletin covers:

- Findings from the IFSP's review of environmental, social and governance (ESG) related funds - including some learnings arising from these reviews.
- Staff's view on the difference between mutual funds and non-redeemable investment funds (NRIFs).
- Reminders on the compliant use of social media with respect to sales communications.
- Caution that adding substantive disclosure to a preliminary prospectus after it has been filed or cleared for final (such as new ESG disclosure) will trigger a further review and may cause delays or additional filing obligations.
- Measurable signs of success from recent regulatory reduction measures.
- Findings around crypto funds' continuous disclosure practices and liquidity and an investigation into crypto custody arrangements.
- Emerging issues for the year ahead, including potential guidance on the composition of independent review committees (IRCs), OSC fee rule changes, and a review of principal distributor practices.
- Reminders regarding reports of exempt distribution, change of auditor filings, and cyber security measures.
- Investment Fund Survey (IFS) changes for 2024.

Findings from the ESG sweeps

Overview. The OSC's findings on prospectus disclosure, sales communications and portfolio holdings of ESG investment funds have stolen the headlines for fiscal 2023 and are likely to remain the top story for the year to come.

The Report marks the first widely disseminated feedback on the industry’s implementation of the Canadian Securities Administrators’ (CSA) [ESG-Related Investment Fund Disclosure Staff Notice](#) (ESG Staff Notice) and on the OSC’s reviews (ESG Sweeps) of continuous disclosure, sales communications and portfolio holdings of funds whose investment objectives reference ESG factors and other funds that use ESG strategies (ESG-related funds). The Report states the hope that the ESG Sweeps “have brought greater clarity and consistency to disclosure so that investors can understand what ESG means and make more informed investment decisions about ESG products.” However, it is our view that additional regulatory clarification of materiality, calibration of definitions and stakeholder input is required to achieve this goal.

Findings from Prospectus Reviews of ESG-Related Funds. The OSC continued to review the prospectuses and associated documents of ESG-related funds, applying the guidance in the ESG Staff Notice. These reviews focused on funds’ investment objectives and names, investment strategies, proxy voting policies and procedures, risk disclosure and suitability disclosure. IFSP Staff’s findings focused on disclosure of the types of ESG strategies used and the specific ESG factors that are relevant to the portfolio manager’s analysis, including how those factors are evaluated and monitored.

IFSP Staff recently introduced the concept of an “ESG consideration fund,” which has generated much discussion in the past few months. The Report highlights issues relating to ESG consideration funds, which are funds that do not have ESG-related investment objectives but consider ESG factors in a more limited way. Staff asked certain issuers to update their prospectuses to clarify the limited role that the consideration of ESG factors and/or ESG strategies play in the investment processes, including the weight given to ESG factors and their impact on the portfolio selection process.

Findings from Reviews of Continuous Disclosure, Sales Communications, and Portfolio Holdings of ESG-Related Funds. The OSC reviewed the continuous disclosure, sales communications and portfolio holdings of ESG-related funds in accordance with the ESG Staff Notice. These reviews focused on:

- evaluating ESG periodic reporting in management reports of fund performance (MRFPs) and on fund websites, especially related to progress in meeting ESG-related investment objectives;
- changes in investment portfolio composition and the results of ESG-related proxy voting and shareholder engagement activities;
- reviewing funds for holdings that should be excluded from their portfolios due to negative screenings or that could be inconsistent with the ESG values of the fund;
- identifying whether an ESG-related fund voted against ESG-related shareholder proposals and, if so, why;
- examining the sales communications and websites of funds to ensure they do not **have statements that are untrue, misleading, or that are in conflict with the fund’s regulatory offering documents;** and,
- for investment fund manager (IFM) sales communications and/or offering documents that state their funds incorporate ESG considerations in their investment process, determining whether the IFM has adopted correlating policies and procedures.

Staff raised comments and required issuers to improve prospectus disclosure of ESG-related funds, mostly relating to investment strategies, but also with respect to fund names, investment objectives, ESG risk disclosure and ESG-related disclosure in the summary of proxy voting policies and processes. We note that IFSP Staff take a broad view by considering any communication that refers to an ESG or a sustainability **strategy to be a “sales communication”, and therefore, expect such communication to comply with Part 15 (Sales Communication and Prohibited Representations) of National Instrument 81-102 Investment Funds (NI 81-102).** This includes responsible investing policies that apply broadly and do not refer to a specific fund or funds. In BLG’s review of funds placed on the Refiling and Errors list, we note that this appears to have been a top issue of concern for IFSP Staff. Therefore, fund managers that wish to post their broad responsible investing policies to their website should consider identifying any funds that do not have investment strategies that lend themselves to the responsible investing policy and include a disclaimer to that effect in order to avoid comments from IFSP Staff. Typically, this would apply to money market funds, cryptocurrency funds, commodity-based funds, passive index funds and, in some cases, fund of funds.

In contrast to the standard continuous disclosure reviews undertaken by IFSP Staff during fiscal 2023 (during which 217 funds across 49 IFMs were randomly selected for review based on risk areas and where no significant findings were made), Staff found issues in all areas of the ESG Sweeps. This difference in compliance likely speaks to the as-yet evolving understanding and categorization of ESG-related funds and interpretation of the ESG Staff Notice on the part of both IFSP Staff and industry.

Funds should not market any ESG integration without corresponding disclosure in their regulatory offering documents. Where IFSP Staff identified issues with respect to **disclosures that were misleading or in conflict with a fund’s offering documents, the communication was removed or revised, as needed and/or disclosure in the prospectus was updated to resolve the conflicting information.** IFSP Staff required certain IFMs to issue news releases related to corrections to their disclosure and placed those funds on the Refilings and Errors list. As noted in a January IFSP publication titled Use of Refilings and Errors list for corrections to continuous disclosure filings, website and social media, “any deficiency for an investment fund issuer identified during a review **that leads to corrective disclosure to continuous disclosure filings, the fund’s website, or its social media may result in Staff putting the investment fund issuer on the Refilings and Errors List.**” BLG has been working with our clients to respond to IFSP Staff on this issue and we continue to assess the use of the Refilings and Errors List in connection **with updates made to an investment fund’s continuous disclosure documents and website as a result of guidance.**

What is an investment fund?

The Report sets out IFSP Staff’s views on the difference between mutual funds and NRIFs and outlines a non-exhaustive list of criteria that should be considered holistically when undertaking this analysis. Satisfying or failing to satisfy any one criterion in the Report is not necessarily indicative of whether a product is an investment fund. Issuers are urged to consider all product features, along with the criteria in the Report, and to consult with their legal counsel. BLG agrees that discussion with legal counsel is critical when seeking to characterize a product, particularly because we believe that some of the discussion in the Report merits a more nuanced analysis, especially around what we view as an over-simplification of the concept of redemption “on demand.”

Marketing materials

In response to complaints, the OSC performed ad hoc reviews of marketing materials that focused on insufficient disclosure made through social media platforms like Facebook, LinkedIn, and X (née Twitter). The OSC reminds registrants that content limitations may prevent IFMs from presenting clear, accurate, and balanced messages, as required under NI 81-102 where these messages are “sales communications.” All information, including disclaimers, should be “easily comprehensible to the retail investor on first viewing of the advertisement” and the required disclaimer language in NI 81-102 should “not be more than one click away” when using alternative media. Additionally, the OSC urges IFMs to review personal use of social media accounts for compliance with NI 81-102, to ensure the existence of adequate policies and procedures, and to implement any required training.

Prospectus filings

IFSP Staff caution that substantive changes made to disclosure after a preliminary or pro forma prospectus has been filed or cleared for final may result in delays in the receipt of the final prospectus. The substantive changes will be subject to the same level of review as the disclosure in a preliminary or pro forma prospectus and, for preliminary prospectuses, an amended and restated prospectus may need to be filed. The Report cites the example of material ESG-related disclosure being added after a prospectus was filed or cleared for final. Where that additional ESG-related disclosure was not prompted by comments raised by IFSP Staff, additional review time was required, since the changes were considered substantive.

Signs of success from regulatory burden reduction measures

Measurable metrics around burden reduction are a good news story. These include a 20 per cent reduction in the number of exemptive relief applications filed, as well as a reduction in the average page length of simplified prospectuses. These signs of success bode well for future projects with burden reduction aims, such as:

- the access-based model for investment fund reporting issuers;
- the proposed modernization of the prospectus filing model; and
- the modernization of continuous disclosure documents, all of which are ongoing.

Crypto asset funds

Staff conducted an issue-oriented review of continuous disclosure (including sales communications) of crypto funds that provide exposure exclusively to bitcoin and/or ether. The review raised findings on general continuous disclosure obligations, valuation, liquidity risk management, and crypto trading platforms.

Significant redemptions in two crypto exchange-traded funds (ETFs) that held bitcoin led IFSP Staff to probe those redemptions. Staff found that crypto funds appear to remain liquid and to not have experienced operational disruptions due to market volatility.

The wider OSC is conducting an issue-oriented review of the custody of funds that primarily hold crypto assets. This is likely a response to the failure of the cryptocurrency exchange FTX, and the alleged theft of hundreds of millions in digital assets in November 2022, which had a reverberating impact on the crypto asset market. Inquiries will focus on the safety of crypto assets held by custodians, the segregation of fund assets, custodial and sub-custodial arrangements, and any impacts of the failure of FTX. **The OSC is also working with these funds' auditors to gain a deeper understanding of their custody-related practices.** We expect more news is forthcoming.

Emerging issues and initiatives

Several issues outlined in the Report may be impactful to IFMs in the coming year, including:

Potential guidance regarding IRCs. The OSC undertook a targeted review of National Instrument 81-107 Independent Review Committee for Investment Funds that focused on IRC diversity and inclusion, size, skills and competencies, oversight, term limits, and compensation. As a result, the OSC is considering the publication of IRC guidance and observations with another CSA jurisdiction. The timing of the publication was not specified.

OSC Fee Rule changes. Changes to the OSC Fee Rules came into force in last April. IFMs should be aware of amendments to late fees on annual and interim financial statements and annual information forms (AIFs) and changes to filing fees and late fees for exempt distribution filings under National Instrument 45-106 Prospectus Exemptions (45-106F1).

There is some good news here - the filing fee payable for a report of exempt distribution under 45-106F1 has dropped from \$500 to \$350. However, instead of calculating late fees based on business days, late fees will now be calculated based on calendar days (up to a maximum of \$5,000 for the year). The maximum late fee payable is attributable to an affiliated entity, not just a single issuer.

Similarly, for late fees on annual and interim financials and AIFs, late fees owed will be calculated using calendar days, not business days and the maximum late fee payable for each of these documents is attributable to an affiliated entity, not just a single issuer.

Review of Principal Distributor Practices. The CSA is continuing to review the practices of mutual funds that have principal distributor relationships with registrants to distribute their securities. The CSA is currently assessing responses to surveys sent to IFMs and principal distributors to better understand current mutual funds sales practices and distribution structures, and to determine the need for any regulatory amendments to National Instrument 81-105 Mutual Fund Sales Practices.

Reminders for IFMs

A few reminders that can be drawn from the Report's findings include:

45-106F1. IFMs are expected to review and reconcile reports of exempt distribution under 45-106F1 to match the information provided on the form with the detailed

purchaser information in Schedule 1. Common deficiencies found in 45-106F1 filings include activity fees owing, discrepancies between the number of Ontario purchasers noted in the form versus on Schedule 1, incorrect issuer information, late fees owing and discrepancies between purchaser information and distribution dates.

Change of auditor. IFMs must file notifications of change of auditors with the regulator and include any information on reportable events upon the termination or resignation of an auditor.

Cyber-breach reporting. IFMs are required to establish and implement controls and supervision to manage the risks of a cyber attack, including if they are outsourcing functions to third-party service providers. While there is no requirement for IFMs to report cyberbreaches to the CSA, the OSC nonetheless encourages IFMs to take all reasonable steps to respond to a cyber breach, including notifying clients and applicable regulators, particularly where client information and assets are threatened or where the breach could have a wider impact. We urge a careful consideration of an IFM's other obligations and notice requirements for breaches under applicable laws. Additional information from BLG on Cybersecurity, Privacy & Data Security are [linked here](#) for your reference.

Investment Fund Survey changes for 2024

Finally, for the year ahead, the January 2024 version of the IFS will require Ontario registered IFMs to complete the IFS for all funds for which they act as an IFM, including labour-sponsored funds and scholarship plans, as well as funds with net assets under \$10M (currently the threshold is above \$10M). Additionally, each IFM will need to report the annual net performance returns, the management expense ratio, performance fees charged, if any and the risk rating for each investment fund.

For more information on [Investment Management](#), or to discuss any of the topics referenced in this article, please reach out to any of our authors or key contacts below.

By

[Jessica Evans](#), [Kathryn M. Fuller](#), [Melissa Ghislanzoni](#), [Lynn McGrade](#), [Roma Lotay](#), [Donna Spagnolo](#), [Whitney Wakeling](#)

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blg.com

BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

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