

## MSC Notice 2001-23

### NOTICE OF PROPOSED POLICY UNDER THE SECURITIES ACT

#### MANITOBA SECURITIES COMMISSION POLICY 81-201 DESIGNATION OF LABOUR SPONSORED INVESTMENT FUNDS AS MUTUAL FUNDS AND PROSPECTUS DISCLOSURE REQUIREMENTS OF SUCH FUNDS

#### Notice of Proposed Policy

The Manitoba Securities Commission (the “Commission”) intends to make Manitoba Securities Commission Policy 81-201, Designation of Labour Sponsored Investment Funds as Mutual Funds and Prospectus Disclosure Requirements of Such Funds (the “Proposed Policy”), a policy in Manitoba. The Commission is publishing the Proposed Policy for a sixty-day comment period.

#### Background

Labour Sponsored Investment Funds (“LSIFs”) (also referred to as labour-sponsored venture capital corporations or “LSVCCs”) were a creation of the federal government by way of amendments to the *Income Tax Act* (Canada) in 1988. Essentially LSIFs are a mutual fund-like security whose investment objective is to achieve significant long-term capital appreciation, primarily through investment in venture capital opportunities. An LSIF registered as a LSVCC under the *Income Tax Act* (Canada) entitles its shareholders to receive a federal tax credit.

A number of provinces, including Manitoba, followed suit by creating their own version of the federal LSVCC legislation. For example, Nova Scotia has the *Equity Tax Credit Act* and Ontario has the *Community Small Business Investment Funds Act*. Manitoba LSIF legislation is somewhat unique in that it consists of *The Labour-Sponsored Venture Capital Corporations Act* (Manitoba) and *The Manitoba Employee Ownership Fund Corporation Act* (Manitoba). *The Labour-Sponsored Venture Capital Corporations Act* is not fund specific while *The Manitoba Employee Ownership Fund Corporation Act* is specific to the Crocus Investment Fund. Recent amendments changed the name of this act to *The Crocus Investment Fund Act* (Manitoba). In Manitoba, a LSIF must also qualify as a LSVCC under *The Income Tax Act* (Manitoba).

All of the provincial legislation is similar in that they offer a provincial tax credit equal to the federal tax credit, provided that the LSIF meets and maintains a specific local or regional investment criteria.

## **LSIFs in Manitoba**

The Crocus Investment Fund (“Crocus”) was formed on March 21, 1992 and as of September 30, 2000 has assets in excess of \$164 million. ENSIS Growth Fund Inc. (“ENSIS”) was formed on December 10, 1997 and as of October 31, 2000 had assets in excess of \$34 million. Crocus and ENSIS are the only two LSIFs that receive tax credits from the Province of Manitoba.

It should be noted that some LSIFs situated in Ontario have qualified their securities for distribution in Manitoba. However, given that these funds do not receive a provincial tax credit, it is believed that their sales are very limited in Manitoba.

## **Regulation of LSIFs in Manitoba**

### **Application of Mutual Fund Regulation to LSIFs**

In other provinces, LSIFs fall within the definition of “mutual funds” and are therefore, regulated by a combination of national instruments and companion policies as well as local policies in some jurisdictions.

The definition of a “mutual fund company” in Manitoba (see section 1(1) of the Regulation to *The Securities Act* (Manitoba)) is a company designated by the director as a mutual fund company. In 1992, the director did not designate Crocus as a mutual fund company. This was consistent with the director’s practice of deeming unconventional funds not to be mutual funds. In 1997, ENSIS was also not designated as a mutual fund company.

The non-designation of Crocus and ENSIS as mutual funds has created a degree of uncertainty in Manitoba regarding the application of certain securities legislation to LSIFs. For example, three national instruments and their related companion policies (or the notices which accompanied their publication) governing mutual funds contain references to LSVCCs.

- National Instrument 81-101 – Mutual Fund Prospectus Disclosure (“NI 81-101”) states in Part 1 that it does not apply to mutual funds that are LSVCCs. The Notice, which accompanied the publication of NI 81-101, indicated that the regime created by the National Instrument and Forms is designed for conventional mutual funds and therefore, specifically excluded LSVCCs as well as other unconventional mutual funds.
- National Instrument 81-102 – Mutual Funds (“NI 81-102”) states in Part 1 that it applies to a mutual fund that offers, or intends to offer, securities under prospectus or simplified prospectus. The Notice that accompanied the publication of NI 81-102 indicated that NI 81-102 will regulate all publicly offered investment funds that fall within the definition of “mutual funds” contained in Canadian securities legislation.

Accordingly, all publicly offered investment funds that give investors the right to redeem securities on demand at a price based on the net asset value of those securities, will be required to comply with NI 81-102. Specialized mutual funds, such as LSVCCs, mortgage funds and commodity pool funds will generally be required to comply with the Instrument.

- National Instrument 81-105 – Mutual Funds Sales Practices (“NI 81-105”). The Companion Policy to NI 81-105 indicated that, although LSVCCs were not considered to be mutual funds in Manitoba, the Commission would be issuing a local instrument to make LSVCCs in Manitoba subject to this National Instrument. On June 30, 1998, the Commission issued Local Policy 3.22 Application of National Instrument 81-105, Mutual Fund Sales Practices to Labour-Sponsored Venture Capital Corporations which made LSIFs subject to NI 81-105.

Therefore, a grey area currently exists in Manitoba regarding the application of mutual fund regulation to LSIFs. The directors decision to not designate Crocus and ENSIS as mutual funds has led to regulatory uncertainty, particularly with respect to the application of NI 81-102 to LSIFs.

### **Prospectus Disclosure Requirements**

Manitoba does not have a specified form requirement for LSIFs, as does, for example, Ontario. Crocus and ENSIS therefore, file prospectuses prepared in accordance with the requirements of *The Securities Act* (Manitoba) and Regulation thereto. This base level of disclosure has been supplemented by requiring Crocus and ENSIS to comply with the additional disclosure requirements of Ontario’s Form 45. This ad hoc process has led to some uncertainty regarding the disclosure requirements for an LSIF in Manitoba.

Ontario Form 45 - Information Required to be Included in a Prospectus of a Labour Sponsored Investment Fund Corporation, has been in place since 1992. As indicated above, the staff of the Commission has been informally requiring Crocus and ENSIS to comply with the additional disclosure requirements of Ontario’s Form 45. The staff of the securities commissions of Saskatchewan and Nova Scotia have also been requiring LSIF prospectuses to comply with the disclosure requirements of Ontario Form 45.

The Commission is of the opinion that Ontario Form 45 adequately addresses the disclosure requirements for LSIFs and is therefore proposing to adopt Ontario Form 45 as policy in Manitoba.

### **Substance and Purpose of the Policy**

The Proposed Policy will clarify the application of mutual fund regulation to LSIFs in Manitoba which will lead to greater regulatory certainty, harmonization and a level playing field for all LSIFs qualified for distribution in Manitoba.

The Proposed Policy will accomplish this by:

- designating LSIFs to be mutual funds upon the coming into effect of the policy (including transitional provisions to allow existing LSIFs to obtain relief where appropriate), and
- specifying the information required to be included in a prospectus of an LSIF through the adoption of the disclosure requirements as set out in Ontario Form 45.

### **Matters Not Dealt With by the Proposed Policy**

The Proposed Policy will not deal with registration, proficiency and suitability requirements regarding the sale and distribution of LSIFs, nor will it deal with the continuous disclosure requirements of LSIFs.

Registration, proficiency and suitability requirements are set out in Commission Notice 2001-11 Notice to Broker-Dealers Restricted to the Sale of Mutual Funds – Sale of Labour- Sponsored Investment Funds Special Requirements dated April, 2001.

Continuous disclosure issues will not be dealt with in the Proposed Policy as these matters will be dealt with by way of the Canadian Securities Administrators initiative to develop National Instrument 81-106 – Mutual Fund Financial Disclosure.

### **Effective Date**

Subject to comments being received, it is the Commission's intention to have the Proposed Policy finalized and in effect by November 1, 2001.

### **Comment Period**

The comment period will end on October 7, 2001. Comments should be submitted to:

The Manitoba Securities Commission  
1130 – 405 Broadway Avenue  
Winnipeg, MB R3K 1X6

Attention: R. B. Bouchard, C.A.  
Director – Corporate Finance

### **Date of Notice**

August 7, 2001