

2011 BCSECCOM 122

March 15, 2011

Headnote

Multilateral Instrument 11-102 *Passport System* and National Policy 11-203 *Process for Exemptive Relief Applications in Multiple Jurisdictions* – National Instrument 81-102 *Mutual Funds*, Section 19.1 - A group of mutual funds seeks relief under section 19.1 of NI 81-102 from the requirements in NI 81-102 prohibiting short selling - The fund will operate primarily by investing in long positions in securities that they expect to increase in value; the funds will mitigate short-selling risk through restrictions including limits on total short-selling and short-selling of a particular issuer, maintaining the short selling proceeds as cash cover, a stop-loss, and limits on the securities that can be borrowed from a person that is not the custodian; the Fund will provide disclosure in its prospectus or annual information form about short-selling and the details of this exemptive relief prior to implementing the short selling strategy; any short sales made by the Fund must comply with the investment objectives of the Fund

Applicable British Columbia Provisions

National Instrument 81-102 *Mutual Funds*, Section 19.1

In the Matter of
the Securities Legislation of
British Columbia and Ontario
(the Jurisdictions)

and

In the Matter of
the Process for Exemptive Relief Applications in Multiple Jurisdictions

and

In the Matter of
CADO Investment Fund Management Inc.
(the Manager)

and

In the Matter of
Maple Leaf Resource Class and
Maple Leaf Income Class

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(the Existing Funds and, together with the Manager, the Filers)

Decision

Background

¶ 1 The securities regulatory authority or regulator in each of the Jurisdictions (the Decision Maker) has received an application (the Application) from the Filers on behalf of each of the Existing Funds and any other mutual funds managed by the Manager or any affiliate of the Manager (together with the Existing Funds, the Funds), for a decision under the securities legislations of the Jurisdictions (the Legislation) exempting the Funds from the following requirements of the Legislation:

- (a) section 2.6(a) of National Instrument 81-102 *Mutual Funds* (NI 81-102) restricting a mutual fund from providing a security interest over a mutual fund's assets;
- (b) section 2.6(c) of NI 81-102 restricting a mutual fund from selling securities short; and
- (c) section 6.1(1) of NI 81-102 restricting a mutual fund from depositing any part of a mutual fund's assets with an entity other than that mutual fund's custodian,

(together, the Exemption Sought).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a dual application):

- (a) the British Columbia Securities Commission is the principal regulator for this application;
- (b) the Filers have provided notice that section 4.7(1) of Multilateral Instrument 11-102 *Passport System* (MI 11-102) is intended to be relied upon in each of Alberta, Saskatchewan, Manitoba, Québec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, Yukon, Northwest Territories, and Nunavut; and
- (c) this decision is the decision of the principal regulator and evidences the decision of the securities regulatory authority or regulator in Ontario.

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Interpretation

- ¶ 2 Terms defined in National Instrument 14-101 *Definitions* and MI 11-102 have the same meaning if used in this decision, unless otherwise defined.

Representations

- ¶ 3 This decision is based on the following facts represented by the Filers:
1. the Manager is a corporation that was incorporated under the laws of Canada on September 14, 2009 and is the manager of the Existing Funds; the Manager's head office is in Vancouver, British Columbia;
 2. each of the Existing Funds is a class of shares of Maple Leaf Corporate Funds Ltd., which was incorporated under the laws of Canada on December 15, 2010;
 3. each Fund is or will be an open-end mutual fund trust or a class of shares of a mutual fund corporation; the Manager, or an affiliate of the Manager, is or will be the manager of the Funds;
 4. each Fund is or will be a reporting issuer in all of the provinces and territories of Canada and distributes or will distribute securities under a simplified prospectus and annual information form, and will be otherwise subject to NI 81-102;
 5. neither the Manager nor the Existing Funds is in default of securities legislation in any jurisdiction of Canada;
 6. each Existing Fund has filed a preliminary simplified prospectus dated December 17, 2010 with the Decision Makers;
 7. the investment practices of each Fund will comply in all respects with the requirements of Part 2 of NI 81-102, except to the extent that a Fund has received the Exemption Sought;
 8. the Filers propose that each Fund be authorized to engage in a limited, prudent and disciplined amount of short selling;
 9. the Filers are of the view that each Fund could benefit from the implementation and execution of a controlled and limited short selling strategy;

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10. this strategy would operate as a complement to the Fund's primary discipline of buying securities with the expectation that they will appreciate in market value;
11. any short sales made by each Fund will be subject to compliance with the investment objectives of the Fund;
12. in order to effect a short sale, a Fund will borrow securities from either its custodian or a dealer (in either case, the Borrowing Agent), which Borrowing Agent may be acting either as principal for its own account or as agent for other lenders of securities;
13. each Fund will implement the following requirements and controls when conducting a short sale:
 - (a) securities will be sold short for cash, with the Fund assuming the obligation to return to the Borrowing Agent the securities borrowed to effect the short sale;
 - (b) the short sale will be effected through market facilities through which the securities sold short are normally bought and sold;
 - (c) the Fund will receive cash for the securities sold short within normal trading settlement periods for the market in which the short sale is effected;
 - (d) the securities sold short will be "liquid securities" in that:
 - (i) the securities will be listed and posted for trading on a stock exchange; and
 - (A) the issuer of the security will have a market capitalization of not less than CDN \$100 million, or the equivalent, at the time the short sale is effected; or
 - (B) the Fund's portfolio advisor will have pre-arranged to borrow the securities for the purpose of such sale; or
 - (ii) the securities will be fixed-income securities, bonds, debentures or other evidences of indebtedness of or guaranteed by the Government of Canada or any province or territory of Canada or by the Government of the United States of America;

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- (e) at the time securities of a particular issuer are sold short:
 - (i) the aggregate market value of all securities of that issuer sold short by the Fund will not exceed 5% of the total net assets of the Fund; and
 - (ii) the Fund will place a stop-loss order with a dealer to immediately purchase for the Fund an equal number of the same securities if the trading price of the securities exceeds 120% (or such lesser percentage as the Manager may determine) of the price at which the securities were sold short;
- (f) the Fund may deposit Fund assets with the Borrowing Agent as security for the short sale transaction;
- (g) the Fund will keep proper books and records of all short sales and Fund assets deposited with Borrowing Agents as security;
- (h) the Fund will develop written policies and procedures for the conduct of short sales prior to conducting any short sales; and
- (i) the Fund will provide disclosure in its simplified prospectus and annual information form of the proposed use of short selling by the Fund, the specific risks related to short selling, and details of this decision prior to implementing the short selling strategy.

Decision

- ¶ 4 Each of the Decision Makers is satisfied that the decision meets the test set out in the Legislation for the Decision Maker to make the decision.

The decision of the Decision Makers under the Legislation is that the Exemption Sought is granted provided that in respect of each Fund:

- (a) the aggregate market value of all securities sold short by the Fund will not exceed 20% of the net assets of the Fund on a daily marked-to-market basis;
- (b) the Fund holds “cash cover” (as defined in NI 81-102) in an amount, including the Fund assets deposited with Borrowing Agents as security in connection with short sale transactions, that is at least 150% of the aggregate market value of all securities sold short by the Fund on a daily marked-to-market basis;

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- (c) no proceeds from short sales by the Fund will be used by the Fund to purchase long positions in securities other than cash cover;
- (d) the Fund maintains appropriate internal controls regarding its short sales including written policies and procedures, risk management controls and proper books and records;
- (e) any short sale made by the Fund complies with the investment objective of the Fund;
- (f) at the time the securities of a particular issuer are sold short:
 - (i) the aggregate market value of all securities of that issuer sold short by the Fund will not exceed 5% of the net assets of the Fund; and
 - (ii) the Fund will place a stop-loss order with a dealer to immediately purchase for the Fund an equal number of the same securities if the trading price of the securities exceeds 120% (or such lesser percentage as the portfolio advisor of the Fund may determine) of the price at which the securities were sold short;
- (g) the Exemption Sought does not apply if the Fund is a money market fund;
- (h) for short sale transactions in Canada, every dealer that holds assets of the Fund as security in connection with short sale transactions by the Fund is a registered dealer in Canada and a member of a self-regulatory organization that is a participating member of the Canadian Investor Protection Fund;
- (i) for short sale transactions outside of Canada, every dealer that holds Fund assets as security in connection with short sale transactions by the Fund:
 - (i) is a member of a stock exchange and, as a result, is subject to a regulatory audit; and
 - (ii) has a net worth in excess of the equivalent of \$50 million determined from its most recent audited financial statements that have been made public;

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- (j) except where the Borrowing Agent is the Fund's custodian, when the Fund deposits Fund assets with a Borrowing Agent as security in connection with a short sale transaction, the amount of Fund assets deposited with the Borrowing Agent does not, when aggregated with the amount of Fund assets already held by the Borrowing Agent as security for outstanding short sale transactions of the Fund, exceed 10% of the total assets of the Fund, taken at market value as at the time of the deposit;
- (k) the security interest provided by the Fund over any of its assets that is required to enable the Fund to effect short sale transactions is made in accordance with industry practice for that type of transaction and relates only to obligations arising under such short sale transactions;
- (l) prior to conducting any short sales, the Fund discloses in its simplified prospectus or annual information form a description of: (i) short selling, (ii) how the Fund intends to engage in short selling, (iii) the risks associated with short selling, and (iv) in the Investment Strategy section of the prospectus, the Fund's strategy and this exemptive relief;
- (m) prior to conducting any short sales, the Fund discloses in its simplified prospectus or annual information form the following information:
 - (i) that there are written policies and procedures in place that set out the objectives and goals for short selling and the risk management procedures applicable to short selling;
 - (ii) who is responsible for setting and reviewing the policies and procedures referred to in the preceding paragraph, how often the policies and procedures are reviewed, and the extent and nature of the involvement of the board of directors of the Manager in the risk management process;
 - (iii) the trading limits or other controls on short selling in place and who is responsible for authorizing the trading and placing limits or other controls on the trading;
 - (iv) whether there are individuals or groups that monitor the risks independent of those who trade; and

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- (v) whether risk measurement procedures or simulations are used to test the portfolio under stress conditions; and
- (n) prior to conducting any short sales, the Fund has provided to its securityholders not less than 60 days' written notice that discloses the Fund's intent to begin short selling transactions and the disclosure required in the Fund's simplified prospectus or annual information form as outlined in paragraphs (l) and (m) above, or the Fund's initial simplified prospectus or annual information form and each renewal thereof has included such disclosure.

The Exemption Sought shall terminate upon the coming into force of any legislation or rule of the principal regulator dealing with matters referred to in sections 2.6(a), 2.6(c) and 6.1(1) of NI 81-102.

Martin Eady, CA
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British Columbia Securities Commission