

2010 BCSECCOM 605

October 27, 2010

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*, s. 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*, s. 19.1

In the Matter of
the Securities Legislation of
British Columbia
(the Jurisdiction)

and

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

and

In the Matter of
Lions Investment Management Ltd.
(the Filer)

and

In the Matter of
Lions Diversified Strategies Fund
(the Fund)

Decision

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Background

- ¶ 1 The principal regulator in the Jurisdiction has received an application from the Filer for a decision under the securities legislation of the Jurisdiction of the principal regulator (the Legislation) exempting the Fund from the following requirements:
- (a) section 2.6(a) of National Instrument 81-102 *Mutual Funds* (NI 81-102) prohibiting a mutual fund from providing a security interest over a mutual fund's assets;
 - (b) section 2.6(c) of NI 81-102 prohibiting a mutual fund from selling securities short; and
 - (c) section 6.1(1) of NI 81-102 prohibiting a mutual fund from depositing any part of a mutual fund's assets with an entity other than the mutual fund's custodian,
- (together, the Exemption Sought).

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

- (a) the British Columbia Securities Commission is the principal regulator for this application, and
- (b) the Filer has provided notice that section 4.7(1) of Multilateral Instrument 11-102 *Passport System* (MI 11-102) is intended to be relied upon in Alberta.

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 Filer:
1. the Filer is a company incorporated under the laws of Canada and is the manager of the Fund; the Filer's head office is in Vancouver, British Columbia;
 2. the Fund is a mutual fund trust established under the laws of British Columbia;

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3. neither the Filer nor the Fund is in default of the securities legislation of any jurisdiction;
4. the Fund has filed a preliminary simplified prospectus dated September 21, 2010 with the Decision Makers;
5. the investment practices of the Fund will comply in all respects with the requirements of Part 2 of NI 81-102, except to the extent that the Fund has received the Exemption Sought;
6. the Filer proposes that the Fund be authorized to engage in a limited, prudent and disciplined amount of short selling;
7. the Filer is of the view that the Fund could benefit from the implementation and execution of a controlled and limited short selling strategy;
8. 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;
9. any short sales made by the Fund will be subject to compliance with the investment objectives of the Fund;
10. in order to effect a short sale, the 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; and
11. the Fund will implement the following 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 on 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:

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- (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 \$100 million, or the equivalent, at the time the short sale is effected; or
 - (B) the investment advisor will have pre-arranged to borrow the securities for the purposes of such short 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 the Government of the United States of America;
- (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 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;
- (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; and
- (h) the Fund will develop written policies and procedures for the conduct of short sales prior to conducting any short sales.

Decision

- ¶ 4 The principal regulator is satisfied that the decision meets the test set out in the Legislation for the principal regulator to make the decision.

The decision of the principal regulator under the Legislation is that the Exemption Sought is granted provided that:

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1. the aggregate market value of all securities sold short by the Fund does not exceed 20% of the net assets of the Fund on a daily marked-to-market basis;
2. 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;
3. no proceeds from short sales by the Fund are used by the Fund to purchase long positions in securities other than cash cover;
4. the Fund maintains appropriate internal controls regarding its short sales including written policies and procedures, risk management controls and proper books and records;
5. any short sale made by the Fund complies with the investment objective of the Fund;
6. at the time securities of a particular issuer are sold short:
 - (a) 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
 - (b) 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;
7. the short selling relief does not apply if the Fund is a money market fund;
8. 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;
9. for short sale transactions outside of Canada, every dealer that holds Fund assets as security in connection with short sale transactions by the Fund:
 - (a) is a member of a stock exchange and, as a result, is subject to a regulatory audit; and

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- (b) 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;
10. 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 net assets of the Fund, taken at market value as at the time of the deposit;
 11. 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;
 12. prior to conducting any short sales, the Fund discloses in its simplified prospectus or annual information form a description of: (a) short selling; (b) how the Fund intends to engage in short selling; (c) the risks associated with short selling; and (d) in the Investment Strategy section of the prospectus, the Fund's strategy and this exemptive relief;
 13. prior to conducting any short sales, the Fund discloses in its simplified prospectus or annual information form the following information:
 - (a) 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;
 - (b) 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 or trustee in the risk management process;
 - (c) 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;
 - (d) whether there are individuals or groups that monitor the risks independent of those who trade; and
 - (e) whether risk measurement procedures or simulations are used to test the portfolio under stress conditions; and

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

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