

2005 BCSECCOM 510

August 8, 2005

Headnote

Mutual Reliance Review System for Exemptive Relief Applications - Securities Act s. 130 - Relief from certain self-dealing restrictions in Part 15 of the Act - An issuer wants relief from self-dealing requirements and conflict of interest reporting requirements for inter-fund trading in connection with a mutual fund reorganization - The conflict provisions apply only for a moment in time when investments by managed accounts in certain existing mutual funds are redeemed *in specie* and reinvested in a new mutual fund; the same result could be achieved by a different procedure but that would impose additional costs on holders of the existing mutual funds; the redemption will be reviewed by the independent review committee of the mutual fund manager and will be completed only if the committee determines that the redemption achieves a fair and reasonable result for the existing funds and the new fund

Applicable British Columbia Provisions

Securities Act, R.S.B.C. 1996, c. 418, ss. 127(1)(b), 130

In the Matter of
the Securities Legislation
of British Columbia, Alberta, Saskatchewan, Ontario, New Brunswick, Nova
Scotia and Newfoundland and Labrador (the Jurisdictions)

and

In the Matter of
the Mutual Reliance Review System for Exemptive Relief Applications

and

In the Matter of
Scotia Cassels Investment Counsel Limited (the “Filer”)

MRRS Decision Document

Background

The local securities regulatory authority or regulator (the “Decision Maker”) in each of the Jurisdictions has received an application from the Filer for a decision under the securities legislation of the Jurisdictions (the “Legislation”) that the prohibition contained in the Legislation which prohibits a portfolio manager from causing an investment portfolio managed by it to buy or sell the securities of any issuer from or to the account of a responsible person, any associate of the

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responsible person or the portfolio manager (the “Self-Dealing Prohibition”), shall not apply to effect certain transfers of securities between the Existing Funds and the Filer’s Managed Accounts and between the Filer’s Managed Accounts and the New Fund.

Under the Mutual Reliance Review System for Exemptive Relief Applications

- (a) Ontario is the principal regulator for this application, and
- (b) this MRRS decision document evidences the decision of each Decision Maker.

Interpretation

Defined terms contained in National Instrument 14-101 Definitions have the same meaning in this decision unless they are defined in this decision.

Representations

This decision is based on the following facts represented by the Filer:

1. The Filer is registered under the Legislation as an adviser in the appropriate categories to provide discretionary advisory services in the Jurisdictions.
2. The Filer provides discretionary portfolio management services to clients through a managed account (each, a “Managed Account” and together, the “Managed Accounts”) pursuant to portfolio management agreements between the clients and the Filer. Based on the size of the assets of the clients and depending on the allocation of a client’s assets to a particular asset class, the Filer either manages the client’s assets on a segregated account basis or on a pooled basis. Pursuant to its agreements with its clients, the Filer has full authority to provide its portfolio management services, including by investing clients in mutual funds for which the Filer is the portfolio manager and for changing those mutual funds as the Filer determines in accordance with the mandate of the clients.
3. Scotia Securities Inc. (“SSI”), an affiliate of the Filer, is the manager of the Scotia Mutual Funds (the “Scotia Funds”), which include the Scotia Canadian Blue Chip Fund and the Scotia American Growth Fund (the “Existing Funds”) and SSI has retained the services of the Filer to act as portfolio manager for certain Scotia Funds, including the Existing Funds. SSI determines the mandate of each of the Scotia Funds and requires a portfolio manager to manage in accordance with such mandate.
4. A number of the Scotia Funds offer Class A, F and I units (the “Retail Classes”) under one prospectus and offer Scotia Private Client units (the “PCU Class”) by way of a separate prospectus. The Scotia Funds pay a management

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fee in respect of the Retail Classes (other than Class I) and SSI is responsible for the payment of the investment management fees to the Filer for those Scotia Funds for which the Filer is the portfolio manager. In the case of the PCU Class, a small management fee is charged to the Scotia Funds by SSI and the Filer receives no investment management fee from the Scotia Funds or SSI in respect of the Existing Funds. The Filer receives its investment management fees pursuant to its agreements with its clients. As a result, there is no duplication of the investment management fees charged by the Filer to such clients.

5. To the extent that all or a portion of a Managed Account was to be allocated to North American securities through investing in mutual funds, the Filer invested the clients in a combination of the Existing Funds in accordance with the weightings between the two markets determined by the Filer on behalf of its clients. Scotia Canadian Blue Chip Fund invests primarily in a broad range of equity securities of large Canadian companies. Scotia American Growth Fund invests primarily in a broad range of U.S. equity securities.
6. While the Filer has treated the weightings to Canadian and U.S. securities identically whether the client is in a segregated portfolio or in a mutual fund, the selection of specific securities within those two markets has changed due to the changes in the investment management team at the Filer within the last two years. While SSI determines the mandate for the Existing Funds and therefore the Filer must comply with the mandate for the Existing Funds, the Filer has changed its investment management approach in North American markets for the segregated clients. It has become apparent that the differences in investment management in accordance with the mandates in the Existing Funds and investment management for the segregated accounts are leading to differences in performance amongst the accounts of the Filer's clients whose assets are managed on a segregated basis and those clients invested in the Existing Funds. Accordingly, the Filer determined that it would have to redeem its clients from the Existing Funds to ensure consistency across its clients.
7. The Filer requested SSI to act as the manager of a new group of mutual funds (the "Scotia Cassels Funds"), including the Scotia Cassels North American Equity Fund (the "New Fund"), for which the Filer recommended the investment mandates. Only a PCU Class is offered by the Scotia Cassels Funds since they are designed specifically for the Filer's Managed Accounts. A receipt for the final prospectus for the Scotia Cassels Funds was issued in each Jurisdiction on June 17, 2005. SSI acts as manager and trustee of the Scotia Cassels Funds. The management fee in respect of the PCU Class of both the Existing Funds and the New Fund is 0.10%.

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8. After analysis of a number of factors, including the adjusted cost base of its existing clients' positions in the Existing Funds, the Filer has determined that it would be appropriate to redeem the positions held by most clients from the Existing Funds and to purchase the New Fund. In order to accomplish this, the Filer has determined to redeem units from the Existing Funds and to invest the proceeds of approximately \$240 million in the New Fund (the "Proposed Redemptions"). The Proposed Redemptions will have minimal tax implications for such clients.
9. Working with SSI, the Filer has also determined that it is not anticipated that the Proposed Redemptions will result in taxation of the Existing Funds due to the adjusted cost base of the portfolio securities and the accrued capital losses in such Existing Funds. The tax result will be the same in any event if a portion of the portfolio was liquidated in order to pay for the redemption.
10. Clients of the Filer holding approximately \$186 million or 23% of the approximately \$806 million invested in the Scotia Canadian Blue Chip Fund and approximately \$54 million or 22% of the \$239 million invested in the Scotia American Growth Fund, as at June 17, 2005, will be transferred to the New Fund. The remaining clients will be transferred when it is suitable given their tax positions.
11. Due to the size of the Proposed Redemptions, and in light of its duty to the Existing Funds as well as its duties to the New Fund and its clients, the Filer has proposed to SSI to "split" the portfolio, based on blocks of securities, of each of the Existing Funds on a pro rata basis between the remaining investors in each of the Existing Funds and its redeeming clients on each effective date of the Proposed Redemptions. The securities which will be transferred to the New Fund will be compatible with the New Fund's investment objectives. To the extent that any security held by any of the Existing Funds will not be compatible with the New Fund's investment objectives or strategy, the relevant proportion of that security holding represented by its redeeming clients will be sold by the relevant Existing Fund prior to the effective date. As a result, the Proposed Redemptions will be for part cash and partly *in specie*. The Filer believes that it is not appropriate nor in the best interests of the investors in the Existing Funds to be required to liquidate that portion of their respective portfolios to fund redemptions, the proceeds of which would be reinvested in the New Fund and used by the New Fund to purchase the same portfolio securities. The transaction represents in substance a form of reorganization whereby a fund is split proportionately between two groups of investors.

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12. The Filer has proposed to SSI that the Proposed Redemptions be carried out by redeeming the units of the Existing Funds held by its clients *in specie* with respect to the securities which are suitable to the New Fund with the remainder of the redemption being paid for in cash. By virtue of its agreement with its clients, the Filer has the consent of the clients to execute all portfolio transactions on behalf of the clients, including redemptions *in specie* for such purpose. Through its regular, general communications with its clients, the Filer has described the creation and use of the Scotia Cassels Funds for its clients.
13. The Filer believes that the Proposed Redemptions are in the best interests of the Existing Funds, the New Fund and its clients, as it is efficient, saves costs of commissions and is fair to the remaining investors in the Existing Funds and to the clients of the Filer who will be invested in the New Fund. The Filer believes the Proposed Redemptions do not result in adverse consequences to the Existing Funds as the Existing Funds are required to redeem the units in any event.
14. The prospectus for the Retail Classes of the Existing Funds discloses the risk of a significant redemption in the Existing Funds by a substantial securityholder. However, due to the remaining size of the Existing Funds, the Filer does not believe there will be any material impact on the expense ratios of the Existing Funds.
15. Since SSI is an affiliate of the Filer, SSI proposes to have an independent review committee (the "IRC") that it has established for other related party matters review the proposal to redeem partly *in specie* on a proportionate basis rather than liquidating all the securities. SSI and the Filer will only proceed with the Proposed Redemptions if, after reasonable inquiry, the IRC determines that the Proposed Redemptions achieve a fair and reasonable result for the Existing Funds and the New Fund.
16. The members of the IRC will exercise their powers and discharge their duties honestly, in good faith, and in the best interests of the remaining investors in the Existing Funds and the investors who will be invested in the New Fund and, in so doing, will exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.
17. On the same day as the Proposed Redemptions, the Filer will subscribe for units of the New Fund on behalf of its clients in consideration for the same portfolio securities and cash received on the Proposed Redemptions. Both the Proposed Redemptions and subscriptions will be effected on the same day immediately after determination of the net asset value of the Existing Funds

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and the New Fund and the Proposed Redemption and subscriptions will be implemented using the same values for the portfolio securities as the values used in determining the net asset value of the applicable Existing Fund. The *in specie* redemption price of the units of the Existing Funds will comply with section 10.4 of National Instrument 81-102. The *in specie* redemption and *in specie* purchase will be effected at the current market price of the securities.

18. The only cost incurred by an Existing Fund or the New Fund on the redemption *in specie* portion and *in specie* purchase will be the nominal administrative charges of the custodian of the Existing Funds and the New Fund in recording the trades (collectively, the “Custodial Charges”).
19. Currently, the only investor in the New Fund is the Filer reflecting its seed capital contribution to the New Fund. No orders will be accepted by the New Fund until the completion of the transaction. Accordingly, there are no investors in the New Fund whose interests will have to be taken into account in connection with the subscription.
20. Since the Filer is the portfolio manager of the Existing Funds and the New Fund and SSI is an affiliate of the Filer, each of the Filer and SSI is considered a responsible person within the meaning of the Legislation with respect to these Funds. Each of the Existing Funds and the New Fund is an associate of SSI within the meaning of the Legislation because SSI is the trustee of the Existing Funds and the New Fund.
21. In the absence of the requested relief, the Filer would be prohibited by the Self Dealing Prohibition from proceeding with the *in specie* portion of the Proposed Redemptions since it contemplates a transfer of securities between the Existing Funds and its Managed Accounts and between its Managed Accounts and the New Fund (the “Transfers”).

Decision

Each of the Decision Makers is satisfied that the test contained in the Legislation that provides the Decision Maker with the jurisdiction to make the Decision has been met.

The decision of the Decision Makers under the Legislation is that the Filer is exempt from the Self-Dealing Prohibition so as to enable the Filer to implement the Transfers associated with the Proposed Redemptions.

Paul K. Bates
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Ontario Securities Commission