

# 2007 BCSECCOM 19

December 1, 2006

## **Headnote**

### **Mutual Reliance Review System for Exemptive Relief Applications**

*Securities Act* s. 114(2) Takeover Bids – Exemption from the formal take over bid requirements in part 13 of the Act - The applicant wants relief so unitholders of certain mutual funds can purchase more than 20% of the units of the fund without constituting a takeover bid - Units of the fund trade on an exchange; the units are “voting” and “equity securities”; no unitholder can control the fund because of the terms of the constating documents; no purchaser will exercise the votes attached to more than 20% of the outstanding units of the fund

*Securities Act* ss. 48 & 76 – Other – Exemption from registration and prospectus requirements for situations other than a corporate acquisition or reorganization; trades to business associates; debt settlements; or trades involving employee investment plans and consultants - The applicant wants relief from the registration requirement to disseminate sales communications relating to the distribution of securities of a mutual fund and from requirement that the prospectus for the fund contain a certificate of the underwriters - Units of the fund trade on an exchange; trades of the fund will be made through underwriters and designated brokers; neither the underwriters nor the designated brokers receive any fees or commissions in connection with the distribution of units of the fund

## **Applicable British Columbia Provisions**

*Securities Act*, R.S.B.C. 1996, c. 418, ss. 34, 48, 69, 76 and 114(2)

In the Matter of  
the Securities Legislation of  
British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New  
Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador,  
Yukon, Northwest Territories and Nunavut  
(the “Jurisdictions”)

and

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

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and

In the Matter of  
Claymore Investments, Inc. (the “Filer”),  
Canadian Financial Income Fund,  
Canadian Fundamental 100 Income Fund and  
Canadian Financial Dividend & Income Fund

## 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:

1. the dealer registration requirement of the Legislation does not apply to the Filer in connection with its dissemination of sales communications relating to the distribution of units (“Units”) of Canadian Financial Income Fund (“FIE”), Canadian Financial Dividend & Income Fund (“FDI”) and Canadian Fundamental 100 Income Fund (“RFI”) (collectively, the “Funds”);
2. in connection with the distribution of securities of the Funds pursuant to a prospectus, the Funds be exempt from the requirement that the prospectus contain a certificate of the underwriter or underwriters who are in a contractual relationship with the issuer whose securities are being offered; and
3. purchasers of Units of the Funds be exempt from the requirements of the Legislation related to take-over bids, including the requirement to file a report of a take-over bid and the accompanying fee with each applicable Jurisdiction, (the “Take-over Bid Requirements”) in respect of take-over bids for the Funds.

Under the Mutual Reliance Review System for Exemptive Relief Applications:

1. the Ontario Securities Commission is the principal regulator for this application; and
2. this MRRS decision document evidences the decision of each Decision Maker.

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### **Interpretation**

“Basket of Securities” means, in relation to a Fund, a group of securities determined by the Filer from time to time representing the constituents of the investment portfolio then held by such Fund.

“Designated Brokers” means registered brokers and dealers that enter into agreements with the Funds to perform certain duties in relation to the Funds.

“Prescribed Number of Units” means, in relation to a Fund, the number of Units of the Fund determined by the Filer from time to time for the purpose of subscription orders, exchanges, redemptions or for other purposes.

“Underwriters” means registered brokers and dealers that have entered into underwriting agreements with the Funds and that subscribe for and purchase Units from the Funds, and “Underwriter” means any one of them.

“Unitholders” means beneficial and registered holders of Units.

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:

### **Background**

1. Each Fund is a mutual fund trust governed by the laws of Ontario and a reporting issuer under the laws of all of the Jurisdictions.
2. The Funds are closed-end funds whose Units are listed and traded on The Toronto Stock Exchange (the “TSX”). The Units of FIE, RFI and FDI were sold to the public by way of initial public offerings made under long form prospectuses dated July 27, 2005, November 21, 2005 and February 15, 2006, respectively.
3. The Filer is manager of the Funds and is a registered investment counsel and portfolio manager in Ontario and is registered as an investment adviser with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940 (the “Advisers Act”). The Filer is a wholly-owned subsidiary of Claymore Group, Inc., a financial services and asset management company based in Lisle, Illinois. Claymore Group, Inc. and its U.S. affiliates include two investment advisers registered with the U.S. Securities and Exchange Commission under the Advisers Act and a broker-dealer registered with the

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National Association of Securities Dealers, Inc. under the United States Securities Exchange Act of 1934.

4. FIE's investment objectives are:
- (a) to maximize total return to Unitholders, consisting of distributions and capital appreciation; and
  - (b) to provide Unitholders with a stable stream of monthly cash distributions of \$0.05 per Unit.

The net proceeds of FIE's initial public offering, together with borrowings under its loan facility, were invested in a diversified and actively managed investment portfolio consisting primarily of common shares, preferred shares, corporate bonds and income trust units of issuers in the Canadian financial sector.

5. RFI's investment objectives are to provide Unitholders with:
- (a) a stable stream of monthly cash distributions of \$0.05 per Unit; and
  - (b) a total return that approximates the returns of the RAFI™ Canadian Fundamental 100 Index, net of expenses, and generally outperforms an investment in the S&P/TSX Composite Index.

The net proceeds of RFI's initial public offering, together with borrowings under its loan facility, were invested in a diversified portfolio of 100 Canadian equity securities selected and weighted on the basis of Research Affiliates, LLC's Canadian Fundamental 100 Index.

6. FDI's investment objectives are:
- (a) to maximize total return for holders of Units, consisting of distributions and capital appreciation; and
  - (b) to provide Unitholders with a stable stream of monthly cash distributions of \$0.05 per Unit.

The net proceeds of FDI's initial public offering, together with borrowings under its loan facility, were invested in a diversified and actively managed investment portfolio consisting primarily of common shares, preferred shares, corporate bonds and income trust units of issuers in the Canadian financial sector.

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7. The Filer has determined that it is in the best interests of the Unitholders and the Funds to convert the Funds into exchange-traded funds (“ETFs”). Upon conversion, the Funds would become “mutual funds” under the Legislation. Units issued by FIE and FDI will not be index participation units within the meaning of National Instrument 81-102 *Mutual Funds* (“NI 81-102”). Units issued by RFI will be index participation units.
8. The investment objectives, investment strategy, investment approach and investment restrictions of the Funds will continue to be the same and the Funds expect to continue to pay their normal distributions following conversion to an ETF structure.
9. In order to implement this proposal, the Filer will call and hold special meetings of the Unitholders of each Fund in order to obtain unitholder approval to the changes that will be required to the Fund trust agreements to implement the conversion. In connection with the special meetings, the Filer will prepare and deliver to Unitholders in accordance with applicable securities laws, a management information circular (the “Circular”) describing the proposal and the changes to be made to the Fund trust agreements as well as their impact on the Funds and Unitholders. It is expected that the Circular will contain prospectus-like disclosure relating to the operation and administration of the Funds on a going forward basis.
10. The Filer has also determined to submit a proposal to the Unitholders of both FIE and FDI to merge the two Funds, with FIE becoming the continuing fund. The merger proposal will be described in the Circular. If the merger proposal is approved by Unitholders and implemented, it will become effective before the proposal to convert the Funds into ETFs. As a result, the relief granted to the Funds under this decision would be required for and apply to FIE as the continuing fund and RFI. If the merger proposal is not approved by Unitholders, it will not be implemented and, assuming the proposal to convert the Funds into ETFs is approved, the relief granted to the Funds under this decision would be required for and apply to each of the Funds.
11. If the requisite unitholder and regulatory approvals are obtained, the Funds will prepare and file a preliminary prospectus of the Funds relating to the proposed continuous distribution of Units of each Fund and enter into the necessary designated broker and underwriting agreements in connection with such offerings. The Filer will not file a final prospectus for the continuous distribution of Units of the Funds until the TSX has conditionally approved the listing of additional Units of the Funds. The Funds will not commence a

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continuous distribution of Units at least until the final prospectus in respect of such distribution has been receipted.

12. The trust agreements for the Funds will be amended to implement the required changes. As a result and in furtherance of these changes, and after the final prospectus has been receipted:
  - (a) Units may only be subscribed for or purchased directly from the Funds by Underwriters or Designated Brokers and orders may only be placed for Units in the Prescribed Number of Units (or an integral multiple thereof) on any day when there is a trading session on the TSX.
  - (b) The Funds will appoint Designated Brokers to perform certain functions which include standing in the market with a bid and ask price for Units of each Fund for the purpose of maintaining liquidity for the Units.
  - (c) Each Underwriter or Designated Broker that subscribes for Units must deliver, in respect of each Prescribed Number of Units to be issued, a Basket of Securities and cash in an amount sufficient so that the value of the Basket of Securities and cash delivered is equal to the net asset value of the Units subscribed for next determined following the receipt of the subscription order. In the discretion of the Filer, the Funds may also accept subscriptions for Units in cash only, in securities other than Baskets of Securities and/or in a combination of cash and securities other than Baskets of Securities, in an amount equal to the net asset value of the Units next determined following the receipt of the subscription order.
  - (d) The net asset value per Unit of each Fund will be calculated and published daily and the investment portfolio of each Fund will be made available daily on the Filer's website.
  - (e) Upon notice given by the Filer from time to time and, in any event, not more than once quarterly, a Designated Broker will subscribe for Units in cash in an amount not to exceed 0.3% of the net asset value of the Fund, or such other amount established by the Filer and disclosed in the prospectus of such Fund, next determined following delivery of the notice of subscription to that Designated Broker.
  - (f) Neither the Underwriters nor the Designated Brokers will receive any fees or commissions in connection with the issuance of Units to them.

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The Filer may, at its discretion, charge an administration fee on the issuance of Units to the Designated Brokers or Underwriters.

- (g) Except as described in subparagraphs (a) through (e) above, Units may not be purchased directly from the Funds. Investors are generally expected to purchase Units through the facilities of the TSX. However, Units may be issued directly to Unitholders upon the reinvestment of distributions of income or capital gains and in accordance with the distribution reinvestment plan of each Fund.
  - (h) Unitholders that wish to dispose of their Units may generally do so by selling their Units on the TSX, through a registered broker or dealer, subject only to customary brokerage commissions. A Unitholder that holds a Prescribed Number of Units or an integral multiple thereof may exchange such Units for Baskets of Securities and cash; Unitholders may also redeem their Units for cash at a redemption price equal to 95% of the closing price of the Units on the TSX on the date of redemption.
  - (i) As manager, the Filer receives a fixed annual fee from each Fund. Such annual fee is calculated as a fixed percentage of the net asset value of each Fund. The Funds are responsible for the payment of all their respective expenses including any extraordinary expenses.
13. No investment dealers will act as principal distributors for the Funds in connection with the distribution of Units. The Underwriters will not receive any commission or other payment from the Funds or the Filer. As a result, the Filer will be the only entity desiring to foster market awareness and promote trading in the Units through the dissemination of sales communications.
  14. Because Underwriters will not receive any remuneration for distributing Units, and because Underwriters will change from time to time, it is not practical to require an underwriters' certificate in the prospectus of the Funds.
  15. Unitholders will have the right to vote at a meeting of Unitholders in respect of a Fund prior to any change in the fundamental investment objectives of such Fund, any change to their voting rights and prior to any increase in the amount of fees payable by a Fund.
  16. Although Units will trade on the TSX and the acquisition of Units can therefore be subject to the Take-over Bid Requirements:

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- (a) it will not be possible for one or more Unitholders to exercise control or direction over a Fund as the trust agreement in respect of each Fund will ensure that there can be no changes made to the Fund which do not have the support of the Filer;
  - (b) it will be difficult for purchasers of Units to monitor compliance with Take-over Bid Requirements because the number of outstanding Units will always be in flux as a result of the ongoing issuance and redemption of Units by the Funds; and
  - (c) the way in which Units will be priced deters anyone from either seeking to acquire control of, or offering to pay a control premium for, outstanding Units because Unit pricing will be dependent upon the performance of the portfolio of a Fund as a whole.
17. The application of the Take-over Bid Requirements to the Funds would have an adverse impact upon Unit liquidity because they could cause Designated Brokers and other large Unitholders to cease trading Units once prescribed take-over bid thresholds are reached. This, in turn, could serve to provide conventional mutual funds with a competitive advantage over the Funds.

### **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:

- 1. the dealer registration requirement of the Legislation does not apply to the Filer in connection with its dissemination of sales communications relating to the distribution of Units of the Funds, provided the Filer complies with Part 15 of NI 81-102;
- 2. in connection with the distribution of Units of the Funds pursuant to a prospectus or any renewal prospectus, the Funds are exempt from the requirement of the Legislation that the prospectus or renewal prospectus contain a certificate of the Underwriters; and
- 3. the purchase of Units by a person or company (a "Unit Purchaser") in the normal course through the facilities of the TSX is exempt from the Take-over Bid Requirements from the time the Funds become and for so long as the Funds remain ETFs provided that, prior to making any take-over bid for Units that is not otherwise exempt from the Take-over Bid Requirements, the Unit



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Purchaser, and any person or company acting jointly or in concert with the Unit Purchaser (a “Concert Party”), provide the Filer with an undertaking not to exercise any votes attached to the Units held by the Unit Purchaser and any Concert Party which represent more than 20% of the votes attached to all outstanding Units.

Paul M. Moore  
Vice-Chair  
Ontario Securities Commission

David L. Knight  
Commissioner  
Ontario Securities Commission