

Annex C

Specific Questions of the CSA relating to Securities Lending, Repurchases and Reverse Repurchases by Investment Funds

The CSA are considering measures to enhance the transparency of the benefits, costs and risks of securities lending, repurchase and reverse repurchase transactions conducted by investment funds. We seek feedback on the following issues.

The CSA understand that it is common practice for securities lending agents to be compensated through receiving a share of the revenue generated from lending securities, repurchases and, if a lending agent is used, reverse repurchases. We also understand that some managers have established revenue-sharing arrangements under which revenue is shared between the investment fund and a lending agent related to the manager or between the investment fund and the manager. As the investment fund bears all the risks from securities lending, repurchases and reverse repurchases, the CSA are of the view that the revenue from engaging in these activities, after the payment of costs for conducting the activities, should be received only by the investment fund.

Currently, depending on the terms of the securities lending agreement, the financial statements of an investment fund that engages in securities lending may disclose the revenue from securities lending net of the lending agent's share. Further, in such cases, the amount paid to the lending agent does not appear in the financial statements as a cost of conducting the activities.

While the amount of revenue generated by securities lending and repurchases may be relatively small, the CSA are of the view that because mutual funds (and, under the Proposed 81-102 Amendments, all investment funds) may lend, or sell in repurchase transactions, up to 50% of total assets,¹ information about the returns, costs and risks of securities lending and repurchase activity is relevant to investors.

The CSA think that it is important for investors to understand the returns from securities lending and how such revenue has contributed to the performance of the investment funds. We also think it is important for investors to be aware of the costs, the profitability and the scope of an investment fund's securities lending activities, so that they can assess the efficiency of the lending. Transparency of the revenue and cost is particularly important if the investment fund uses a lending agent that is related to the manager, which may give rise to conflicts of interest. Further, if the related lending agent shares in the revenue from securities lending, the manager could market its funds to investors as having a management fee that is lower than it would otherwise be, without investors being aware of the additional compensation paid to the affiliated lending agent through the revenue sharing arrangement.

¹ The CSA are proposing to change the limit on the amount of securities loaned, or sold in repurchases, by all investment funds from 50% of total assets (excluding collateral delivered to the fund) to 50% of NAV. See "Summary of Proposed Amendments – (ii) Investment Restrictions – Securities Lending, Repurchases and Reverse Repurchases".

Accordingly, we are considering measures to enhance the transparency of the benefits from securities lending and the costs paid to earn the returns. We are of the view that disclosure of the gross returns from, and the costs of, securities lending would provide additional transparency.

We seek feedback on approaches that would achieve the outcome of providing disclosure of the gross returns and the costs of securities lending.

1. Are there other costs of conducting securities lending, other than the fee paid to the lending agent?
2. What approaches could the CSA consider to ensure that the financial statements of an investment fund disclose the revenue from securities lending inclusive of the share paid to the agent? What approaches could the CSA consider to ensure that the financial statements of an investment fund disclose the costs of securities lending?
3. What approaches could the CSA consider to ensure that the costs of securities lending are included in either the management expense ratio or the trading expense ratio of the investment fund?
4. We think that the disclosure of the returns and the costs of repurchases should be the same as the disclosure of securities lending, since both activities are substantively similar. Should the same type of disclosure for reverse repurchases be provided? Should the returns and costs of securities lending and repurchases be aggregated, rather than disclosed separately?
5. In order to provide investors with transparency on the profitability and scope of an investment fund's securities lending and repurchase activities, the CSA are considering requiring the following additional disclosure, in the investment fund's management reports of fund performance, regarding such activities:
 - The average daily aggregate dollar value of securities lent (or sold in repurchase transactions) obtained by
 - (i) adding together the aggregate dollar value of portfolio securities that were lent (or sold) in the securities lending (or repurchase) transactions of the investment fund that are outstanding as at the end of each day during the financial year or interim period; and
 - (ii) dividing the amount obtained under (i) by the number of days during the financial year or interim period.
 - The percentage profitability of securities lending (or repurchase transactions) obtained by
 - (i) dividing the revenue from securities lending (or repurchase) transactions during the financial year or interim period by the average daily aggregate dollar value of securities lent (or sold in repurchase transactions); and

- (ii) multiplying the amount obtained under (i) by 100.
- The percentage return from securities lending (or repurchase transactions) obtained by
 - (i) dividing the securities lending (or repurchase) revenue by the average net asset value of the investment fund during the financial year or interim period; and
 - (ii) multiplying the amount obtained under (i) by 100.
- The percentage of net asset value lent (or sold) obtained by
 - (i) dividing the average daily aggregate dollar value of securities lent (or sold in repurchase transactions) by the average net asset value of the investment fund during the financial year or interim period; and
 - (ii) multiplying the amount obtained under (i) by 100.
- The maximum amount of securities lent (and sold in repurchase transactions) in any day during the financial year or interim period, both as a dollar amount and as a percentage of net asset value on that date.

Do you agree that these disclosure items are useful in increasing transparency regarding the profitability and scope of a fund's securities lending and repurchases? Are any of these items less useful to investors, in light of the costs to the investment fund of calculating and disclosing them?

6. Are there any other measurements regarding securities lending, repurchases or reverse repurchases that would provide useful information to investors in addition to, or in lieu of, the items described in question 5?

7. Items 3.4 and 19 of Form 41-101F2, Item 5 of Part A and Item 4 of Part B of Form 81-101F1, and Item 10 of Form 81-101F2 require disclosure in an investment fund's prospectus or annual information form (AIF), as applicable, regarding certain service providers to the fund. The CSA are considering adding the agent in respect of securities lending, repurchases and, if applicable, reverse repurchases to the list of service providers detailed in these Items. Another outcome of adding the agent to these Items would be that the agent's relationship to the manager would also be disclosed in the prospectus or AIF, so that investors can assess whether amounts are being paid to entities affiliated with the manager in connection with the investment fund's securities lending, repurchase or reverse repurchase activities. Is this disclosure useful? Should any additional details regarding the agent be provided in an investment fund's prospectus or AIF?

8. We understand that investment funds may seek different indemnities from their lending agent, which provide varying degrees of protection from losses that could arise from securities lending. Would disclosure of the indemnities obtained by an investment fund from its lending

agent in the AIF or prospectus of the investment fund be useful for investors in assessing the risks from securities lending?

9. Generally, investment funds do not file the agreements that they enter into with their lending agent on SEDAR. Currently, these agreements are not listed in the AIF under Item 16 of Form 81-101F2 or the prospectus under Item 31 of Form 41-101F2. Should these agreements be required to be included as material contracts and filed on SEDAR?