

## **2004 BCSECCOM 27**

### **Headnote**

Mutual Reliance Review System for Exemptive Relief Applications – exemption from section 2.1 of National Instrument 81-105 *Mutual Fund Sales Practices* granted to labour sponsored investment fund corporation to permit it to pay certain specified distribution costs out of fund assets, subject to conditions

### **Applicable British Columbia Provisions**

National Instrument 81-105 *Mutual Fund Sales Practices*

**IN THE MATTER OF THE SECURITIES LEGISLATION OF BRITISH  
COLUMBIA, ALBERTA, SASKATCHEWAN, MANITOBA, ONTARIO,  
NEW BRUNSWICK, NOVA SCOTIA, PRINCE EDWARD ISLAND,  
NEWFOUNDLAND AND LABRADOR**

**AND**

**IN THE MATTER OF THE MUTUAL RELIANCE REVIEW SYSTEM  
FOR EXEMPTIVE RELIEF APPLICATIONS**

**AND**

**IN THE MATTER OF NATIONAL INSTRUMENT 81-105 MUTUAL  
FUND SALES PRACTICES**

**AND**

**IN THE MATTER OF THE ROYNAT CANADIAN DIVERSIFIED FUND  
INC.**

### **MRRS DECISION DOCUMENT**

WHEREAS the local securities regulatory authority or regulator (the “Decision Maker”) in each of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Newfoundland and Labrador, Nova Scotia, and Prince Edward Island (the “Jurisdictions”) has received an application from RoyNat Canadian Diversified Fund Inc. (the “Fund”) for a decision pursuant to section 9.1 of National Instrument 81-105 Mutual Fund Sales Practice (“NI 81-105”) that the prohibition contained in section 2.1 of NI 81-105 against the making of certain payments by the Fund to participating dealers shall not apply to the Fund;

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AND WHEREAS under the Mutual Reliance Review System for Exemptive Relief Applications (the “System”), the Ontario Securities Commission is the principal regulator for this application;

AND WHEREAS, the Fund represented to the Decision Makers as follows:

1. The Fund is a corporation incorporated under the *Canada Business Corporations Act* by Articles of Incorporation dated October 31, 2003.
2. The Fund will be registered as a labour sponsored investment fund corporation under the *Community Small Business Investment Funds Act* (Ontario), as amended (the “Ontario Act”), a labour-sponsored venture capital corporation under the *Income Tax Act* (Canada) (the “Federal Act”), as amended, a labour-sponsored venture-capital corporation under the *Equity Tax Credit Act* (Nova Scotia) and prescribed as a labour-sponsored venture capital corporation by regulation under the *New Brunswick Income Tax Act*.
3. The Fund is a mutual fund pursuant to the securities legislation of the Jurisdictions (the “Legislation”), and will distribute securities in the Jurisdictions under two prospectuses. The Fund has filed a preliminary prospectus in all provinces in Canada, except Québec, and will be filing a separate prospectus in Québec.
4. The Fund will become a reporting issuer or equivalent in the Jurisdictions that recognize this concept when its prospectuses are receipted in such Jurisdictions.
5. The Fund will invest in small and medium-sized eligible Canadian businesses with the objective of achieving long-term capital appreciation.
6. The Christian Labour Association of Canada, The International Federation of Professional and Technical Engineers – Local 160 (also known as The Society of Energy Professionals) and The International Federation of Professional and Technical Engineers – Local 164 are the sponsors of the Fund (the “Sponsors”).
7. B.E.S.T. Capital Management Ltd., (the “Manager”) provides management services to the Fund. The Sponsors formed and organized the Fund.
8. The authorized capital of the Fund consists of an unlimited number of Class A Shares, an unlimited number of Class B Shares and an unlimited number of Class C Shares as at the date hereof. The Sponsors of the Fund are the sole owners of the Class B Shares of the Fund. RoyNat Management Inc. (the

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“Private Equity Specialist”) and its affiliates will be the sole owner of Class C Shares of the Fund.

9. The prospectus defines “Net Asset Value Per Share” when used in reference to Class A Shares and Class C Shares as being determined by subtracting the value of the liabilities of the Fund and the stated capital of the Class B Shares, from the value of the assets of the Fund and dividing the resulting amount by the total number of outstanding Class A Shares and Class C Shares at the date such value is determined (the “Net Asset Value Per Share”).
10. As will be disclosed in the Fund’s prospectuses, the Fund will pay the following distribution costs (“Distribution Costs”):
  - (a) a sales commission in an amount of 6% of the original issue price of each Class A Share to the registered dealer selling the Class A Shares (“Sales Commission”);
  - (b) a quarterly servicing commission equal to 0.5% annually of the aggregate Net Asset Value Per Share attributable to the Class A Shares held by clients of participating dealers; and
  - (c) the reimbursement of co-operative marketing expenses incurred by certain dealers in promoting sales of the Class A Shares, pursuant to co-operative marketing agreements the Fund enters into with such dealers from time to time.
11. The structural aspects of the Fund relating to the payment of commissions are consistent with the legislative requirements contemplated under the Ontario Act. Gross investment amounts will be paid to the Fund as opposed to, for example, first deducting a commission and remitting the net investment amount to the Fund, in order to ensure that the entire amount paid by an investor is eligible for applicable federal, and in the case of Ontario, New Brunswick and Nova Scotia, provincial tax credits which arise on the purchase of the Class A Shares of the Fund. Section 25(4) of the Ontario Act, for example, provides that the provincial tax credit is a defined percentage “of the amount received by the corporation as equity capital on the issue”. Accordingly, the most tax efficient way for sales commissions to be financed is for the Fund to pay such expenses and amortize them in the manner described above.
12. For accounting purposes, the Fund will expense all Distribution Costs in the fiscal period when incurred.

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13. Gross investment amounts will be contributed to the Fund in respect of each subscription. This is to ensure that the entire subscription amount contributed by the investor is counted for the purpose of the applicable federal and provincial tax credits in connection with the purchase of Class A Shares.
14. Due to the structure of the Fund, the most tax efficient way for the Distribution Costs to be financed is for the Fund to pay them directly.
15. As other labour sponsored investment funds have been granted this relief, requiring the Manager to pay the Distribution Costs would put the Fund at a permanent and serious competitive disadvantage with its competitors.
16. The Fund undertakes to comply with all other provisions of NI 81-105. In particular, the Fund undertakes that all Distribution Costs paid by it will be compensation permitted to be paid to participating dealers under NI 81-105.
17. The payment of commissions on the sale of Class A Shares by the Fund is an event contemplated under the Ontario Act and the Federal Act.

AND WHEREAS under the System, this MRRS Decision Document evidences the decision of each Decision Maker (collectively, the “Decision”);

AND WHEREAS 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 subsection 9.1(1) of NI 81-105 is that the Fund shall be exempt from section 2.1 of NI 81-105 to permit the Fund to pay the Distribution Costs, provided that:

- (a) Distribution Costs are otherwise permitted by, and paid in accordance with, NI 81-105;
- (b) the Fund will in its financial statements expense all Distribution Costs in the fiscal period when incurred;
- (c) the summary section of the prospectus will have full, true and plain disclosure explaining to investors that they pay the Sales Commission indirectly, as the Fund pays the Sales Commission using investors’ subscription proceeds, and this summary section must be placed within the first 10 pages of the prospectuses; and

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- (d) this Exemption shall cease to be operative with respect to the Decision Maker on the date that a rule or regulation replacing or amending section 2.1 of NI 81-105 comes into force.

DATED: December 18, 2003.

Harold P. Hands

Robert W. Korthals