

# 2007 BCSECCOM 144

March 7, 2007

## **Headnote**

National Instrument 81-105 s. 9.1 - Mutual Fund Sales Practices - A mutual fund wants relief from the prohibitions in sections 2.1 and 2.2 of NI 81-105 to permit it to pay a novel form of compensation to sales representatives and investors - The compensation arrangement does not provide a monetary incentive for representatives to recommend one product over another; the compensation arrangement is clearly outlined in the fund's prospectus; the fund will remind participating dealers that they must comply with the usual suitability and good faith obligations in the legislation.

## **Applicable Legislative Provisions**

National Instrument 81-105 *Mutual Fund Sales Practices* s. 9.1 – exemption from the prohibitions in Part 2 of NI 81-105

**In the Matter of  
the Securities Legislation of  
British Columbia, Alberta, Ontario and Quebec  
(the Jurisdictions)**

**and**

**In the Matter of  
National Instrument 81-105 Mutual Funds (NI 81-105)**

**and**

**In the Matter of  
Nexgen Financial Limited Partnership (Nexgen)**

**and**

**In the Matter of  
Nexgen Global Value Registered Fund and  
Nexgen Global Value Tax Managed Fund  
(collectively, the Global Funds)**

**MRRS Decision Document**

## **Background**

- ¶ 1 The local securities regulatory authority or regulator (the Decision Maker) in each of the Jurisdictions has received an application from NexGen in respect of the

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Global Funds and all NexGen open-end mutual funds established from time to time (the Future Funds) for a decision under the securities legislation of the Jurisdictions (the Legislation) that:

- (a) exempts NexGen from the prohibition in paragraph 2.1(1)(a) of National Instrument 81-105 – Mutual Fund Sales Practices (NI 81-105) in connection with the payment of the NexGen Founders' Benefit (the Benefit) in connection with the Global Funds and the Future Funds, and
- (b) exempts dealers that are members of the Investment Dealers Association of Canada (IDA) or the Mutual Fund Dealers Association of Canada (MFDA) that will distribute securities of the Global Funds and the Future Funds (the Participating Dealers) from the prohibition in subsection 2.2(1) of NI 81-105 in connection with the Participating Dealers' acceptance of the Benefit (collective, the Requested Relief).

Under the Mutual Reliance Review System for Exemptive Relief Applications:

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

### **Interpretation**

- ¶ 2 Defined terms contained in National Instrument 14-101 *Definitions* or in Quebec Commission Notice 14-101 have the same meaning in this decision unless they are defined in this decision.

### **Representations**

- ¶ 3 This decision is based on the following facts represented by NexGen:
- 1. NexGen Financial Limited Partnership (NexGen) is a limited partnership formed under the laws of the Province of Ontario having its head office in Toronto, Ontario. NexGen is registered in the Province of Ontario as an adviser in the categories of investment counsel and portfolio manager and as a dealer in the categories of mutual fund dealer and limited market dealer;
  - 2. NexGen is the manager of the NexGen Funds, a group of 26 open-end mutual funds (the Existing Funds), whose securities are qualified for sale in the Jurisdictions pursuant to a simplified prospectus and annual information form dated May 5, 2006;

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3. NexGen has filed a preliminary simplified prospectus and annual information form dated December 15, 2006 (the "Preliminary Prospectus") in respect of the Global Funds with the securities regulatory authorities of each of the Jurisdictions for which a preliminary receipt dated December 15, 2006 was issued. The Global Funds have similar characteristics to those of the Existing Funds;
4. the securities of the Global Funds and the Future Funds will be distributed through independent third party brokers and dealers. In consideration for ongoing services, advisors will receive both a sales commission and ongoing trailer commission in respect of an investment in the Global Funds (as described in the Preliminary Prospectus) or the Future Funds. Specifically, a Participating Dealer shall be entitled to receive a 5% sales commission from NexGen in respect of sale of deferred load securities and 0% to 5% sales commission from the investor in respect of the sale of front load securities. In addition, a dealer is entitled to receive a trailer commission payment (the "Standard Trailer Payment") monthly based upon the value of securities held in an investor account of up to 1% for front load securities and .50% for deferred load securities;
5. in addition to the Standard Trailer Payment, investors of the Global Funds or the Future Funds who purchase the regular, loyalty, high net worth, ultra high net worth front load series or deferred load series of the Global Funds or the Future Funds, as the case may be, will be eligible to receive the Benefit. The Benefit will entitle such investors and their Participating Dealers to receive from NexGen a payment equal to a portion of the value of NexGen at the end of the seven year vesting period from the date of purchase or deemed date of purchase of such Global Fund or Future Fund securities, subject to the terms and conditions respecting the Benefit described in the applicable prospectus documents;
6. the Benefit will be temporary. NexGen may terminate the offering of the Benefit at any time, but will terminate the offering of the Benefit no later than 7 years from the date the applicable NexGen Fund receives a final receipt for its prospectus;
7. the Benefit does not share the attributes of a standard trailing commission as envisioned in section 3.2 of Part 3 of National Instrument 81-105 because it is not derived from the application of a fixed commission rate to the balance of NexGen Fund units held by the investor. The Benefit is calculated based upon the growth of NexGen, as manager of the NexGen Funds, and is contingent upon the performance of NexGen. Also, the Benefit, if paid, will be paid in a lump sum at the end of the 7 year vesting period rather than periodically;

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8. an investor and their Participating Dealer are entitled to receive one Benefit payment for each 100 securities of NexGen Funds that the investor holds for 7 years. The value of a Benefit payment is based upon the growth in the value of NexGen over the 7 year holding period. The Benefit's value is equal to the fully diluted value of one NexGen common partnership unit on a payment date less an initial base price of \$1 per Benefit and less a compounding inflator of 8% per annum applied in respect of the initial base price. NexGen will pay one half of the Benefit to investors in the form of additional securities of the NexGen Funds. NexGen will pay the remainder of the Benefit to Participating Dealers in cash;
9. the Participating Dealers' share of the Benefit is subject to the following limit in connection with front end load securities (the Front Load Maximum). Participating Dealers will receive a cash payment equal to the lesser of: (1) one half of the value of the Benefit, as calculated in paragraph 8 above; and (2) the difference obtained by subtracting the total Standard Trailer Payments paid over the 7 year period from the standard trailing commissions that NexGen would have paid over the 7 year period if the standard trailing commission rate was 1.25%. Consequently, the cash payment to Participating Dealers, comprised by the Benefit and the Standard Trailer Payment, will at all times be no more than the cash payment represented by a 1.25% standard trailing commission paid throughout the 7 year vesting period;
10. the Front Load Maximum will only be achieved assuming that NexGen has approximately \$20 billion in assets under management at the end of its first 7 years of operation. If NexGen has approximately \$10 billion in assets under management at the end of its first 7 years of operation, the value of the Benefit and the Standard Trailer Payment will be less than the cash payment represented by a 1.15% standard trailing commission paid throughout the 7 year vesting period. If NexGen has approximately \$5 billion in assets under management, the value of the Benefit and the Standard Trailer Payment will be less than the cash payment represented by a 1.04% standard trailing commission paid throughout the 7 year vesting period;
11. the Participating Dealers' share of the Benefit is subject to the following limit in connection with deferred load securities (the Deferred Load Maximum). Participating Dealers will receive a cash payment equal to the lesser of: (1) one half of the value of the Benefit, as calculated in paragraph 8 above; and (2) the difference obtained by subtracting the total Standard Trailer Payments paid over the 7 year period from the standard trailing commissions that NexGen would have paid if the standard trailing commission rate was .75%. Consequently, the cash payment to Participating Dealers, comprised by the

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Benefit and the Standard Trailer Payment, will at all times be no more than the cash payment represented by a .75% standard trailing commission paid throughout the 7 year vesting period;

12. the Deferred Load Maximum will only be achieved assuming that NexGen has approximately \$20 billion in assets under management at the end of its first 7 years of operation. If NexGen has approximately \$10 billion in assets under management at the end of its first 7 years of operation, the value of the Benefit and the Standard Trailer Payment will be less than the cash payment represented by a .65% standard trailing commission paid throughout the 7 year vesting period. If NexGen has approximately \$5 billion in assets under management, the value of the Benefit and the Standard Trailer Payment will be less than the cash payment represented by a .54% standard trailing commission paid throughout the 7 year vesting period;
13. the Benefit is contingent and based upon the performance of NexGen, which will in turn be dependent upon numerous factors including superior investment performance of the NexGen Funds throughout the seven year vesting period of the Benefit;
14. the Benefit, unlike a standard trailing commission, provides a benefit to eligible investors of the NexGen Funds. The value of the Benefit to investors will be equal to the value of the Benefit paid to Participating Dealers. Investors, however, will be paid through the issuance of additional securities of the NexGen Funds rather than cash. The Benefit has been designed to reinforce the rewards provided to long-term investors of the Funds;
15. the Participating Dealers are registrants under the Legislation that are subject to an obligation to ensure that an investment in NexGen Funds is suitable and in keeping with the client's investment objective. The Participating Dealers are subject to "Know Your Product" obligations that require them to review each product including "an assessment of the commissions and other compensation to be paid to the dealer and the advisor for selling the product, and consideration of potential conflict issues that may arise under the compensation structure". The Benefit is required to be included in any such review as "other compensation"; and
16. the Preliminary Prospectus contained and the final simplified prospectus of the Global Funds and the Future Funds will contain full, true, and plain disclosure regarding the Benefit including how it is calculated. NexGen will also disclose the value of NexGen for purposes of the calculation of the Benefit on an annual basis in each applicable renewal simplified prospectus.

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### **Decision**

- ¶ 4 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 Requested Relief is granted so long as:

1. the NexGen Global Funds and the Future Funds disclose the Benefit in each renewal simplified prospectus and annual information form;
2. NexGen discloses the value of NexGen for purposes of the calculation of the Benefit in the applicable NexGen fund renewal simplified prospectus and annual information form;
3. NexGen ceases to offer the Benefit with respect of the NexGen Global Funds and the Future Funds no later than 7 years after the date of the funds' first final prospectuses respectively;
4. the total cash payment to Participating Dealers is subject to the Front Load maximum and the Deferred Service Charge Maximum, as applicable;
5. NexGen provides each Participating Dealer with a copy of this Decision and specifically refers each Participating Dealer to paragraph 15 above; and
6. NexGen pays at least one half of the value of the Benefit to investors.

Wendell S. Wigle  
Commissioner  
Ontario Securities Commission

David L. Knight  
Commissioner  
Ontario Securities Commission