

## **2002 BCSECCOM 1034**

### **Headnote**

Mutual Reliance Review System for Exemptive Relief Application – relief from the provisions of section 2.1 of National Instrument 81-105 *Mutual Fund Sales Practices*, subject to certain conditions

### **Applicable British Columbia Provisions**

National Instrument 81-105 *Mutual Fund Sales Practices*

**IN THE MATTER OF THE SECURITIES LEGISLATION OF ALBERTA,  
BRITISH COLUMBIA, NEW BRUNSWICK, NEWFOUNDLAND AND  
LABRADOR, NOVA SCOTIA, PRINCE EDWARD ISLAND, QUEBEC,  
SASKATCHEWAN, THE YUKON, NORTHWEST TERRITORIES AND  
NUNAVUT**

**AND**

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

**AND**

**IN THE MATTER OF THE VENGROWTH II INVESTMENT FUND INC.**

### **MRRS DECISION DOCUMENT**

WHEREAS the local securities regulatory authority or regulator (the “Decision Maker”) in each of Alberta, British Columbia, New Brunswick, Newfoundland and Labrador, Nova Scotia, Prince Edward Island, Saskatchewan, the Yukon, Northwest Territories and Nunavut (the “Jurisdictions”) has received an application from The VenGrowth II Investment Fund Inc. (the “Fund”) for a decision under section 9.1 of National Instrument 81-105 *Mutual Fund Sales Practices* (“NI 81-105”) that the prohibition 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;

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

AND WHEREAS, unless otherwise defined, the terms herein have the meaning set out in National Instrument 14-101 *Definitions* or in Quebec Commission Notice 14-101;

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AND WHEREAS the Fund has represented to the Decision Makers that:

1. The Fund is a corporation incorporated under the *Canada Business Corporations Act* by Articles of Incorporation dated October 18, 1999;
2. The Fund is registered as a labour sponsored investment fund corporation under the *Community Small Business Investment Funds Act* (Ontario) (the "Ontario Act"). The Fund will not be applying for registration as a labour sponsored venture capital corporation, or similar concept, under the provincial legislation of the Jurisdictions;
3. The Fund is currently prescribed as a labour sponsored venture capital corporation under the *Income Tax Act* (Canada) (the "Tax Act"). The Fund intends to apply shortly for registration under the Tax Act as a labour sponsored venture capital corporation and anticipates being registered as such early in 2003;
4. The Fund is a mutual fund pursuant to the securities legislation of the Jurisdictions (the "Legislation"), and will distribute securities in the Participating Jurisdictions under a prospectus. The Fund has filed a combined pro forma prospectus (in Ontario) and a preliminary prospectus (in each of the Jurisdictions);
5. The Fund is a reporting issuer in Ontario and will become a reporting issuer or equivalent in the Jurisdictions that have this concept when its prospectus is receipted in such Jurisdictions;
6. The Fund invests in small and medium-sized eligible Canadian businesses with the objective of achieving long-term capital appreciation;
7. The authorized capital of the Fund consists of an unlimited number of Class A shares (The "Class A Shares") and 25,000 Class B shares, of which approximately 49.3 million Class A Shares and 100 Class B shares are issued and outstanding as of the date hereof;
8. VenGrowth II Capital Management Inc. (the "Manager"), the manager of the Fund and the Association of Public Service Financial Administrators (the "Sponsor"), the sponsor of the Fund, formed and organized the Fund;
9. The Fund pays all costs of distributing its shares directly to participating dealers or representatives of a participating dealer including a sales commission of 6% of the subscription price for each Class A Share (the "6% Sales Commission") to the dealer procuring such subscription;

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10. As will be disclosed in the Fund's prospectus, the Fund currently pays the following distribution costs ("Distribution Costs"):
- a. A sales commission in an amount of 6% of the subscription price derived on the sale of a Class A Share to the dealer procuring such subscription ("Sales Commission"). Sales commissions payable by the Fund are amortized by it on a straight-line basis over a period of eight years on its financial accounts and are recoverable on a straight line basis, at the rate of 0.75% per annum, in the event that Class A Shares are redeemed by the holders thereof prior to the expiry of an eight-year period following the purchase thereof. This mechanism is viewed by the Fund as an appropriate and beneficial mechanism through which the Fund may match distribution expenses against subscriptions;
  - b. A monthly servicing commission ("Servicing Commission") of up to ½ of 0.5% of the total net asset value of Class A Shares held by clients of participating dealers; and
  - c. The reimbursement of co-operative marketing expenses (the "Co-op 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, 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:
- a. Defers and amortizes the amount paid or payable in respect of the Sales Commission on its financial accounts on a straight line basis over eight years and reflects its recovery on a straight-line basis at the rate of 0.75% per annum, in the event that Class A Shares are redeemed by the holders

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thereof prior to the expiry of an eight-year period following the purchase thereof; and

- b. Charges to retained earnings the Servicing Commission and the Co-op Expenses in the fiscal period when incurred and does not defer and amortize any Co-op Expenses;
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 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 Tax Act; and
18. The Ontario Securities Commission issued a decision document on December 10, 1999 in respect of the relief requested;

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 section 9.1 of 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:

1. Distribution Costs are otherwise permitted by, and paid in accordance with, NI 81-105;

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2. The Fund will in its financial statements:
  - a. Defer and amortize the amount paid or payable in respect of the Sales Commission to retained earnings on a straight line basis over eight years; and
  - b. Charge the Servicing Commission and the Co-op Expenses to retained earnings in the fiscal period when incurred;
3. The summary section of the prospectus of the Fund has full, true and plain disclosure explaining to investors that:
  - a. They pay the Sales Commission indirectly, as the Fund pays the Sales Commission using investors' subscription proceeds; and
  - b. A portion of the net asset value of the Fund is comprised of a deferred commission, rather than an investment asset; and

this summary section must be placed within the first 10 pages of the prospectus;
4. 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 11, 2002.

Barbara Shourounis  
Director