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February 5, 2008

Headnote

Mutual Reliance Review System for Exemptive Relief Applications – Securities Act, s. 130 - Relief from certain self-dealing restrictions in Part 15 of the Act

Related Party Relief: A mutual fund manager wants relief from section 127(1)(b) of the Act so that it can sell the securities of an issuer to the account of responsible person - The purchase or sale is consistent with, or is necessary to meet, the investment objectives of the mutual fund and is in the best interests of the fund's investors; the IRC of the mutual fund has approved the transaction, or the fund manager follows any standing instructions that the IRC provides in connection with the transaction

Reporting Relief: A registered mutual fund manager wants relief from the reporting requirements contained in sections 126(b) and (c) of the Act - The mutual fund may receive loans from, or make loans to, any of its related persons; the portfolio advisers of the mutual fund have discretion to allocate brokerage business in any manner consistent with the fund's best interests; the allocation of brokerage business represents the business judgement of responsible persons uninfluenced by considerations other than the best interests of the mutual fund; the management report of fund performance for the mutual fund will disclose the names of and fees paid to related persons; the mutual fund's records of portfolio transactions will include information about purchases or sales effected through a related person on a per transaction basis

Applicable British Columbia Provisions

Securities Act, R.S.B.C. 1996, c. 418, ss. 126(b) and (c), 127(1)(b) and 130

In the Matter of
the Securities Legislation of
British Columbia, Alberta, Saskatchewan, Ontario, Quebec, New Brunswick,
Nova Scotia, and Newfoundland and Labrador
(the Jurisdictions)

and

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

and

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In the Matter of
HSBC Investment Funds (Canada) Inc. (the Manager)
and
HSBC Investments (Canada) Limited
(the Portfolio Manager and together with the Manager, the Filers and each a Filer)
and

In the Matter of
HSBC Mortgage Fund (the Fund)

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 the Filers for a decision under the securities legislation of the Jurisdictions (the Legislation):
- (a) that the restriction contained in the Legislation prohibiting a mutual fund or a responsible person (as defined in the Legislation) of a mutual fund from knowingly causing the mutual fund to purchase or sell securities of any issuer from or to the account of a responsible person do not apply to the purchase and sale of mortgages between HSBC Bank Canada, HSBC Mortgage Corporation (Canada), other affiliates (as defined in the Legislation) of the Filers (collectively, the HSBC Affiliates) and the Fund (the Securities Act Self-Dealing Relief); and
 - (b) that the requirement contained in the Legislation requiring the management company of a mutual fund, or in British Columbia, a mutual fund manager, to file a report in the required form in connection with transactions in mortgages between the HSBC Affiliates and the Fund and with respect to loans made by HSBC Bank Canada to the Fund do not apply with respect to the purchase and sale of mortgages between the HSBC Affiliates and the Fund and with respect to loans made by HSBC Bank Canada to the Fund (the Reporting Relief and together with the Securities Act Self-Dealing Relief, the Requested Relief).

Under the Mutual Reliance Review System for Exemptive Relief Applications:

- (i) the British Columbia Securities Commission is the principal regulator for this application; and

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(ii) this MRRS decision document evidences the decision of each Decision Maker.

Interpretation

- ¶ 2 Defined terms contained in National Instrument 14-101 Definitions 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 the Filers:
1. each Filer is a corporation organized under the laws of Canada, with a head office located in British Columbia;
 2. the Manager is a wholly-owned subsidiary of the Portfolio Manager; the Portfolio Manager is a wholly-owned subsidiary of HSBC Bank Canada;
 3. the Manager is registered under applicable securities legislation in each province of Canada, other than Prince Edward Island, as a dealer in the category of mutual fund dealer (or equivalent) and is a member of the Mutual Fund Dealers Association of Canada;
 4. the Manager is the manager, trustee and promoter of the Fund;
 5. the Fund is an open-ended mutual fund established under a declaration of trust governed by the laws of British Columbia; units of the Fund are qualified for sale in each of the Jurisdictions under a simplified prospectus and annual information form filed in and accepted by each of the Jurisdictions;
 6. the Manager has appointed an independent review committee (IRC) in accordance with the requirements under National Instrument 81-107 *Independent Review Committee for Investment Funds* (NI 81-107) for the Fund;
 7. the Portfolio Manager is registered under applicable securities legislation in each province of Canada, other than Prince Edward Island, as an adviser in the category of portfolio manager and investment counsel (or equivalent);
 8. the Portfolio Manager is the principal investment advisor of the Fund;
 9. the Fund's investment objective is to earn as high a level of income as possible while protecting invested capital by investing primarily in Canadian dollar denominated residential first mortgages on property in Canada and other debt obligations;

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10. the Fund purchases mortgages from the HSBC Affiliates;
11. HSBC Bank Canada has agreed to repurchase any mortgage purchased by the Fund from it or HSBC Mortgage Corporation (Canada) if the mortgage is in default in respect of the payment of principal and interest beyond 90 days of the due date, or if the mortgage fails to meet the criteria for a mortgage in which the Fund may invest established by National Policy Statement No. 29 or by the Fund's internal statement of policies;
12. in addition, the Fund has agreed not to sell any mortgage purchased from HSBC Bank Canada or HSBC Mortgage Corporation (Canada) to any other person without giving HSBC Bank Canada the first right to purchase the mortgage within 30 days of receipt of written notice from the Fund of its intention to sell;
13. HSBC Bank Canada has agreed to administer the mortgages which are acquired by the Fund from it or HSBC Mortgage Corporation (Canada);
14. the Fund will purchase a mortgage from or sell a mortgage to an HSBC Affiliate only if:
 - (a) the transaction is made in accordance with clause 2.4(c) of Section III of National Policy Statement No. 29 such that
 - (i) the purchase or sale is made at the principal amount which will produce a yield to the Fund of not more than a quarter of one percent less than the interest rate at which the HSBC Affiliate is making commitments, at the time of purchase, to loan on the security of comparable mortgages, and
 - (ii) in the case of a purchase of a mortgage,
 - (A) the HSBC Affiliate that sells it to the Fund enters into an agreement (the Repurchase Agreement) with the Fund whereby the HSBC Affiliate that sells the mortgage is obligated to repurchase it if the mortgage goes into default for more than 90 days and in circumstances benefiting the Fund, and
 - (B) the Filer considers that the Repurchase Agreement is sufficient to justify the difference in yield referred to in subparagraph (i) above;

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- (b) HSBC Bank Canada guarantees the performance of the other HSBC Affiliate under the Repurchase Agreement referred to in paragraph (a)(ii)A. above;
 - (c) the Filer causes the Fund to comply with the disclosure provisions of Section IV of National Policy Statement No. 29; and
 - (d) the Filer causes the Fund to include disclosure in its prospectus that the Fund will engage in principal transactions in mortgages with the HSBC Affiliates;
- 15. in the event that the total amount required to effect redemptions of units of the Fund as at the close of business on any valuation day exceeds the liquid assets then held by the Fund, HSBC Bank Canada has agreed that, upon receipt of written notice from the Fund, it will purchase or find a purchaser for such value of mortgages held by the Fund as may be necessary to provide the Fund with the amount required; the sale of mortgages in such circumstances will be carried out in accordance with the representations provided in paragraph 14 above; HSBC Bank Canada may, in lieu of purchasing or finding a purchaser for mortgages, lend, on a temporary basis only, such sums to the Fund as may be necessary to effect such redemptions but not exceeding in the aggregate 5% of the net asset value of the Fund; HSBC Bank Canada is entitled to receive from the Fund, in respect of such loans, interest at a rate at least as favourable to the Fund as the rates then generally charged by HSBC Bank Canada on comparable loans to other persons who are not affiliated with HSBC Bank Canada;
- 16. the provisions of National Policy Statement No. 29 set out guidelines relating to the acquisition of mortgages by a mutual fund from lending institutions with whom such fund does not deal at arm's length and provide certain protections to the investing public;
- 17. the Filers or the Portfolio Manager will only cause the Fund to purchase a mortgage from or sell a mortgage to an HSBC Affiliate if the transaction is made in accordance with section 2.4(c) of Section III of National Policy Statement No. 29;
- 18. none of the HSBC Affiliates from which mortgages are purchased or to which mortgages are sold for the Fund, or any of their directors, officers or employees, participate in the formulation of investment decisions made on behalf of, or advice given to, the Fund by the Portfolio Manager; all decisions to purchase mortgages for the Fund's portfolio from the HSBC Affiliates are

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made based on the judgement of responsible persons uninfluenced by considerations other than the best interests of the Fund;

19. each Filer is of the view that the purchase and sale of mortgages between the Fund and the HSBC Affiliates is in the best interests of the Fund;
20. to the extent that a Fund purchases mortgages from, or sells mortgages to the HSBC Affiliates this fact is set out, and will continue to be set out, in the simplified prospectus and annual information form of the Fund;
21. under the Legislation, the Portfolio Manager is prohibited, among other things, from purchasing or selling on behalf of the Fund, the securities of any issuer from or to its own account; accordingly, the Fund is prohibited from purchasing mortgages from, or selling mortgages to the HSBC Affiliates as such mortgages are deemed to be beneficially owned by the Portfolio Manager;
22. under the Legislation, the Manager is required to file a report with respect to each purchase and sale of mortgages between the Fund and the HSBC Affiliates and with respect to each loan from HSBC Bank Canada to the Fund; this report is to be filed within 30 days after the end of the month in which the transaction occurs, disclosing the issuer of the securities purchased or sold, the class or designation of the securities, the amount and number of securities and the consideration paid, together with the name of any related person receiving a fee on the transaction, the name of the person or company that paid the fee and the amount of the fee paid;
23. National Instrument 81-106 *Investment Fund Continuous Disclosure* requires the Fund to include the dollar amount of commission, spread, or any other fee paid to a related party in connection with a portfolio transaction; to the extent that the Fund is purchasing mortgages from, or selling mortgages to the HSBC Affiliates and to the extent that HSBC Bank Canada is making loans to the Fund, these facts will be set out in the management report of fund performance of the Fund filed with the securities regulatory authorities in the applicable Jurisdictions and delivered to unitholders (if requested) on a semi-annual basis, so that the information will be provided to the securities regulatory authorities in the applicable Jurisdictions and to unitholders the Fund in fulfillment of its continuous disclosure obligations;
24. NI 81-107 does not provide an exemption for principal trading of the type contemplated by the Requested Relief;

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25. in British Columbia only, the Filers or the Portfolio Manager may cause the Fund to rely on BC Instrument 81-504, Transactions Between Mutual Funds and Responsible Persons Relating to Certain Debt Securities, Mortgages, and Equity Securities (BCI 81-504), to purchase a mortgage from or sell a mortgage to an HSBC Affiliate, if the transactions meets the requirements of sections 5 and 6 of BCI 81-504; and
26. the Filers are not in default of requirements under the Legislation except for their inadvertent failure to obtain the Requested Relief for transactions prior to the date of this decision document; despite this inadvertence, the Filers have complied with all terms and conditions, including the requirements under National Policy Statement No. 29, of prior MRRS decisions granting relief similar to the Requested Relief based on similar facts now presented in the Filers' application.

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.

- (1) The decision of the Decision Makers is that the Securities Act Self-Dealing Relief is granted provided that:
 - (a) the purchase or sale is consistent with, or is necessary to meet, the investment objective of the Fund;
 - (b) the IRC of the Fund has approved the transaction in accordance with section 5.2(2) of NI 81-107;
 - (c) the Manager, as manager of the Fund, complies with section 5.1 of NI 81-107;
 - (d) the Manager, as manager of the Fund, and the IRC of the Fund comply with section 5.4 of NI 81-107 for any standing instructions the IRC provides in connection with the transactions;
 - (e) the Fund keeps the written records required by section 6.1(2)(g) of NI 81-107.
- (2) The decision of the Decision Makers is that the Reporting Relief is granted provided that:

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- (a) the annual and interim management reports of fund performance for the Fund disclose
 - (i) the name of the HSBC Affiliate,
 - (ii) the amount of fees paid to each HSBC Affiliate, and
 - (iii) the person or company who paid the fees if they were not paid by the Fund; and
- (b) the records of portfolio transactions maintained by each Fund include, separately for every mortgage transaction effected by the Fund through a HSBC Affiliate
 - (i) the name of the HSBC Affiliate,
 - (ii) the amount of fees paid to the HSBC Affiliate, and
 - (iii) the person or company who paid the fees.

Martin Eady, CA
Director, Corporate Finance
British Columbia Securities Commission