

2004 BCSECCOM 597

October 4, 2004

Headnote

National Instrument 81-105 s. 9.1 *Mutual Fund Sales Practices* - Requirement in section 2.1 - A labour sponsored investment fund wants relief from the provision in s. 2.1 of the Instrument that prohibits a mutual fund from making certain payments to participating dealers. The applicant is registered as a labour sponsored investment fund in Ontario and has applied to be registered as a labour sponsored venture capital corporation under the Income Tax Act (Canada). The prospectus will contain full disclosure about how investors indirectly support the payment of sales commissions; the distribution costs are permitted by and paid in accordance with the Instrument; the applicant would be disadvantaged if the relief were not granted because other labour sponsored investment funds have obtained the relief.

Applicable British Columbia Provisions

National Instrument 81-105 *Mutual Fund Sales Practices*, s. 9.1

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

and

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

and

In the Matter of The Vengrowth III Investment Fund Inc. (the Filer)

MRRS Decision Document

Background

The local securities regulatory authority or regulator (the Decision Maker) in each of the Jurisdictions has received an application from the Filer for a decision under section 9.1 of *National Instrument 81-105, Mutual Fund Sales Practices* (the Legislation) that the prohibition against the making of certain payments by the Filer to participating dealers shall not apply to the Filer;

Under the Mutual Reliance Review System for Exemptive Relief Applications

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- (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

Defined terms contained in National Instrument 14-101 Definitions have the same meaning in this decision unless they are defined in this decision.

Representations

This decision is based on the following facts represented by the Filer:

1. The Filer is a corporation incorporated under the Canada Business Corporations Act by articles of incorporation dated April 26, 2004.
2. The Filer is registered as a labour sponsored investment fund corporation under the *Community Small Business Investment Funds Act* (Ontario) (the Ontario Act).
3. The Filer has applied to be registered as a labour sponsored venture capital corporation under the *Income Tax Act* (Canada) (the Tax Act).
4. The Filer is a mutual fund pursuant to the securities legislation of the Jurisdictions. The Filer is not considered a mutual fund in Québec. The Filer will distribute securities in the Jurisdictions and Québec under a prospectus. The Filer has filed a preliminary prospectus dated July 13, 2004 under SEDAR Project No. 666722 in each of the Jurisdictions and Québec.
5. The Filer will become a “reporting issuer” or equivalent in the Jurisdictions and Québec that have this concept when its prospectus is receipted in such Jurisdictions and Québec.
6. The Filer will invest in small and medium-sized eligible Canadian businesses with the objective of achieving long-term capital appreciation.
7. The authorized capital of the Filer consists of an unlimited number of Class A Shares, 25,000 Class B Shares and 10,000 Class C Shares, of which 100 Class B Shares and 100 Class C Shares are issued and outstanding as of the date hereof.
8. VenGrowth III Capital Management (the Manager) is the sole owner of the Class C Shares of the Filer (the Class C Shares).

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9. The Filer's securities are not listed on any exchange.
10. The Association of Canadian Financial Officers (formerly the Association of Public Service Financial Administrators), the sponsor of the Filer, formed and organized the Filer.
11. As will be disclosed in the Filer's prospectus, the Filer or the Manager will pay the following distribution costs (Distribution Costs) as set forth below:
 - (a) Purchasers of Class A Shares will have the option to select from one of two commission options when purchasing Class A Shares (described in the Filer's prospectus as Option I and Option II). Under either option investors will not pay any sales commissions directly. Under Option I, the dealer from whom the purchaser purchases his or her Class A Shares will be paid a sales commission equal to 6% of the gross proceeds received on a subscription for Class A Shares. The Filer and the Manager have agreed that (subject to termination on 90 days' notice by the Manager) the Manager will pay sales commissions to dealers selling Class A Shares pursuant to Option I. The Manager is compensated by the Filer for the payment of sales commissions (and the provision of various other services) through the fees paid in respect of general and investment management services, funding services, marketing dealer support and ancillary services. These fees enable the Manager to arrange its own financing to pay the sales commissions. Under Option II, there will be no sales commission paid to dealers;
 - (b) The Filer will pay to each dealer having clients holding Class A Shares purchased pursuant to Option I a monthly servicing commission of $\frac{1}{12}$ of 0.50% of the total net asset value per Class A Shares held by those clients. Each dealer having clients holding Class A Shares purchased pursuant to Option II will receive a monthly servicing commission of $\frac{1}{12}$ of 1.25% of the total net asset value of Class A Shares held by those clients. The Filer will pay that part of the servicing commission equal to 0.50% of the total net asset value of Class A Shares that choose Option II and the Manager will pay the remaining 0.75% of such amount (collectively, the servicing commissions paid by the Filer under Option I and Option II being referred to as the Servicing Commission); 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 Filer enters into with such dealers from time to time. For accounting purposes, the

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Filer expenses the Co-op Expenses in the fiscal period when incurred and does not defer or amortize any Co-op Expenses.

12. The structural aspects of the Filer 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 Filer as opposed to, for example, first deducting a commission and remitting the net investment amount to the Filer, 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 Filer. 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 in the manner described above.
13. Due to the structure of the Filer, the most tax efficient way for the Distribution Costs to be financed is for the Filer or the Manager to pay them directly.
14. The payment of commissions on the sale of Class A Shares by the Filer is an event contemplated under the Ontario Act and the Tax Act.
15. As other labour sponsored investment funds have been granted this relief, requiring investors to pay the Distribution Costs would put the Filer at a permanent and serious competitive disadvantage with its competitors.
16. The Filer undertakes to comply with all other provisions of NI 81-105. In particular, the Filer undertakes that all Distribution Costs paid by it will be compensation permitted to be paid to participating dealers under NI 81-105.

Decision

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 Filer shall be exempt from the Legislation in order to permit the Filer to pay the Servicing Commission and the Co-op Expenses directly provided that:

1. The Distribution Costs are otherwise permitted by, and paid in accordance with, NI 81-105;
2. The Filer will in its financial statements expense the Servicing Commission and the Co-op Expenses in the fiscal period when incurred; unless any

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securities laws applicable to the Fund from time to time specifically require accounting treatments other than as described;

3. The summary section of the prospectus of the Filer (the Summary Section) has full, true and plain disclosure explaining to investors that they indirectly support the payment of the sales commission as the Manager pays the sales commissions when a purchaser purchases his or her Class A Shares under Option I but the Manager is compensated by the Filer for the payment of sales commissions (and the provision of various other services) through the fees paid in respect of general and investment management services, funding services, marketing dealer support and ancillary services described in the Summary Section. The Summary Section must be placed within the first 10 pages of the prospectus;
4. The Filer shall include in the Summary Section a summary table of fees and expenses payable by the Filer in the following format:

Summary of Fees, Charges and Other Expenses Payable by the Fund

Type and Amount of Fee

Description

5. The summary table shall also include the annual management expense ratio of the Filer for each of the last five completed financial years of the Filer with a brief description of the method of calculating the management expense ratio and the annual returns of the Filer for each of the last five completed financial years of the Filer;
6. This exemption shall cease to be operative with respect to each Decision Maker on the date that a rule or regulation replacing or amending section 2.1 of NI 81-105 comes into force.

Wendell S. Wigle

Suresh Thakrar

Commissioner
Ontario Securities Commission

Commissioner
Ontario Securities Commission