Autorité des marchés financiers and New Brunswick Securities Commission Staff Notice on Proposed Changes to:

National Instrument 81-106 Investment Fund Continuous Disclosure

Companion Policy to *National Instrument 81-106 Investment Fund Continuous Disclosure*

And Related Amendments

Introduction

The Autorité des marchés financiers (AMF) and the New Brunswick Securities Commission (NBSC) are publishing for a 90-day comment period a notice that sets out the proposed substantive changes specific to investment funds reflected in proposed amendments published by the Canadian Securities Administrators (CSA), except the AMF and the NBSC. The other CSA jurisdictions are publishing these proposed amendments today for a 90-day comment period. They are related to the following regulatory instruments and policies:

- *National Instrument 81-106 Investment Fund Continuous Disclosure* (NI 81-106),
- *Companion Policy to National Instrument 81-106 Investment Fund Continuous Disclosure* (Companion Policy 81-106CP).
- *Form 41-101F2 Information Required in an Investment Fund Prospectus* (Form 41-101F2),
- *National Instrument 81-101 Mutual Fund Prospectus Disclosure* (NI 81-101),
- *Companion Policy to National Instrument 81-101 Mutual Fund Prospectus Disclosure* (Companion Policy 81-101CP),
- *National Instrument 81-102 Mutual Funds* (NI 81-102) and
- *National Instrument 81-104 Commodity Pools* (NI 81-104).

The proposed amendments relate primarily to the upcoming changeover to International Financial Reporting Standards (IFRS) in Canada and need to be in place before January 1, 2011.

The AMF and the NBSC support the proposed amendments. However, because of the legal obligation to publish amending instruments simultaneously in French and English in Québec and New Brunswick, and because the French IFRS terminology is still in a state of flux, publication for comment of amending instruments in these provinces is presently not feasible. It is expected that the AMF and the NBSC will publish for comment corresponding amending instruments, in French and in English, during the first quarter of 2010. Market participants in Québec and New Brunswick are encouraged to comment on the proposed substantive changes presented in this notice, and on the amendments published by the other CSA jurisdictions, that have been posted on the websites of certain securities regulatory authorities.

This notice uses the term "proposed amendments" to refer both to the proposed amendments to NI 81-106, Companion Policy 81-106CP, Form 41-101F2, NI 81-101, Companion Policy 81-101CP, NI 81-102 and NI 81-104 collectively, as they are being published for comment today in the other CSA jurisdictions, and to the proposed corresponding amending instruments, as they are expected to be published for comment during the first quarter of 2010 in Québec and New Brunswick.

Substance and purpose of the amendments

Background

NI 81-106 currently refers to existing Canadian generally accepted accounting principles (GAAP) which are established by the Canadian Accounting Standards Board (AcSB) and published in the Canadian Institute of Chartered Accountants (CICA) Handbook. Following a period of public consultation, the AcSB adopted a strategic plan to move financial reporting for Canadian publicly accountable enterprises to IFRS as issued by the International Accounting Standards Board (IASB). For financial years beginning on or after January 1, 2011, Canadian GAAP for publicly accountable enterprises will be IFRS incorporated into the CICA Handbook.

Purpose

The purpose of the proposed amendments is to accommodate the transition to IFRS. The proposed amendments require investment funds, for financial years beginning on or after January 1, 2011, to prepare financial statements in accordance with Canadian GAAP applicable to publicly accountable enterprises and to report compliance with IFRS. The AMF, the NBSC and the other CSA jurisdictions (or "we") are also proposing to update the accounting terms and phrases in the NI 81-106 to reflect that, for financial years beginning on or after January 1, 2011, Canadian GAAP for publicly accountable enterprises will be IFRS incorporated into the CICA Handbook.

The proposed amendments to NI 81-106 are consistent with the CSA's proposal to repeal and replace *National Instrument 52-107 Acceptable Accounting Principles, Auditing Standards and Reporting Currency* (to be renamed *Acceptable Accounting Principles and Auditing*

Standards) (NI 52-107), published for comment on September 25, 2009. The proposed amendments are also consistent with proposed changes to *National Instrument 51-102 Continuous Disclosure Obligations, National Instrument 41-101 General Prospectus Requirements* and *National Instrument 14-101 Definitions* also published for comment by the CSA, except the AMF and the NBSC, on September 25, 2009.

The changeover to IFRS will also result in certain consequential amendments to other rules and forms applicable to investment funds, including the prospectus rules (Form 41-101F2 and *National Instrument 81-101*, including Form 81-101F1 *Contents of Simplified Prospectus*).

The proposed amendments are not intended to substantively alter securities law requirements, but the adoption of IFRS will change the accounting principles currently used by investment funds, and will impact the presentation of financial statements. The proposed amendments cover terminology differences between Canadian GAAP and IFRS, and also reflect changes to financial statement presentation stemming from the adoption of IFRS. Two of the major changes that impact investment funds are the classification of securities issued by investment fund and consolidation.

Classification of Investment Fund Securities (Puttable Instruments)

International Accounting Standard (IAS) 32 *Financial Instruments: Presentation* classifies a puttable financial instrument as a financial liability, unless the instrument has certain features, in which case it is classified as an equity instrument. Generally, puttable instruments are securities which are redeemable by the securityholder[1]. As most investment funds issue redeemable securities, investment funds will have to determine if their securities are puttable instruments, and if so, whether they should be classified as financial liabilities or as equity instruments.

Currently, NI 81-106 contemplates that securities issued by investment funds are usually classified as equity. The proposed amendments alter some of the line items in the financial statements to accommodate either an equity or liability presentation. The proposed amendments attempt to keep the financial statement presentation as consistent as possible, regardless of whether the investment fund's own securities are classified as equity or liability under IFRS. For example, the proposed amendments allow an investment fund to disclose either total equity (if the fund's own securities are classified as equity) or net assets attributable to securityholders (if the fund's own securities are classified as liabilities).

While the classification of an investment fund's own securities as either equity instruments or financial liabilities will affect the presentation of the financial statements, we do not expect it to impact other aspects of investment fund disclosure such as performance or management expense ratios.

We are seeking feedback on this approach to the classification of the securities issued by investment funds.

Consolidation

Under current Canadian GAAP, the requirement to consolidate (Accounting Guideline 15 *Consolidation of Variable Interest Entities*) does not apply to investment funds that account for their investments at fair value in accordance with Accounting Guideline 18 *Investment Companies* (AcG-18). Generally, AcG-18 requires investment funds to measure their portfolio assets at fair value and present them on this basis in their financial statements.

Current Canadian GAAP differs from IFRS as IAS 27 *Consolidated and Separate Financial Statements* applies to all entities including investment funds. Paragraph 16 of IAS 27 stipulates that "a subsidiary is not excluded from consolidation simply because the investor is a venture capital organisation, mutual fund, unit trust or similar entity."

The IASB is currently reviewing the consolidation requirements under IFRS. The IASB published Exposure Draft 10 - *Consolidated Financial Statements* (ED 10) for comment in December 2008. Investment funds are included in the scope of the proposed revised standard which is expected to be issued later this year. The objective of ED 10 is to clarify the definition of control in IFRS and to provide more specific application guidance. The interpretation of "control" could lead to situations where investment funds may have to consolidate underlying investments.

Some respondents to the IASB's request for comments on ED 10, including members of the Canadian investment fund industry, asked the IASB to reconsider the application of the consolidation standard to investment funds. Some respondents noted that consolidation does not provide meaningful, relevant information to readers of the financial statements. These respondents are of the view that investment funds should always measure and present their investments at fair value, whereas consolidation could result in underlying investments being presented using another valuation method employed by the subsidiary (for example, at cost). In 2009, the CICA published a research report, *Financial Reporting By Investment Funds* (Second Edition)[2], which outlines a study group's views on financial reporting issues that may arise from the changeover to IFRS for investment funds, including the preparation of consolidated financial statements.

It is unclear how many investment funds will have to prepare consolidated financial statements under IFRS given certain restrictions, either in securities law or the investment fund's own policies, on their ability to control or become involved in the management of issuers in which they invest. However, the proposed definition of control in ED 10 will result in some investment funds concluding that they have to consolidate certain portfolio investments when preparing their financial statements under IFRS. This could be a significant change in a long-standing Canadian accounting practice and affect the presentation of investment fund financial statements.

Consolidation for investment funds is an important issue which the CSA will continue to monitor. Currently, it appears that under IFRS, investment funds may be required to present consolidated financial statements, but the specifics of this requirement will not be known until

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[1] This document is periodically updated by the CICA. The latest version currently available is dated July 2009.

the IASB publishes its decision with respect to ED 10. Until then, the proposed amendments to NI 81-106 contemplate that:

- investment funds will prepare and file consolidated financial statements (other than the statement of investment portfolio), if required by IFRS
- the statement of investment portfolio will be prepared on a non-consolidated basis
- the statement of investment portfolio will be audited
- the financial highlights in the management reports of fund performance will be presented on a non-consolidated basis.

We are seeking feedback on this approach to consolidation for investment funds. We would like specific information about the impact of consolidation on Canadian investment funds, including your analysis and determination of how this standard will be applied and the consequences to the presentation of the financial statements.

We also invite focused comments on the ability of investment funds to prepare the statement of investment portfolio on a non-consolidated basis, and to have this statement audited in accordance with Canadian GAAS using a fair presentation framework. In addition, will the proposed requirement to explain differences between the statement of investment portfolio and the statement of financial position result in useful disclosure about the relationship between these two statements? If not, would a numerical reconciliation achieve this result?

We are of the view that the consolidation requirement will not impact the calculation of net asset value, as this must continue to be done using the fair value standard established in NI 81-106. However, the requirement to consolidate could result in additional differences between net assets (as shown on the financial statements) and net asset value, which could impact the reconciliation of these amounts required to be disclosed in the notes to the financial statements. Please consider whether this will result in any additional presentation issues.

Comments

We request your comments on the proposed amendments outlined above. Please provide your comments in writing by [January 14, 2010]. If you are not sending your comments by email, an electronic file containing the submissions should also be provided (Windows format, Word).

Deliver your comments **only** to the following address. Your comments will be distributed to the other participating CSA member jurisdictions.

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Please note that comments received will be made publicly available and posted at www.osc.gov.on.ca and the websites of certain other securities regulatory authorities. We cannot keep submissions confidential because securities legislation in certain provinces requires that a summary of the written comments received during the comment period be published.

Questions

Please refer your questions to any of:

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