

Investment Products & Wealth Management Bulletin

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Ontario Securities Commission releases OSC Staff Notice 33-733 - *Report on Focused Reviews of Investment Funds, September 2008 - September 2009*

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On January 19, 2010, the Ontario Securities Commission (OSC) released Staff Notice 33-733 – Report on Focused Reviews of Investment Funds, September 2008 – September 2009.

The report summarizes the compliance review conducted by staff of the OSC from September 2008 to September 2009 in response to concerns emerging from the market turmoil experienced by the global financial services industry.

The OSC reviewed three major segments of the Canadian investment fund industry namely (i) money market funds; (ii) non-conventional investment funds (including open-end and closed-end funds listed on the Toronto Stock Exchange such as split share corporations, actively managed funds, index tracking funds and structured products based on credit related derivatives); and (iii) hedge funds.

The primary focus of the OSC was to assess fund managers' compliance with Ontario securities laws. The OSC gathered information about the funds' portfolio holdings, exposure to distressed and/or illiquid assets, valuation methodologies, and how the managers managed the risk of large redemptions during the market downturn. The OSC

findings were gathered from questionnaires and observations from on-site visits.

The report also sets out suggested practices of the OSC. The OSC encourages fund managers to use the report as a self-assessment tool to strengthen compliance with Ontario securities laws and to improve their systems of internal controls and supervision.

The OSC's review of money market funds focused on the following areas: (i) compliance with National Instrument 81-102 restrictions; (ii) portfolio holdings; (iii) redemption risk; (iv) valuation of portfolio securities; and (v) changes in fees and expenses.

In its review of non-conventional investment funds, the OSC focused on the following areas: (i) response to the market turmoil; (ii) counterparty, credit and financial sector exposure; (iii) level and valuation of illiquid assets; and (iv) investor communication and continuous disclosure.

The OSC's review of hedge funds focused on the following areas: (i) custody; (ii) portfolio holdings; (iii) leverage usage

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and monitoring; (iv) prime broker/counterparty exposure; (v) monitoring of funds of hedge funds; (vi) liquidity or viability issues; (vii) fund valuation; (viii) use of service providers; (ix) offering document disclosure; (x) other regulatory compliance matters and (xi) comparison of fund manager practices to best practices suggested by Alternative Investment Management Association.

The OSC reported that despite the overall market downturn and its impact on the returns of many of these products during the review period, the OSC did not observe any industry-wide compliance issues.

For more information and a detailed list of the OSC's suggested practices, please see the complete report at http://www.osc.gov.on.ca/documents/en/Securities-Category3/sn_20100119_33-733_rpt-rev-inv-funds.pdf.

For more information on the subject of this bulletin, please contact the author.

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