



# PRACTICE NOTE 12

## EXEMPTIVE RELIEF ORDERS AND NON-REPORTING ISSUER FUNDS' USE OF AN IRC

### Introduction

The National Instrument 81-107 (“**NI 81-107**” or the “**Instrument**”) has been in force since November 2007 and has worked well for reporting issuer funds. Recently, two exemptive relief orders have been sought by and granted to managers of non-reporting issuer funds (the “**Manager**”) and another similar decision is expected in the February/March timeframe. In each case, the applicable Securities Commission required that a form of Independent Review Committee (“**Specialized IRC**”) be established to deal with the specific conflict of interest matter identified by the Manager. These orders have come from three different Securities Commissions creating an accepted, albeit limited, practice of the Commissions. IRI has worked with the Managers and their counsel in these three cases to draft language to address issues facing the Manager as well as the potential Specialized IRC members.

Each of the exemptive relief orders have involved issues of related party transactions; however, the principles set out in the exemptive relief orders are applicable to any transaction that might have involved an independent review committee of reporting issuer funds.

Since the funds are non-reporting issuers, NI 81 – 107 does not apply. Accordingly, the Specialized IRCs are entirely the creatures of the exemptive relief order. In this Practice Note, IRI will set out the matters to be considered in order to ensure that the Specialized IRC is set up correctly and in compliance with the exemptive relief order.

### Establishing a Specialized IRC through an Exemptive Relief Order

#### 1. Sections imported into the Exemptive Relief Order

- A. Section 3.7 To form the Specialized IRC, the Managers and their counsel wisely imported the bulk of Section 3.7 of the Instrument. Accordingly, the exemptive orders indicate that” the IRC will be composed in accordance with section 3.7 of NI 81-107”.<sup>1</sup>

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<sup>1</sup> 3.7 Composition (1) An independent review committee must have at least three members. (2) The size of the independent review committee is to be determined by the manager, with a view to facilitating effective decision-making, and may only be changed by the manager. Every independent review committee member must be independent. An independent review committee must appoint a

- B. Section 3.9 Another major benefit of the Instrument are the default statutory protections under section 3.9. Since the non-reporting issuer funds are not subject to the Instrument, an IRC constituted under these exemptive relief orders cannot avail itself of the statutory protections unless inserted properly into the exemptive relief order. The Commissions have been generally amenable to clear and comprehensive language to give the Specialized IRCs the benefit of these statutory protections.
- C. Section 6.2 As these cases have involved related party investments some of the exemptive relief orders have imported the relevant parts of Section 6.2. Interestingly, some of the decisions have not explicitly required that the Manager comply with the provisions of section 6.2. In IRI's view, it is important to require compliance with this section to the extent possible given that the fund is a non-reporting issuer.

## 2. *Limited Mandate*

- A. Time: Generally speaking, the mandates for the Specialized IRCs tend to be based on the need to manage a particular transaction either for a short period of time (imminent transaction) or for a limited period of time which can extend over a few years. It is important to establish at the outset when the mandate ends so that it is clear when the Specialized IRC has completed its assignment.
- B. Scope: One should be careful to draft the language of the Exemptive Relief Order to catch the specific matter at hand as well as any ancillary matters that may impact the holding or transaction. The language in one order read; .... (ii) *"to review other matters referred to the IRC by the Filer in accordance with Section 5.1 of NI 81-107, as if the Fund were subject to NI 81-107."* This is very broad language. In fact, it is broader language than applied to the subject transaction in that exemptive relief order.
- C. Due Diligence: Conducting the detailed due diligence may be somewhat difficult given the time constraints often imposed by these types of exemptive relief orders. Therefore given the limited amount of time for the Specialized IRC to conduct its due diligence on the Manager, its principals, the fund and the transaction itself, IRI's experience in doing so can help streamline the due diligence process and assist in managing the worked on the Specialized IRC. In essence, one needs to work within the Manager's timeline while not short-circuiting this very important step.

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*member as Chair. And (5) The Chair of an independent review committee is responsible for managing the mandate, and responsibilities and functions, of the independent review committee*

- D. Compensation for IRC Members: As the terms of the Exemptive Relief Order show, the Manager is not required to have an independent review committee on an ongoing basis and only needs a Specialized IRC for the limited mandate at hand. Accordingly, it is important to ensure that compensation is appropriate given the circumstances. Indeed, compensation may become a matter of some negotiation. The economics of the particular transaction need to be balanced against the cost of the set-up and ongoing costs of the Specialized IRC. Where the mandate is ongoing and may have the open language noted above, the Specialized IRC may wish to consider a combination of a retainer and a more significant per meeting fee.

### *3. Liability and Insurance*

As the Specialized IRC will be accepting the potential liability with a new and unknown client with whom it has no experience, it is important to consider insurance. Many insurers are reluctant to take on these very short-term assignments where they have specific liability but a short timeframe to lay off the risk and therefore will collect a relatively small amount of fees against that perceived risk. IRI has found that it has been able to insure the IRC members through the Manager's D & O and E & O insurance. However, it is incumbent on the IRC members to ensure that adequate coverage exists under the Manager's insurance.

## **Best Practice**

While the matters below are not specified in the exemptive relief order, IRI considers them to be best practice in these situations. IRI visited one of the Commissions and discussed drafting a written charter and an Annual Report to Securityholders in the circumstances. They were generally in agreement with our approach.

### *1. Written Charter*

IRI has taken the view that while the Exemptive Relief Order usually establishes a Specialized IRC under section 3.7 of the Instrument and incorporates the statutory provisions of 3.9 of the Instrument, a written charter should be drafted to establish and describe all of the other rules and codes of conduct by which the Specialized IRC and the Manager have agreed to abide.

### *2. Annual Report to Securityholders*

An Annual Report to Security holders should be prepared after the completion of the mandate where the Specialized IRC was set up to handle a one-time transaction, or annually where the mandate might be ongoing. While the Instrument requires its publication on the Manager's website, a Manager may choose to mail the annual report where the non-reporting issuer funds have fewer than 50 unitholders.



### 3. Certification

The exemptive relief orders have generally required that the Specialized IRC of the Fund approve the transaction in accordance with subsection 5.2(2) of NI 81-107. IRI's practice is to not only ensure that the transaction is conducted in compliance with that section, but to ask the Manager to sign a certification incorporating all the elements of that section and certain elements referred to in the Crown Hill decision.<sup>2</sup>

### 4. The Minutes of the IRC Meeting

The matters raised above spill into the approach that IRI takes to the drafting of the minutes, especially where it is a one transaction mandate. IRI tends to create more comprehensive minutes since there is no shared history with the Manager. The Minutes also enumerate the facts buttressing the elements set out in section 6.2 regarding related party transactions as having been met by the Manager.

In any referral made by the Manager, there is a requirement for the Manager to prepare a memorandum setting out the facts of the case and describing why the Specialized IRC should grant the relief requested. As these transactions have to stand on their own, the Specialized IRC should work closely with the Manager to ensure that the memorandum and any appended schedules are as comprehensive as possible in order to take full advantage of the statutory protections under section 3.9 of the Instrument.

## Conclusion

Over the past several years, IRI has seen the Securities Commissions granting exemptive relief that stretches beyond the four corners of the Instrument. The Commissions are now allowing non-reporting issuer funds to avail themselves of the benefits of the Instrument to conduct and manage transactions that would otherwise be prohibited by securities legislation. In our view, IRI can add value by being brought in early in the process to assist the Manager and counsel as they develop the relief in the exemptive relief order and thereafter to assist the Manager and the Specialized IRC members to successfully manage the conflict of interest. IRI can ensure that the application for the exemptive relief order is drafted to make the Specialized IRC process manageable on a practical footing and well defined.

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<sup>2</sup> [Crown Hill Decision](#) (Re) (2013), 36 OSCB 8721.



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**To discuss your needs please contact Michelle McCarthy, Geoff Salmon or Leslie Deschamp at IRI on 416-849-1928**

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