

OSC

ONTARIO
SECURITIES
COMMISSION

OSC Staff Notice 81-733

Summary Report for Investment Fund and Structured Product Issuers

October 19, 2022



Ontario

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Director's Message

I am pleased to share this overview of the activities of the Investment Funds and Structured Products Branch (**IFSP**) of the Ontario Securities Commission (**OSC**) during this continuing period of unprecedented change and challenges. This Summary Report (**Report**) will cover the activities of IFSP during the 2021-2022 fiscal year.

The OSC is strongly committed to its mandate of investor protection. Investor profiles are diverse and wide-ranging, as are the investment fund products available today. More than ever, investors can benefit from competitive investment funds and product choices to meet their financial goals. We continue to facilitate investment fund offerings which provide different market and asset class exposure, objectives, and portfolio and risk management skills. Traditional and innovative products alike are reviewed to ensure that there is appropriate transparency to allow investors to make informed investment decisions. We enhanced consultation and communication with industry stakeholders to ensure emerging issues are managed to protect the interests of investors, while acknowledging and facilitating the innovation in the capital markets.

I am very proud of the accomplishments of IFSP during this fiscal year. I am even more proud of how IFSP worked collaboratively with stakeholders, recognizing different views, and embracing new skills and approaches, to accomplish our goals. I want to thank IFSP staff for their dedication and passion in their work.

Throughout the pandemic, the investment funds industry has continued to show its resilience and innovation. During the period of significant market volatility which occurred at the onset of the pandemic in March 2020, no public funds suspended redemptions and assets under management (**AUM**) were able to rebound over the course of several months. IFSP issued final prospectus receipts in connection with several novel investment funds, including those with exposure to crypto assets which were the first of their kind in the world. As we do with all novel products, IFSP is continuing to monitor developments in crypto asset funds closely.

Environmental, social and governance (**ESG**) funds are another emerging area which IFSP prioritized this year. OSC and IFSP staff have been extensively involved in domestic and international initiatives on disclosure practices related to ESG products and investor protection concerns. As a result of these initiatives, the Canadian Securities Administrators (**CSA**) published CSA Staff Notice 81-334 *ESG-Related Investment Fund Disclosure*. With this first milestone for ESG-specific regulation of investment funds in Canada, we are hopeful that this guidance will bring greater clarity to ESG-related fund disclosure and sales communications and enable investors to make more informed investment decisions about ESG products.

In the policy area, IFSP has continued to work on rule proposals and amendments that align with our commitment to burden reduction while maintaining investor

protection. After years of consultation and collaboration, a series of amendments came into effect during the period which eliminate duplication, streamline regulatory processes, and codify frequently granted exemptions from certain requirements for investment fund issuers. Another notable achievement in the policy area is the ban on the deferred sales charge option which now harmonizes Ontario with the rest of the CSA.

Finally, IFSP is excited to be working with the new Digital Solutions Branch to use internal and external data to operationalize our oversight of larger market risks. Data obtained from the annual Investment Fund Survey will be a key input in developing a risk framework to help us identify higher risk issuers using key performance indicators.

We hope you find this Report helpful and informative. As always, if you have a question, comment, or would like to discuss regulatory matters, please reach out to us. Our [Staff Contact Information](#) has been included for your convenience.

Raymond Chan
Director, IFSP
Ontario Securities Commission

Part A: Introduction

This Report provides an overview of the key activities and initiatives of the IFSP Branch that impact investment fund and structured product issuers, and is organized into four broad areas:

1. Operational highlights

- I. Prospectus filings
 - i) Pre-file process
 - ii) Data on prospectus filings
 - iii) Novel prospectus filings
 - iv) ESG-related funds
- II. Exemptive relief applications
 - i) Data on exemptive relief applications
 - ii) Novel exemptive relief applications
- III. Continuous disclosure reviews
 - i) Summary of completed reviews

2. Regulatory policy initiatives

3. Emerging issues and initiatives

4. Stakeholder outreach

These activities were conducted within the scope of IFSP's responsibilities and structure which are briefly described below, along with market composition data to provide context on the scale of the industry.

Responsibilities of the IFSP Branch

The OSC's mandate is to protect investors from unfair, improper or fraudulent practices, to foster fair, efficient and competitive capital markets and confidence in the capital markets, to foster capital formation, and to contribute to the stability of the financial system and the reduction of systemic risk.

In support of the OSC's mandate, the IFSP Branch is responsible for administering the regulatory framework for investment funds and structured products, including linked notes and scholarship plans, that are sold to Ontario investors. Ontario-based publicly offered investment funds account for over 80% of the approximately \$2.39 trillion in publicly offered investment fund assets in Canada which are comprised of conventional mutual funds, non-redeemable investment funds, exchange traded funds (**ETFs**), and alternative mutual funds.

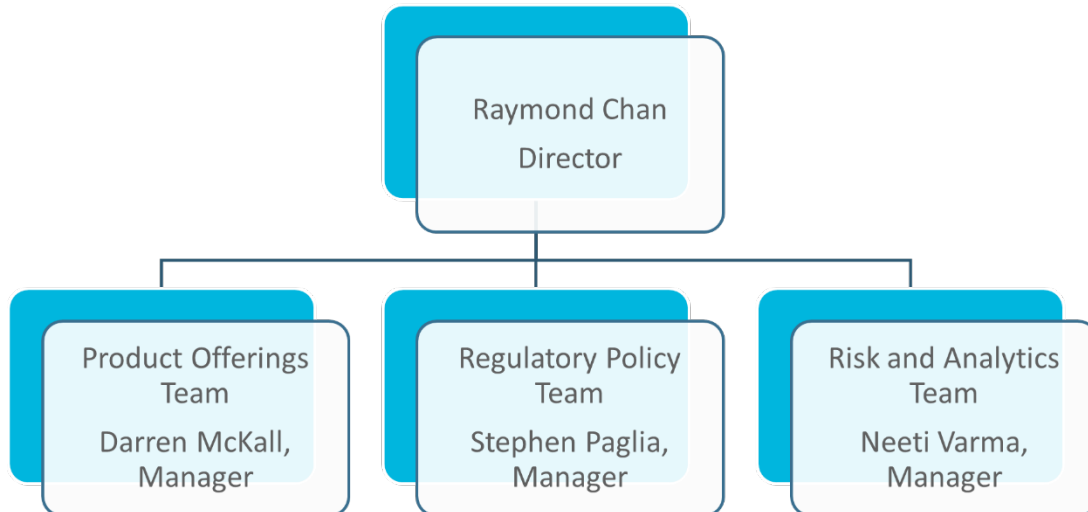
Our key functions include

- reviewing and assessing product disclosure for all types of investment funds,
- considering applications for discretionary relief from securities legislation,
- developing new rules and policies to adapt to changes in the investment funds industry,

- using data sources to identify and monitor risks, and
- monitoring and participating in investment fund regulatory developments globally, primarily through our work with the International Organization of Securities Commissions (**IOSCO**).

Structure of the IFSP Branch

In 2020, the IFSP Branch was reorganized from one operational group into three dedicated teams with the objective of streamlining and improving processes and proactively assessing and monitoring risks. Each team has its own Manager and staff which may include lawyers, accountants, a financial examiner, review officers, a business and market analyst and administrative assistants. The new structure is presented below:



Product Offerings Team

The Product Offerings team is responsible for reviewing all investment fund and structured note product filings. By streamlining the review of prospectuses and applications onto one team, the IFSP Branch is building efficiencies and identifying redundancies to improve the filings process while developing product offering expertise. On novel filings, members of the team interact directly with the CSA Investment Funds Operations Committee to brief and resolve any issues raised.

The OSC currently has a [Service Commitment](#) document on its website that sets out stakeholder expectations and service standards. The IFSP Branch is committed to ensuring that services are delivered efficiently and effectively, and in accordance with those standards. The service standards include timelines for prospectus filings and amendments, and the review of exemptive relief applications.

Regulatory Policy Team

The Regulatory Policy team is responsible for policy initiatives affecting investment funds and often collaborates with its CSA counterparts in other jurisdictions to work on rule proposals and amendments. The policy process includes research in the form of stakeholder consultations, drafting consultation papers and reviewing industry comments on proposed rules and amendments before final approvals and publication.

The team also monitors, reviews, and assesses regulatory proposals and product developments in Canada and abroad to determine possible impacts on our regulatory regime. The team regularly consults with industry associations, investor advocacy groups and OSC advisory committees on policy matters.

Risk and Analytics Team

The objective of the Risk and Analytics team is to assess and monitor the investment funds industry using risk and data analytics. The team considers available data to develop a risk-based approach to oversee this large segment of the market in an efficient and effective manner.

The team has three key functions:

- Assess and monitor risks at the enterprise level and the industry level
- Gather key data on the investment funds industry through internal and external sources, such as the Investment Fund Survey
- Quality control
 - Monitoring and reporting on internal processes
 - Developing and maintaining policies and procedures for key processes

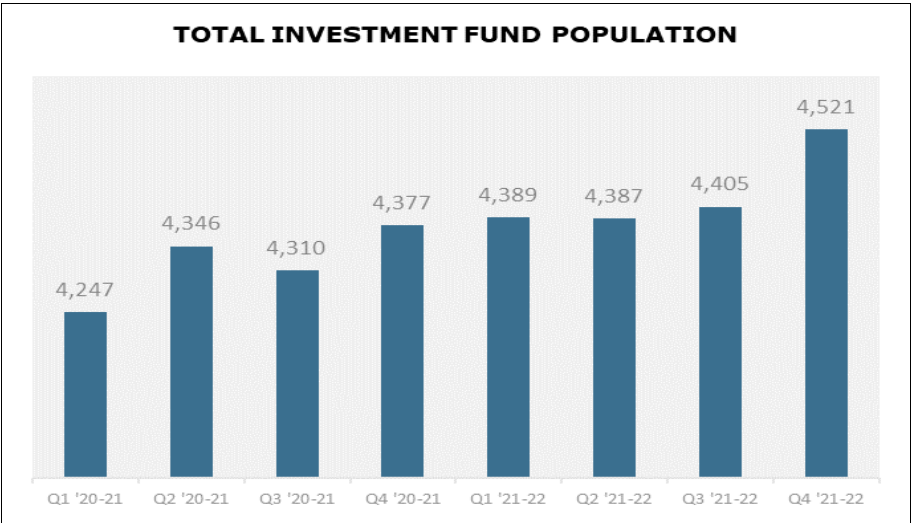
Market Composition

Investment funds in Canada currently have about \$2.39 trillion in AUM¹:

INVESTMENT FUND PRODUCTS	AUM as of March 31, 2022	Approximate % of Investment Fund AUM
Conventional Mutual Funds	\$2.0 trillion	84%
ETFs	\$352.8 billion	15%
Closed End Funds	\$36.8 billion	1%

Structured notes outstanding as of March 31, 2022 are approximately \$21.7 billion.

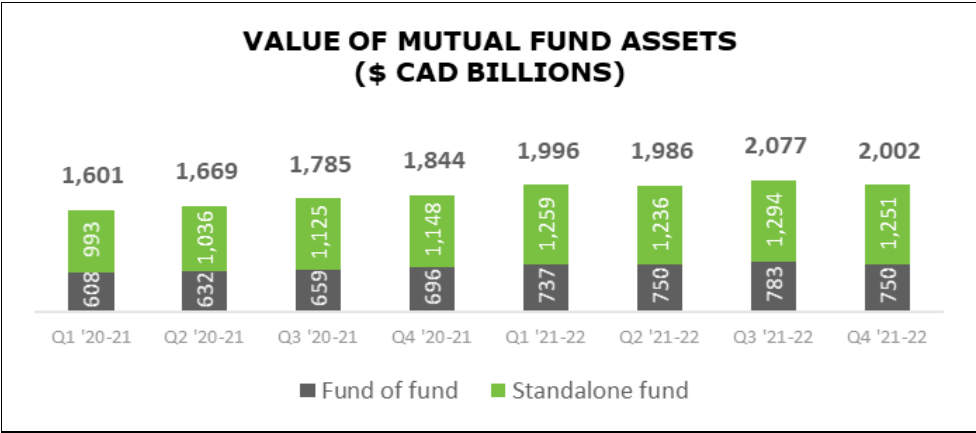
¹ Mutual funds and ETFs AUM obtained from Investor Economics and closed end fund AUM from TSX



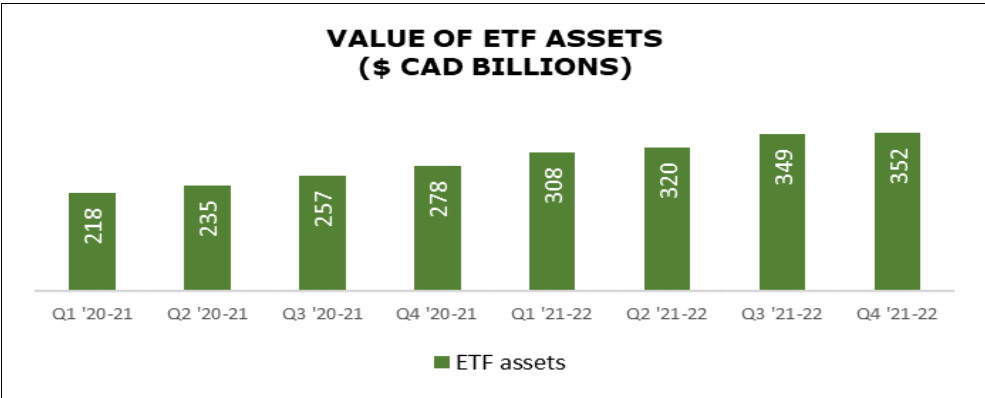
Source: Internal reporting issuer database showing investment funds active in Ontario

The creation of new ESG funds has remained steady at double digit growth through fiscal 2021/2022, ending the fiscal year with ESG funds making up 23% of new funds.

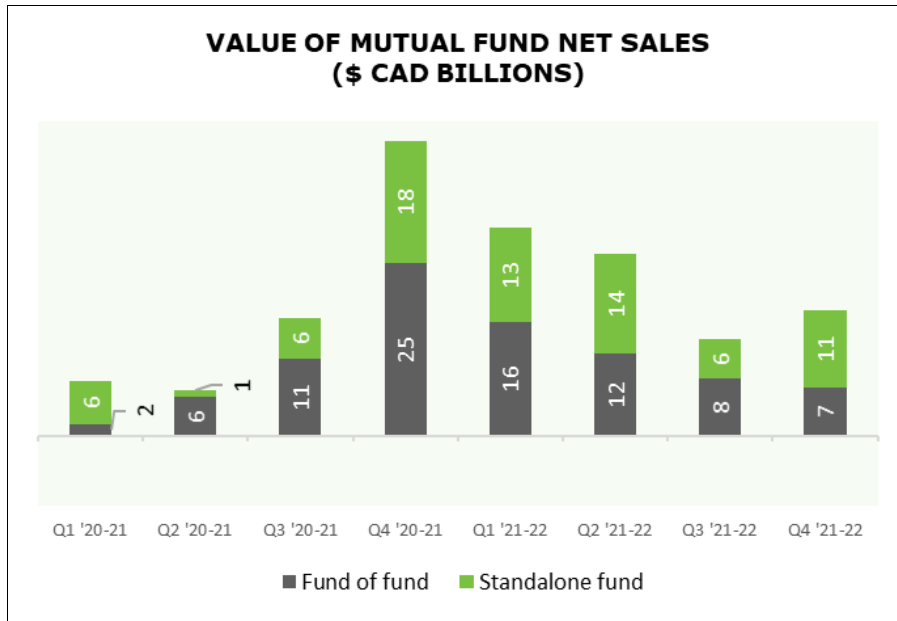
Comparatively, the creation of new crypto asset funds has steadily declined making up less than 5% of new funds for the fiscal year.



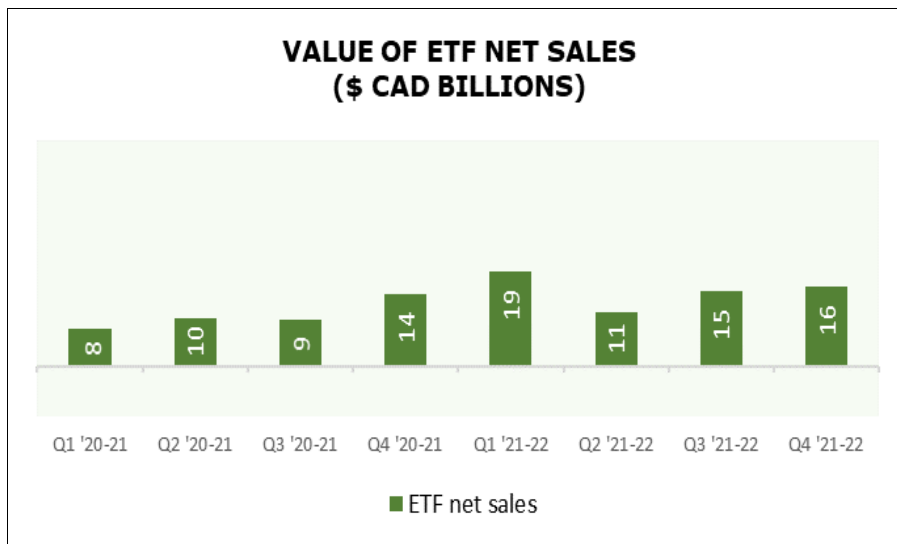
Source: Investor Economics



Source: Investor Economics



Source: Investor Economics



Source: Investor Economics

Consistent with the trend in the rising number of ESG investment funds, there has been a significant increase in ESG net sales in the last two years. In 2021, ESG net sales totalled \$13.2 billion, which represented 11.7% of total industry net sales, and ESG ETF net sales totalled \$4.2 billion, or 7.2% of total industry net sales.²

²IFIC 2021 Investment Funds Report

Part B: Operational Highlights

I. Prospectus Filings

One of our key operational functions is the intake and review of prospectuses and supplements in connection with the distribution of publicly offered investment funds and linked notes. Under Canadian securities law, an issuer must file and obtain a receipt for a prospectus to “distribute” securities to the public or rely upon a prospectus exemption.

Prospectus filings are categorized by IFSP into one of three review types: standard, issue-oriented or full review. Most prospectus filings are subject to standard review, as these generally relate to investment funds that are already in distribution and have been previously reviewed. An issue-oriented review targets a specific issue with the filing while a full review is undertaken when the prospectus is for a new fund or product that has features or characteristics that could raise novel issues. These filings may also be accompanied by a related application for exemptive relief.

Pre-File Process

For unique or novel products, we recommend that filers use the confidential pre-file process for prospectus and exemptive relief applications. Many filers who wish to launch a novel type of product in the market have used this process as it maintains the confidentiality of the product offering as the regulatory issues are resolved.

The pre-file process is optional and can be opted out of at any time by the filer by making a public filing. It can provide issuers with greater assurance and flexibility in planning the launch of a novel product. This process supports innovation in the capital markets by providing a mechanism for issuers to develop new products and seek staff’s feedback without publicly disclosing details of those new products.

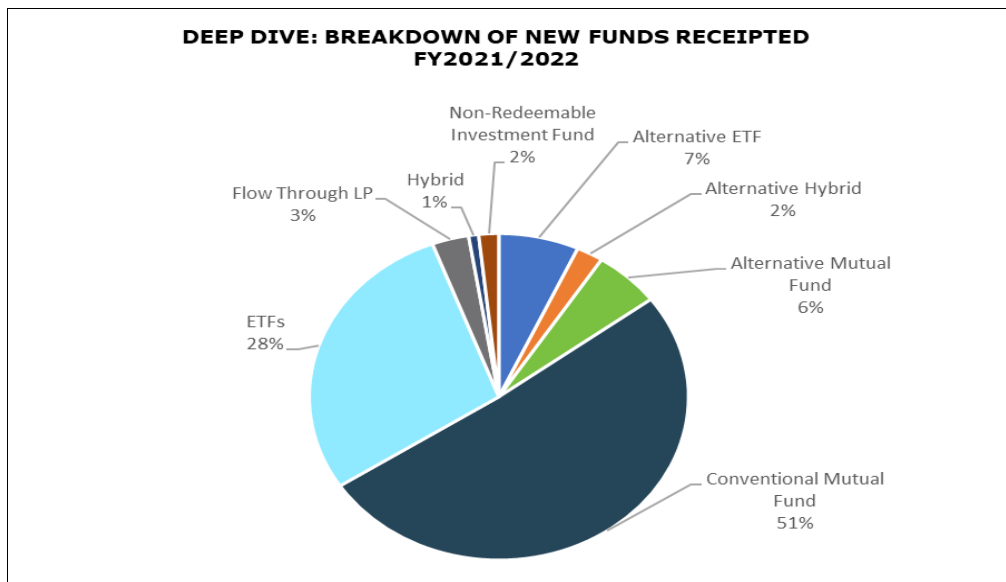
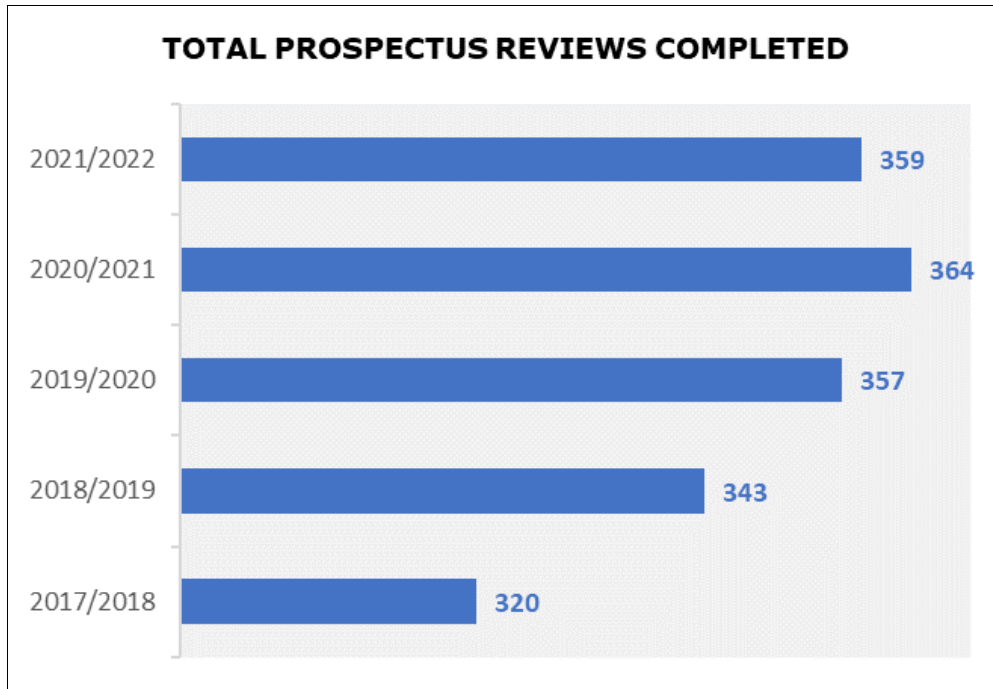
Review timelines for pre-filings progress as they would for a novel public filing and are not subject to the service standards. How quickly the pre-filing is resolved depends on several factors: the completeness and quality of the materials submitted, the complexity or novelty of the issues raised in the filing, the responsiveness of the issuer to staff’s comments, and discussions with other CSA jurisdictions. All else being equal, filings whether pre-filed or not, are reviewed on a first-in, first-out basis. Staff work to ensure that all similar and concurrent filings are dealt with fairly based on these factors.

The pre-filing process concludes when all issues identified during staff’s review of an issuer’s pre-filing have been resolved. The filer is then able to make a public filing. Staff work to issue a “no comment” letter on the public filing as quickly as possible and clear the issuer to file its final prospectus after ensuring that the filing is consistent with the pre-filed materials. We encourage filers to provide a separate cover letter (that will be made public) that references the pre-filing and its date to assist in staff’s ability to issue a comment letter promptly. The review of the

preliminary prospectus may be assisted by providing a clear blackline to the pre-filing.

Fees charged in connection with a prospectus pre-filing are applied to the fees due upon the public filing of the preliminary prospectus or exemptive relief application.

Data on Prospectus Reviews



Novel Prospectus Filings

Some of the novel prospectus filings that were receipted during the fiscal period are summarized below, along with details on any related exemptive relief.

Crypto Asset Funds

During the fiscal year, IFSP issued final prospectus receipts in connection with five funds that hold substantially all their assets in ether. Four of these funds are exchange-traded funds, which were the first of their kind in the world, and one is a conventional mutual fund that is exposed to ether through a fund-of-fund structure. These funds are similar to the bitcoin ETFs that launched in the last quarter of the prior fiscal year.

As with all novel prospectus filings, the risk profile of the product is considered to determine the adequacy of the risk disclosure to investors and if any related exemptive relief is required. As innovation in this asset class continues, additional ETFs were recently launched that hold substantially all their assets in bitcoin or ether. However, for the first time, the ETF's market makers will be able to pay the subscription price of new creation units of the ETF in bitcoin or ether, as applicable. The related exemptive relief is subject to several conditions, including that the ETFs will only accept subscriptions in-kind from market makers that source their crypto assets on platforms registered in the U.S. and in Canada that adhere to know your client and anti-money laundering regulations.

In total, there are 23 public investment funds with crypto asset exposure in Ontario offered by eight investment fund managers (**IFMs**), with assets under management totaling approximately \$6.9 billion.³ 17 of these funds were receipted during the fiscal year.

Income for Life Fund

During the fiscal year, a novel mutual fund product offering of an "income for life" option was receipted. The product was pre-filed and subject to extensive discussion with the CSA. This fund is designed for investors who are at, or approaching, retirement and aims to offer longevity risk protection for investors that anticipate a lengthy lifespan and are concerned about having sufficient income in the later years of their life.

The lifetime payments on the units are funded primarily through investment returns generated by the fund's portfolio and forced redemptions due to mortality. Investors who survive longer than the average person in their age cohort earn a "longevity benefit", which is reflected in ongoing annual increases to the lifetime income payments.

The CSA granted [exemptive relief](#) to the fund to permit it to calculate the redemption price of a security of a class of the fund at a price that may be less than

³ As of March 31, 2022.

the net asset value (**NAV**) per security of that class, with specific disclosure requirements related to this feature. The decision also permits the fund facts document to include certain charts intended to assist investors in understanding the unique investment objective of the fund and assessing the appropriateness of the fund for their needs.

Interval Fund

The first interval fund was receipted by the CSA and is similar to the interval funds that have been available in the United States. The review of this non-redeemable investment fund was subject to an extensive pre-filing process with the filer and the CSA. As an “interval fund”, it is structured to offer its units for purchase on a monthly basis and offers to repurchase units (effectively, redeem) on a quarterly basis. The repurchases are capped at 5% of its NAV per quarter. Investors will be paid out on a pro rata basis if the repurchase offer is oversubscribed.

The CSA granted [exemptive relief](#) to allow the fund to invest in illiquid private credit assets. Given the type of investments and the limited redemption features of the fund, the fund is for long-term investors who can bear the risks associated with the limited liquidity of the units. The fund is only distributed by dealers who are registered with the Investment Industry Regulatory Organization of Canada (**IIROC**).

The exemptive relief is subject to several conditions, including that an independent valuator must be used to calculate the monthly NAV of the private credit assets of the fund and that the prospectus and fund facts document for the fund has text box disclosure that highlights the unique features of the fund. The exemptive relief is subject to a five-year sunset clause.

Carbon Credit Futures Funds

Two IFMs launched funds with investment objectives to invest their assets in listed futures that reference carbon credits. These carbon credits (also known as carbon allowances) are tradeable credits that are used by companies in a “cap and trade” carbon emissions regime to offset their emissions output for the purposes of complying with emissions limits under the program. These funds specifically invest in futures that reference the largest and most liquid credit programs in the world: The EU Allowance, the California Carbon Allowance and the Regional Greenhouse Gas Initiative Allowance. The futures are standardized futures that trade on the ICE Exchanges, however, there are similar programs launching in other jurisdictions (including China) soon that will likely expand this market considerably.

This is a new asset class for retail funds in Ontario and a relatively new fund strategy worldwide, being used by only a small number of funds which mostly launched within the last few years. However, the futures in which these funds invest have over a decade of trading history, having launched shortly after the respective cap and trade programs and are highly liquid.

ESG-Related Funds

On January 19, 2022, the CSA published [CSA Staff Notice 81-334 ESG-Related Investment Fund Disclosure](#) (the **ESG Staff Notice**). The ESG Staff Notice provides guidance for investment funds on their disclosure practices as they relate to ESG considerations, particularly funds whose investment objectives reference ESG factors and other funds that use ESG strategies (**ESG-Related Funds**).

The purpose of the guidance is to enhance the ESG-related aspects of the funds' regulatory disclosure documents and to ensure that the sales communications of such funds are not untrue or misleading and are consistent with the funds' regulatory offering documents.

During the prospectus review process, staff have been reviewing, and will continue to review, the prospectuses and related documents of ESG-Related Funds in accordance with the guidance provided in the ESG Staff Notice to assist IFMs in improving the disclosure of such funds.

The reviews have generally been focused on, but not limited to, the fund's:

- investment objectives and name
- fund type
- investment strategies
- proxy voting policies and procedures
- risk disclosure
- suitability disclosure

Comments raised during these reviews have covered a wide range of issues relating to ESG-related disclosure, but the most common issues raised so far have been in relation to:

- revising the investment objectives to ensure that the ESG-related focus of the fund is clearly and accurately stated; and
- revising the investment strategies disclosure to explain which ESG-related strategies are applied by the fund and to identify and explain the ESG factors considered by the fund.

As part of these reviews, staff are asking IFMs to provide copies of all sales communications relating to the ESG-Related Fund(s) in question that were disseminated recently and are reviewing those sales communications in accordance with the guidance provided in the ESG Staff Notice.

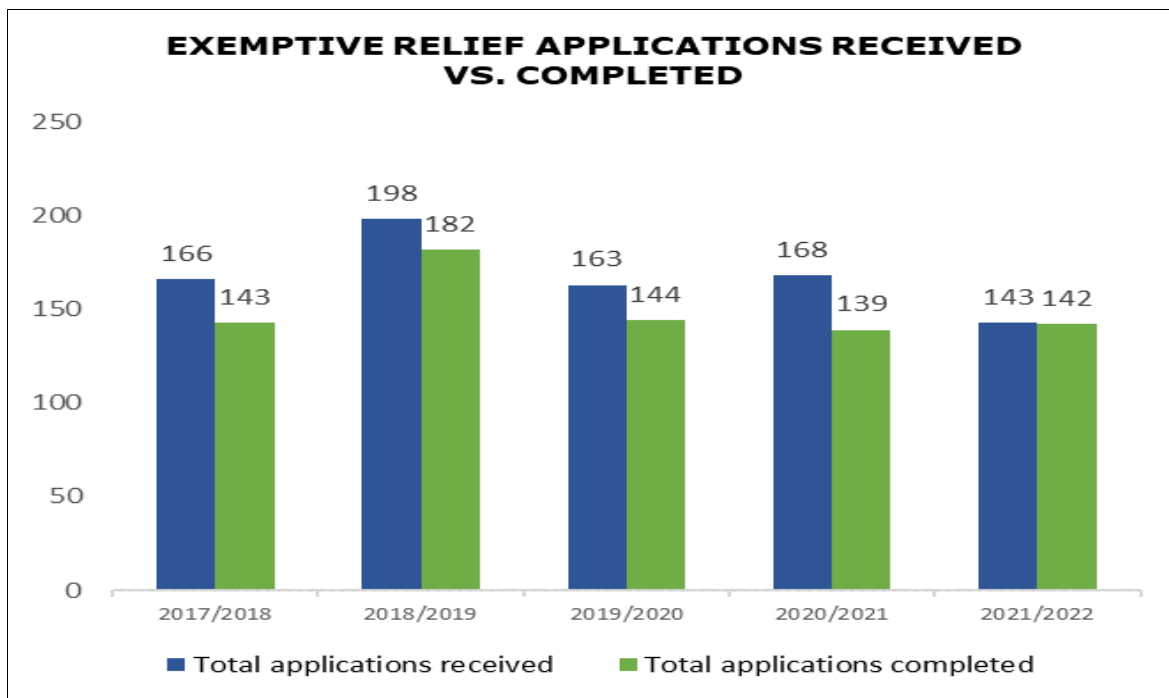
II. Exemptive Relief Applications

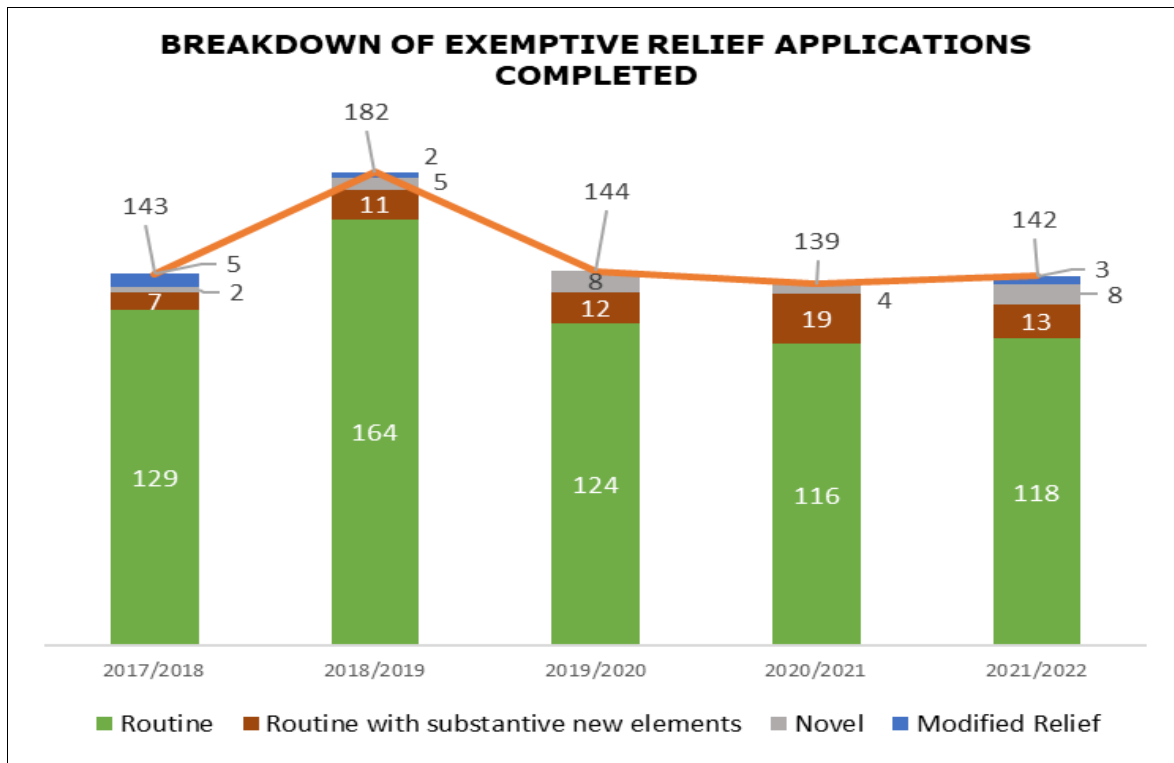
IFSP reviews applications for exemptive relief to determine whether granting the requested relief would not be prejudicial to the public interest and makes a recommendation on that basis. We receive exemptive relief filings that are

considered either routine or novel in nature. Routine applications generally mirror a prior decision and contain similar representations and conditions in the decision document as a previous decision. In some cases, routine applications contain changes that would be considered substantive new elements, and these are considered based on the fact patterns of the application to determine whether the same or modified conditions of the relief would be appropriate.

Novel applications generally consist of requests for relief that have not previously been granted or that deviate substantially from the fact patterns underlying any prior decisions. These applications generally take longer to review because of their nature and complexity, and we consult with the CSA on all novel applications.

Data on Exemptive Relief Applications





Novel Exemptive Relief Applications

In addition to the exemptive relief that was granted in relation to the novel prospectus filings discussed earlier, a summary of additional noteworthy exemptive relief granted during the last fiscal period is described below.

Inter-Fund Trading Relief

In May 2021, the CSA granted exemptive relief to a group of investment funds and a registered adviser to permit domestic and cross-border (U.S.) inter-fund trading. The relief granted gives investment funds more flexibility on how to comply with the market integrity requirements in section 6.1 of National Instrument 81-107 *Independent Review Committee for Investment Funds (NI 81-107)*. The relief is expected to help investment funds execute transactions more efficiently and streamline their compliance procedures without compromising investor protection.

The relief permits the funds to comply with market integrity requirements by using either to execute an inter-fund trade: (a) a third-party IIROC registered dealer, or (b) a third-party broker or dealer domiciled and registered in the U.S provided certain additional conditions are met. Additionally, in certain circumstances, inter-fund trades in Canada-U.S. inter-listed securities executed by a third-party U.S. broker or dealer may be printed on a marketplace in Canada or in accordance with applicable U.S. market transparency obligations.

This relief exempts this particular group of funds from subsection 4.2(1) of National Instrument 81-102 *Investment Funds (NI 81-102)* and a registered adviser from subparagraphs 13.5(2)(b)(ii) and (iii) of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

The relief is subject to a three-year sunset clause and reporting requirements.

Canadian Depository Receipts

The CSA granted [exemptive relief](#) to a Schedule I Bank (**Bank**) to facilitate the distribution of Canadian Depository Receipts (**CDRs**). CDRs trade over a Canadian marketplace and track the performance of large, highly liquid public companies in the United States. The product was subject to extensive pre-filing discussions.

Investors can purchase CDRs in their Canadian dollar brokerage accounts and they are denominated in Canadian dollars. Also, the U.S. dollar exposure of the underlying U.S. company is hedged back to the Canadian dollar. CDRs are in continuous distribution and are subscribed for, and redeemed by, authorized participants in a similar way to exchange-traded funds. They are qualified for distribution under a base shelf prospectus and prospectus supplements.

The decision grants exemptive relief to the Bank from:

- the requirement to deliver to the purchaser of a CDR or its agent the latest prospectus or prospectus supplement (similar to exemptions provided to at-the-market distributions);
- certain prospectus form requirements relating to the statements regarding the delivery to purchasers of the prospectus or prospectus supplements and relating to the statement regarding purchasers' statutory rights of withdrawal and remedies of rescission or damages;
- the requirement to distribute securities under a prospectus at a fixed price to permit the CDRs to be issued at the current market price;
- the requirement to file a pricing supplement to distribute securities under a base shelf prospectus by way of a continuous distribution; and
- other technical relief to facilitate the proposed CDR structure.

The exemptive relief is subject to several conditions, including that CDRs not be used by U.S. companies to raise capital, and the Bank maintain a website that discloses certain specified information relating to the CDRs.

Under the exemptive relief, a U.S. company must be incorporated in the United States, be listed on the S&P 500 Index and have a market capitalization in excess of US\$20 billion. The underlying shares must be listed on the NASDAQ or New York Stock Exchange, and the average daily trading volume of the shares in the month before the date of the first prospectus supplement for that CDR must exceed US\$100 million.

III. Continuous Disclosure Reviews

IFSP regularly conducts reviews of the prospectus and continuous disclosure filings of Ontario-based investment funds. Risk-based criteria are used to select investment funds for reviews of their disclosure documents. We may also choose to conduct targeted reviews of a particular industry segment, on a particular issue or based on complaints received.

On a go-forward basis, IFSP is coordinating with the Digital Solutions Branch on using internal and external data sources to develop dashboards that will be used to identify investment fund outliers in key risk areas to identify higher risk fund issuers and conduct focused reviews. A major contributor to this information will be the data gathered as part of the annual Investment Fund Survey discussed in Part D of this Report.

Summary of Completed Reviews

Outlined below are the major reviews completed by IFSP during the fiscal period:

Liquidity Risk Management

In the first quarter, we completed a review on liquidity risk management for IFMs that experienced significant redemptions during the period January 1 to June 30, 2020. On July 9, 2020, a survey was sent to registrants on the impact of COVID-19 on their business. As part of the survey, IFMs were asked whether any of their prospectus qualified investment funds experienced redemptions which exceeded 10% of the fund's NAV on a redemption date during the specified period. A total of 38 IFMs responded "Yes" to the survey question, with 336 impacted funds. IFSP staff commenced a follow-up review of 12 of these IFMs in fiscal 2020-2021 to assess how they dealt with these significant redemption events and to obtain information on their liquidity risk management policies. The IFMs sampled included a range of small, mid-size and large firms and the impacted funds comprised ETFs, conventional mutual funds, closed end funds, and a labour sponsored investment fund. We found that all these IFMs were able to manage their funds' significant redemptions as part of the normal course of operations, without breaching any borrowing restrictions under NI 81-102 or requiring exemptive relief.

IFMs are reminded to review [CSA Staff Notice 81-333 Guidance on Effective Liquidity Risk Management for Investment Funds](#) for best practices in this area.

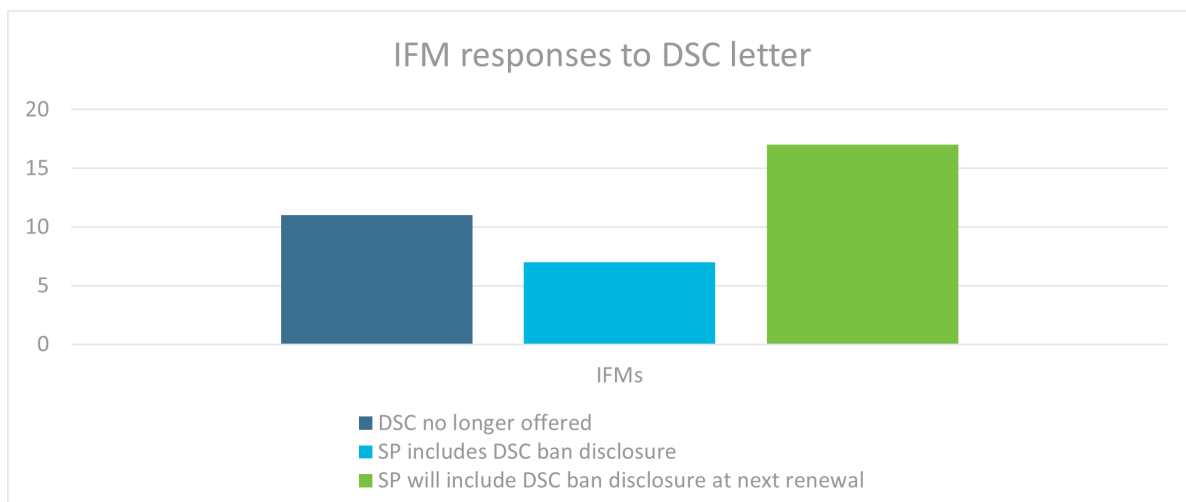
Crypto Asset ETFs

IFSP staff carried out an issue-oriented review on crypto asset ETFs considering the market volatility during the week of May 17, 2021 which arose partly due to concerns around digital assets by foreign regulators. The purpose of the review was to understand how IFMs managed their subscription and redemption activity, where they sourced the crypto assets, and how IFMs continued to accurately value their funds. Inquiries were made to 11 crypto asset ETFs managed by six IFMs with total assets under management of \$2.7 billion as of May 21, 2021.

IFSP found that the majority of the crypto asset ETFs traded very close to their NAV during the period of volatility.

Compliance with DSC Ban

Effective June 1, 2022, IFMs will be prohibited from paying upfront sales commissions to dealers, which will result in the discontinuation of all forms of the deferred sales charge option (**DSC ban**). On September 10, 2021, IFSP sent letters to 35 IFMs who manage a material amount of mutual funds with the deferred sales charge (**DSC**) option to ascertain their readiness to comply with the DSC ban and whether their prospectus disclosure was being modified in anticipation of the upcoming ban. The letters asked the IFMs about the specific measures that will be taken to comply with the DSC ban prior to the effective date of June 1, 2022, and whether the DSC option will be discontinued. Of the responses received, the IFMs indicated that (1) the DSC option is no longer offered, (2) their prospectus already includes disclosure about the DSC ban and/or that the DSC option will no longer be available as of a date prior to the effective date of the DSC ban, or (3) at their next renewal, the prospectus will include disclosure about the DSC ban and/or that the DSC option will no longer be available as of a date prior to the effective date of the DSC ban.



ESG-Related Funds

Staff conducted a targeted continuous disclosure review of the regulatory disclosure documents and sales communications of 32 ESG-Related Funds managed by 23 different IFMs, as a follow-up to a similar continuous disclosure review of ESG-Related Funds conducted in 2020. The purpose of both the 2020 and 2021 reviews was to assess the quality of the fund's ESG-related disclosure, including whether the fund's disclosure of how ESG factors are integrated into its investment objectives and/or strategies in the fund's prospectus met the standard of full, true and plain disclosure of all material facts, and whether the fund's sales

communications were misleading. The reviews were also aimed at evaluating how well the current disclosure requirements address ESG-Related Funds and ESG-related disclosure to determine whether guidance was needed to explain how the current disclosure requirements apply to ESG-Related Funds and ESG-related disclosure.

In staff's view, the reviews indicated that, while the current disclosure requirements are broad enough in scope to address ESG-Related Funds and other ESG-related disclosure, regulatory guidance was needed to clarify how the current disclosure requirements apply to ESG-Related Funds and other ESG-related disclosure to improve the quality of ESG-related disclosure and sales communications. In addition, staff found that the disclosure of ESG-Related Funds would benefit from greater detail about the ESG-related aspects of the fund, particularly regarding disclosure on investment strategies, proxy voting and continuous disclosure.

Based on the findings of the reviews, staff's observations of ESG-related changes to existing funds, and recommendations from IOSCO's Sustainable Finance Task Force which are discussed further below under Part D, the CSA published the ESG Staff Notice. A more detailed summary of the findings from this review are included in Part E of the ESG Staff Notice.

As part of OSC staff's ongoing continuous disclosure review program, staff are reviewing, and will continue to review, the continuous disclosure documents of ESG-Related Funds in accordance with the guidance provided in the ESG Staff Notice to assist IFMs in improving the disclosure of such funds. For these reviews, the primary focus is on the summary of the results of operations in annual and interim management reports of fund performance. As part of these reviews, staff are also requesting copies of all sales communications relating to ESG-Related Fund(s) and are reviewing those sales communications in accordance with the guidance provided in the ESG Staff Notice.

Marketing Materials

Staff have received some complaints related to sales communications and have performed several ad hoc reviews in this area. The complaints have typically dealt with insufficient disclosure and exaggerated or misleading claims, particularly in internet advertising and on social media platforms like Facebook, Twitter, and LinkedIn. The use of social media has become more widespread and popular for marketing purposes by IFMs and their employees. However, content limitations with these types of media may prevent IFMs from providing clear, accurate and balanced messages which are necessary when these meet the definition of a sales communication under NI 81-102. Part 15 of NI 81-102 outlines requirements related to sales communications and prohibited representations which IFMs must comply with, irrespective of the type of media in which these communications are presented. Further, [OSC Staff Notice 81-720 Report on Staff's Continuous Disclosure Review of Sales Communications by Investment Funds](#) provides

additional guidance when the sales communication is presented with alternative media. The guidance states that “*Staff expect that all information, including disclaimers, should be easily comprehensible to the retail investor on their first viewing of the advertisement.*” Further, investors should not be required to click more than once to view the required disclosures and warnings, which should be presented in an easily readable manner. These principles should be applied to both the IFM’s social media accounts, and those of its employees where they are using their personal platforms such as LinkedIn to market specific funds or performance. Staff expects that these should still contain all the required disclosure and warning language that are applicable to more traditional marketing platforms.

IFMs should review the use of personal social media with their employees who use their accounts to market investment funds to ensure that all information presented complies with Part 15 of NI 81-102, including the required warning language, appropriate performance data measurement periods and is not misleading. Where performance information is intended for “advisor use only” but is disseminated or available widely on social media, particularly by IFM wholesalers, the information presented should comply with NI 81-102. IFMs should also ensure that they have adequate policies and procedures related to the use and monitoring of social media, and that training is provided to employees where necessary.

Custodian Compliance Reporting

During 2021, we conducted reviews on more than half the submissions of custodian compliance reports. The findings from the review reveal that approximately 30% of the submissions require follow up with the IFMs due to non-compliance with the reporting requirements outlined in section 14.6 of National Instrument 41-101 *General Prospectus Requirements (NI 41-101)* or section 6.7 of NI 81-102, as applicable.

The compliance issues found include late submissions of the custodian reports by the custodian and/or IFM, and submissions that did not contain the accompanying list of the names and addresses of the sub-custodians.

Other issues identified include:

- Custodian reports that contained the previous names of active investment funds;
- Submissions of custody reports on the incorrect SEDAR fund group number;
- Funds listed in the same custody report that have different year ends, which results in a late submission for certain of the funds listed, and;
- Incorrectly stating the section for which compliance is satisfied, for example funds qualified under the long form prospectus should be stating compliance with section 14.2 of NI 41-101.

All reports that are required to be delivered on behalf of investment funds, including the custodian reports, should be thoroughly reviewed for completeness and accuracy, and delivered to the Commission in a timely manner.

Cybersecurity Disclosure

As part of a desk review, we reviewed the cybersecurity risk disclosure for a sample of funds managed by small, medium and large IFMs based on assets under management. The review focused on whether there was some type of cybersecurity risk disclosure in the publicly filed fund documents, primarily the prospectus. Investment fund products and their service providers are susceptible to risks through breaches in cybersecurity. Cybersecurity breaches can cause major disruptions in the operation of a fund and may allow cybercriminal activity to occur.

IFMs generally included cybersecurity risk disclosure under the “What are the Risks of Investing in the Fund” section of the prospectus, with 80% of the prospectuses reviewed including some type of disclosure in this area. We also reviewed the funds’ financial statements, management reports of fund performance, annual information forms and the IFMs’ websites to identify any other information provided on cybersecurity risks, however, no particular trends on disclosure practices were noted in these documents.

Given the real threat of cybersecurity attacks due to the increased dependency by IFMs on technology and the growing sophistication of cyber criminals, all IFMs should review the risks disclosed in their funds’ prospectus and perform a thorough risk assessment to determine whether cybersecurity risk is a material risk to its funds which merits disclosure in the prospectus. IFMs who do not include this type of disclosure in their funds’ prospectus may be selected for a more in-depth review to explain the rationale for excluding this important risk disclosure in their funds’ regulatory documents.

Part C: Regulatory Policy

IFSP has been engaged in numerous policy initiatives affecting investment funds. We are pleased that several of these major initiatives resulted in the publication of final rule amendments during the period. This section details the major policy initiatives that were completed or are in progress during the period:

Prohibition of Deferred Sales Charges

On June 3, 2021, the OSC published final [amendments](#) to National Instrument 81-105 *Mutual Fund Sales Practices* that prohibit the payment by fund organizations of upfront sales commissions to dealers, resulting in the discontinuation of all forms of the deferred sales charge option. The DSC ban took effect on June 1, 2022 in Ontario, which coincides with the effective date of the DSC ban in the other CSA jurisdictions.

Blanket Order Issued to Codify Permitted Means to Comply with the Trailer Ban for Order Execution Only (OEO) Dealers

On March 18, 2022, the OSC published [Ontario Instrument 81-508 *Temporary Exemptions from the OEO Trailer Ban to Facilitate Dealer Rebates of Trailing Commissions and Client Transfers*](#). Other CSA jurisdictions also published exemptions in the form of local blanket orders. These orders codify the methods permitted to be used by industry to comply with the trailer ban in circumstances where forced redemptions may be harmful to investors. In September 2020, the CSA adopted final rules that implement a trailing commission ban to prohibit the payment of trailing commissions by fund organizations to dealers who do not make a suitability determination, such as OEO dealers (the **OEO Trailer Ban**). The OSC order came into force on June 1, 2022, the effective date of the OEO Trailer Ban, and expires on November 30, 2023.

The CSA consulted with industry stakeholders to identify temporary provisions which would enable IFMs and OEO dealers to implement the ban without penalizing investors who are holding trailer paying funds in their OEO dealer accounts.

OEO dealers and IFMs are permitted to facilitate dealer rebates of trailing commissions to clients holding mutual funds in OEO dealer accounts and process client transfers in certain circumstances. Under the terms and conditions of the temporary exemptions:

- Dealer rebates will be provided to clients where switches to an equivalent or a substantially similar series or class of mutual fund securities of the same fund are not available and where a management fee rebate of the trailing commission is also not available;
- OEO dealers and fund organizations will also be exempted from the OEO Trailer Ban for a period of up to 45 days upon the acceptance of client-

- initiated transfers of mutual funds on or after June 1, 2022, to facilitate the processing of such transfers; and
- Affected clients of OEO dealers will receive communications about how their holdings will be impacted. The local blanket orders outline these client communication plans.

Reducing Regulatory Burden for Investment Fund Issuers

On October 7, 2021 the CSA published [amendments](#) that implement eight initiatives to reduce regulatory burden for investment funds. The changes eliminate duplicative requirements, streamline regulatory approvals and processes, and codify frequently granted exemptions from certain requirements. Most of the amendments came into force on January 5, 2022, with the remainder on January 6, 2022. There are exemptions available from some of the requirements to give issuers more time to comply.

These amendments complete the first stage of the CSA's initiative to reduce the regulatory burden on investment fund issuers. Subsequent stages will include further examination of the prospectus filing regime; modernizing the continuous disclosure regime; and exploring alternatives to the current requirements for delivering various investment fund related materials.

A summary of the eight amendment initiatives is as follows:

Consolidate the Simplified Prospectus and the Annual Information Form

Previously, investment funds had to file a simplified prospectus (**SP**) and an annual information form (**AIF**), among other documents, every 12 months to receive a prospectus receipt to allow them to distribute securities over the course of the next year. The requirements for the SP and AIF contained duplicative or similar information in several places, or information that was no longer considered necessary based on stakeholder feedback. The amendments consolidate the form requirements of the AIF into the form requirements for the SP such that investment funds in continuous distribution will now only need to file a single streamlined document annually.

Mandate each Reporting Issuer Investment Fund have a Designated Website

The amendments require investment funds to identify a website where their regulatory disclosures, previously in printed documents, will be posted. This formalizes existing industry practice, improves investor access to disclosure and potentially creates opportunities for additional burden and cost reduction initiatives.

Codify Exemptive Relief Granted in Respect of Notice-and-Access Applications

Securities rules require that when a person or company solicits proxies from a registered holder of securities of an investment fund, a notice of meeting and an information circular must be sent. The information circular can oftentimes be lengthy and therefore expensive to print and deliver. In 2016, securities regulators began granting discretionary exemptive relief to permit investment funds to use the notice-and-access system. The notice-and-access document provides instructions on how to obtain a copy of the information circular via a website or by requesting a paper copy. The amendments permit use of the notice-and-access system for investment funds without the need to file an exemptive relief application and pay the requisite fee.

Minimize Filings of Personal Information Forms

Securities rules require that when an investment fund seeks a receipt that will permit them to distribute securities, they must submit personal information forms as part of the process. The amendments eliminate the need for investment funds to file these forms for certain individuals, where comparable information is already available through the national registration system maintained by Canadian securities regulators.

Codify Exemptive Relief Granted in Respect of Conflicts Applications

Currently, securities rules do not permit investment funds to engage in certain transactions due to concerns that the entities managing the investment funds may engage in these transactions out of self-interest, instead of the interests of the investment fund. Despite the presence of these prohibitions, securities regulators have frequently granted investment funds and IFMs exemptive relief to engage in these transactions provided that certain conditions are met which mitigate the conflicts of interest and protect investment fund securityholders. The amendments permit investment funds to engage in eight transactions that were previously prohibited, without the need to apply for exemptive relief to do so.

Broaden Pre-Approval Criteria for Investment Fund Mergers

Securities rules require regulatory approval of a merger of investment funds before the merger is undertaken. However, exceptions to this requirement are available if certain conditions, known as “pre-approval criteria”, are met. The amendments broaden the pre-approval criteria for investment fund mergers so that there will be fewer instances where an investment fund must seek regulatory approval to engage in a merger.

Repeal Regulatory Approval Requirements for a Change of Manager, a Change of Control of a Manager, and a Change of Custodian that Occurs in Connection with a Change of Manager

Previously, investment funds had to undertake an approval process each time any of these changes occurred. The amendments eliminate the requirement to obtain regulatory approval of a change of manager of an investment fund, a change of control of a manager of an investment fund, or a change of custodian that occurs in connection with a change of manager of an investment fund.

Codify Exemptive Relief Granted in Respect of the Fund Facts Delivery Requirement and Corresponding Exemptions from the ETF Facts Delivery Requirement

The amendments provide exceptions from the Fund Facts and ETF Facts delivery requirements in the context of managed accounts, permitted clients, pre-authorized purchase plans, model portfolio products, portfolio rebalancing services, and automatic switch programs. Delivering a Fund Facts or ETF Facts in these situations may often be unnecessary and of no value to an investor as the Fund Facts or ETF Facts was initially delivered at the outset when the investment decision was made.

Proposed Modernization of the Prospectus Filing Model

On January 27, 2022, the CSA published for [comment](#) a two-staged proposal to modernize the prospectus filing model for investment funds for a 90 day comment period.

The first stage consists of proposed amendments that would allow investment funds in continuous distribution to file a new prospectus every two years instead of on an annual basis as they currently do. The requirement to file a final prospectus no more than 90 days after the issuance of a receipt for a preliminary prospectus for all investment funds would also be repealed.

As part of the second stage, the CSA is seeking stakeholder comments on a consultation paper introducing a new shelf prospectus filing model which could apply to all investment funds in continuous distribution. The conceptual framework for this model is based on an adaptation of the current shelf prospectus system.

In keeping with current requirements, investor access to continuous disclosure documents as well as delivery of the Fund Facts and the ETF Facts remains unchanged. Investors will still be able to request the prospectus or access it online.

Blanket Relief for Proficiency Requirements to Distribute Alternative Mutual Funds

On February 24, 2022, the OSC published [Notice of Commission Approval of OSC Rule 81-507 Extension to Ontario Instrument 81-506 Temporary Exemptions from National Instrument 81-104 Alternative Mutual Funds \(Rule 81-507\)](#).

Rule 81-507 extends the blanket relief issued on January 28, 2021 by [Ontario Instrument 81-506 Temporary Exemptions from National Instrument 81-104 Alternative Mutual Funds](#) (the **OSC Blanket Order**) by 18 months. The OSC Blanket Order provides mutual fund restricted dealing representatives (**MFRIs**) in the Mutual Fund Dealers Association channel with additional proficiency options for distributing alternative mutual funds. Additional proficiency requirements are necessary to support appropriate know your product and suitability assessments of alternative mutual funds by MFRIs for their clients.

Alternative mutual funds were introduced to the Canadian retail market through amendments to NI 81-102 in 2019. These amendments aimed to provide retail investors with greater access to alternative investment strategies, while maintaining appropriate protections. Alternative mutual funds are permitted to invest in asset classes and use investment strategies that are not permitted for other types of mutual funds. The OSC Blanket Order and Rule 81-507 provide additional proficiency course options to better align proficiency requirements with information on alternative mutual funds, and to ensure MRFIs seeking to distribute alternative mutual fund securities have the education, training and experience that is necessary to understand the structure, features, and risks of any alternative mutual fund that they may wish to recommend to a client, to support investor protection.

The OSC Blanket Order ceased to be effective on July 28, 2022, and Rule 81-507 extends the relief provided in the OSC Blanket Order for an additional 18-month period from July 29, 2022 to January 29, 2024.

Part D: Emerging Issues and Initiatives

Environmental, Social and Governance Funds

On June 30, 2021, the Sustainable Finance Task Force (**STF**) of IOSCO published a consultation report titled [*Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management*](#) (the **IOSCO Consultation Report**). The OSC is a co-lead of the asset management workstream of the STF that produced the IOSCO Consultation Report, and as such, IFSP Branch staff have been involved extensively in the workstream. The IOSCO Consultation Report set out proposed recommendations for securities regulators and policymakers, as applicable, to improve sustainability-related practices, policies, procedures, and disclosure in asset management. The proposed recommendations covered asset manager practices, policies and procedures, product-level disclosure, supervision and enforcement, terminology, and financial and investor education.

On November 2, 2021, the STF published its final report titled [*Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management*](#) which sets out recommendations for securities regulators and policymakers, as applicable, that aim to improve sustainability-related practices, policies, procedures and disclosure in asset management.

As discussed earlier in the Report, the CSA published [*CSA Staff Notice 81-334 ESG-Related Investment Fund Disclosure*](#) on January 19, 2022. As part of the process of preparing this ESG Staff Notice, OSC staff conducted a series of stakeholder consultations on ESG-related fund disclosure in August 2021. The CSA also hosted the CSA Roundtable on ESG-Related Regulatory Issues in Asset Management on September 27, 2021 as part of the consultation process for the ESG Staff Notice. The roundtable was a virtual public roundtable featuring a panel discussion about the benefits, challenges and experiences associated with ESG-related fund disclosure, marketing and other issues from the perspective of asset managers, ESG ratings providers and retail investors.

Investment Fund Survey

On April 26, 2021, the OSC issued its first annual data request seeking key information about investment funds managed by IFMs registered in Ontario (the **Investment Fund Survey**). The OSC published [*OSC Staff Notice 81-732 Investment Fund Survey*](#) which provided further background information on this initiative and explains the role of the Investment Fund Survey in data collection and analysis by the OSC. In the past, the OSC has collected and sourced data pertaining to investment funds through the Risk Assessment Questionnaire. The Investment Fund Survey complements this data collection and focuses on different key areas, including leverage, liquidity, and asset class exposures. The 2021 Investment Fund

Survey requested this information for the period from January 1, 2020 to December 31, 2020 and 100% of IFMs responded to the request. Moving forward, the OSC will collect data through the Investment Fund Survey on an annual basis. Accordingly, the 2022 Investment Fund Survey was launched January 12, 2022 with responses due on April 29, 2022.

The Investment Fund Survey is compatible with the OSC's ambition to aggregate, streamline, and modernize our data collection strategies. Staff is currently working with the Digital Solutions Branch to aggregate and analyse the received data as part of the development of a risk identification framework that will help deliver on our mandate. We will continue to consider ways in which this data collection can be further streamlined in future years, including by incorporating feedback received from stakeholders on the 2021 Investment Fund Survey to reduce regulatory burden, as appropriate, without sacrificing information necessary for regulatory oversight.

The data gathered will also allow for comprehensive and meaningful information sharing and interactions with regulatory partners, both domestically and internationally. The OSC collaborates its monitoring activities with other regulatory bodies with a shared interest in promoting financial stability. Domestically, the OSC is part of the Heads of Regulatory Agencies (**HoA**), which provides a forum for federal and provincial bodies to discuss financial sector issues. Globally, the OSC is a member of IOSCO and coordinates information sharing with bodies such as the Financial Stability Board (**FSB**). IOSCO requests information regarding leverage within investments funds on an annual basis, with an April reporting deadline.

To contribute to financial stability, we will consider making summary or aggregated data publicly available on a no-names basis. Aggregated data may also be shared with other regulatory partners such as through the HoA and the FSB. In addition, we may also share the information provided in this survey on a confidential basis with other CSA jurisdictions.

Exchange Traded Funds

In light of the continued growth of the ETF market, staff are considering whether the current regulations applicable to ETFs remain appropriate, or whether additional measures are needed. The areas of our focus are: (i) the ETF unit creation and redemption mechanism; (ii) the secondary market trading of ETFs; and (iii) the arbitrage mechanism that acts to keep the market price of ETFs close to the underlying value of its units. These areas are also being considered in the ETF project undertaken by IOSCO Committee 5. We continued to monitor the IOSCO ETF project:

- I. we compared the findings in IOSCO's *Exchange Traded Funds Thematic Note - Findings and Observations during COVID-19 Induced Market Stresses*

(published in August 2021) with the experience of Canadian ETFs, concluding that Canadian ETFs exhibited similar performance as ETFs in other jurisdictions.

- II. we considered the good practices proposed in IOSCO's *Exchange Traded Funds – Good Practices for Consideration* report published for consultation in April 2022, and also encouraged ETF managers to provide their feedback to the consultation.

We expect that any additional policy measures for ETFs will be informed by the IOSCO ETF Good Practices.

We have also started to develop a program to monitor the robustness of ETF trading and increase our current knowledge of ETF market practices, including reviewing the information about authorized dealer arrangements and portfolio transparency practices obtained through our annual Investment Fund Survey.

Finally, we are considering potential models for civil liability for misrepresentations in ETF prospectuses in connection with the consultation in the *Capital Markets Act* consultation draft.

Part E: Stakeholder Outreach

IFSP supports and encourages regular engagement and communication with our stakeholders to provide education and make improvements on our regulatory processes. The following are key IFSP outreach initiatives for our stakeholders:

IFSP Landing Page on OSC Website

The [IFSP landing page](#) of the OSC website contains information relevant for investment fund issuers and their respective IFMs. This is a good resource to obtain information on the following areas:

- Types of investment funds
- Prospectus offerings for investment funds in Ontario
- Operating an investment fund in Ontario
- Ongoing disclosure requirements for investment funds in Ontario
- Marketing and sales of investment funds
- IFSP eNews publications
- Applying for discretionary relief
- Investment fund survey
- Latest policy developments affecting investment funds
- Latest orders, rulings and decisions involving investment funds

Launch of IFSP eNews

On February 24, 2021, the IFSP branch launched IFSP eNews, a web-based publication which aims to provide timely information about regulatory news and issues to investment fund and structured product issuers and their advisors in the form of articles published on a timely, as-needed basis. IFSP eNews replaces the Investment Funds Practitioner as IFSP's primary method of stakeholder communication. IFSP eNews articles are posted on a [dedicated page](#) on the OSC website, while IFSP branch email list subscribers also receive each eNews article via an e-mail blast. Registration for email subscription can be done [here](#). Articles that remain relevant from the Investment Funds Practitioner are now included in the list of IFSP eNews articles.

During the fiscal year, we published several eNews articles that cover topics already discussed throughout the Report:

June 3, 2021: OSC adopts ban on deferred sales charges

June 16, 2021: Relief from redemption price requirement for "income for life" mutual fund

June 18, 2021: Relief granted to permit domestic and cross-border (U.S.) inter-fund trading

July 5, 2021: IFSP Branch encourages stakeholders to provide comments on recent IOSCO Sustainable Finance Task Force consultation report

July 15, 2021: OSC publishes staff notice on recent investment fund survey

August 27, 2021: Relief granted to permit distribution of Canadian Depository Receipts

October 15, 2021: Capital Markets Act consultation on civil liability framework for misrepresentations in ETF prospectuses

November 4, 2021: IOSCO Sustainable Finance Task Force publishes final report on sustainability-related practices and disclosure in asset management

November 26, 2021: OSC encourages stakeholders to provide comments on proposed MFDA Policy No. 11 *Proficiency Standards for the Sale of Alternative Mutual Funds*

January 26, 2022: Prospectus, continuous disclosure and sales communication reviews of ESG-related funds

February 24, 2022: OSC extends blanket relief providing additional proficiency options for distributing alternative mutual funds

Stakeholder Survey

In November 2020, IFSP launched a pilot stakeholder survey which coincided with the publication of the OSC's enhanced service standards. The survey complements the service standards by allowing us to maintain and improve the quality of how we deliver our work. The survey is designed to solicit input from stakeholders about their experience during a recent regulatory interaction with IFSP, with a focus on key qualitative elements such as the timeliness and clarity of communication.

Initially, the survey was delivered via email upon the completion of a prospectus or application file or a continuous disclosure review. Since July 5, 2021, we have been directing stakeholders, upon the completion of a file, to our landing page on the OSC website where the [link to the survey](#) is posted.

Since the implementation of the survey, we have seen positive results about our regulatory interactions with stakeholders and have not identified any negative trends.

Investment Funds Technical Advisory Committee

The Investment Funds Technical Advisory Committee (**IFTAC**) provides an opportunity for stakeholders to engage with the OSC to further effective regulation in the investment funds and structured products space. The IFTAC advises OSC staff on technical compliance challenges in the investment funds product regulatory

regime and highlights opportunities for improving alignment between investor, industry, and regulatory goals.

IFTAC meets four times a year with members participating for two-year terms.

Topics discussed by IFTAC over the past year included:

- Perspectives on portfolio management
- Diversity and Inclusion
- Liquidity Risk Management
- ESG
- Fund Governance
- Product innovation

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The OSC Inquiries & Contact Centre operates from 8:30 a.m. to 5:00 p.m. Eastern Time, Monday to Friday, and can also be reached on the [Contact Us](#) page on the OSC website.

You may also refer to the [OSC Phone Directory](#) on the OSC website to contact staff members from other branches and offices at the OSC.

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