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Legal newsletter to investment fund / venture capital fund promoters, managers and investors

lavery Lawyers

LAVERY: A LEADER IN MONTREAL IN THE PRIVATE EQUITY, VENTURE CAPITAL AND INVESTMENT MANAGEMENT INDUSTRY

Creating and setting up private equity and venture capital funds are complex initiatives requiring specialized legal resources. There are very few law firms offering such services in Quebec. Lavery has developed enviable expertise in this industry by working closely with promoters to set up such structures in Canada and, in some cases, the United States and Europe, in conjunction with local firms. Through Lavery's strong record of achievements, the firm sets itself apart in the legal services market by actively supporting promoters, managers, investors, businesses and other partners involved in the various stages of the implementation and deployment of private equity and venture capital initiatives.

FATCA FOR INVESTMENT FUNDS – BE READY FOR MAY 1, 2015!

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The *Foreign Account Tax Compliance Act*, or FATCA, has been an integral part of Canada's tax system for over a year. Originally legislated under U.S. law, FATCA allowed the Internal Revenue Service ("IRS") to obtain information from financial institutions about the financial accounts of U.S. citizens and residents. This U.S. regime was introduced into Canada through the Intergovernmental Agreement for the Enhanced Exchange of Tax Information under the Canada-U.S. Tax Convention ("IGA") and then through the enactment of Part XVIII of the *Income Tax Act*. Under Canada's FATCA regime, Canadian financial institutions, including several investment funds, are required to file their first report on their U.S. reportable accounts by May 1, 2015.

STATUS

Under the FATCA, only Canadian financial institutions can have obligations to register and report the U.S. reportable accounts they maintain.

Investment funds are generally considered a Canadian financial institution. An investment fund, its general partner, fund manager and holding companies are usually required to report under the FATCA rules. A fund's limited partners may also have their own FATCA obligations.

Most Canadian investment funds have addressed the issue of their FATCA status and obtained a global intermediary identification number (or "GIIN") from the IRS.

However, there is still some uncertainty which can cause market players to put off analyzing their obligations or registering. There are several reasons for this, including the fact that the rules are relatively new, the lack of formal administrative positions regarding their application, qualification and exception issues, etc. For an investment fund, these issues require an in-depth analysis of all entities forming part of its structure in order to come to an adequate determination.

It should be noted that an investment fund that determines that it does not qualify as a financial institution for the purpose of FATCA could be considered a passive non-financial foreign entity and be required to report such information at the request of a financial institution and disclose more information about its beneficiaries in order to determine their status.

DUE DILIGENCE

A reporting Canadian financial institution is required to determine whether the financial accounts it maintains for its clients contain U.S. indicia (residence and citizenship of account holder, place of birth, mailing address, telephone number, etc.). This verification includes a review of available information about the account by the financial institution and a mechanism for requesting information. Such a request may be in the form of an IRS Form W-8, an official IRS document, or an equivalent document prepared by the financial institution, to be filled out by the account holder.

A financial institution is required to collect this information for existing accounts and any new account it opens for a client. The financial institution's verification obligations may be more or less strict depending on the account, the date it was opened and its value.

REPORTING

Canadian financial institutions are required to file an electronic report on their U.S. reportable accounts with the Canada Revenue Agency ("**CRA**"). The first such report covers financial accounts held by financial institutions as of December 31, 2014 and must be filed by May 1, 2015.

Financial institutions must also complete, by June 30, 2015, a review of their high-value financial accounts, i.e. those worth one million dollars ($1M) or more, held as of June 30, 2014.

After that, financial institutions will be required to file annual reports.

EVOLUTION

The FATCA rules are the precursor of a broad, evolving trend toward the exchange of information about taxpayers' assets among the tax authorities of different countries. The United Kingdom has set up a similar although less wide-sweeping regime than the U.S. China is also looking at the possibility of setting up its own regime but has not released any details so far. The Organisation for Economic Co-operation and Development ("**OECD**") has also set up a common standard for the automatic exchange of information regarding financial accounts, which Canada has committed to implement by 2018. This standard is expected to be similar to FATCA but involve all countries that have signed agreements involving the automatic exchange of information.

In future we will certainly see greater transparency and increased reporting requirements regarding information about financial accounts to be provided to the tax authorities.

Since investment funds are directly affected by these rules, they should make sure they have the tools they need to meet these requirements.

PROPOSAL FOR NEW TSX LISTING REQUIREMENTS FOR ETFS, CLOSED-END FUNDS AND STRUCTURED PRODUCTS: CODIFICATION OF EXISTING PRACTICES

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On January 15, the Toronto Stock Exchange (the "**Exchange**") published proposed amendments to the *Toronto Stock Exchange Company Manual* (the "**Manual**"). More specifically, a completely new section will be added to the Manual (Part XI) for determining the minimum listing requirements to be met by non-corporate issuers, i.e. exchange traded products (ETPs), closed-end funds and structured products.

ENTITIES COVERED BY THIS PROPOSAL

In their current version, the rules proposed by the Exchange provide definitions for the non-corporate issuers covered by these rules. However, the Exchange has given itself some level of discretion to decide that issuers not covered by this definition may still be subject to the obligations of non-corporate issuers. The three groups of issuers covered by these new rules are as follows:

1) Exchange traded products, i.e. redeemable equity securities ("**Exchange Traded Funds**" or "**ETFs**") and redeemable debt securities ("**Exchange Traded Notes**" or "**ETNs**") offered on a continuous basis under a prospectus which give an investor exposure to the performance of specific index, sectors, managed portfolios or commodities through a single type of securities
2) Closed-end funds, i.e. investment funds, mutual funds, split share corporations, capital trusts or other similar entities that are managed in accordance with specific investment goals and strategies
3) Structured products, i.e. securities generally issued by a financial institution (or similar entity) under a base shelf prospectus and pricing supplement where an investor's return is contingent on, or highly sensitive to, changes in the value of underlying assets, index, interest rates or cash flows. Structured products include securities such as non-convertible notes, principal or capital protected notes, index or equity linked notes, tracker certificates and barrier certificates

RATIONALE FOR THIS PROPOSAL

The Manual sets out the requirements enforced by the Exchange to all issuers as part of its mission to ensure a transparent, fair and orderly market for listed securities. These requirements were designed to recognize the specific features of various classes of issuers. However, the current version of the Manual does not take into account the specific features of ETFs and closed-end funds, which have become much more common in the Canadian market over the past 10 years.

Indeed, according to the data provided by the Exchange, while there were only three ETF providers offering 84 products listed on the Exchange at the end of 2008, by October 31, 2014, there were nine providers offering 335 ETFs. In addition, every year over the past five years, an average of 35 closed-end investment funds have been listed on the Exchange, representing a market value of more than $26B.

In the course of the elaboration of these proposed rules, the Exchange reviewed the listing requirements used by various recognized stock markets, including the New York Stock Exchange, NASDAQ, London Stock Exchange and, closer to home, the brand new Aequitas NEO Exchange. According to the Exchange's analysis, the products listed on NASDAQ and NYSE are the most comparable to those listed on the TSX.

PROPOSED MINIMUM LISTING REQUIREMENTS

In the proposed amendments, the Exchange intends to set the minimum market capitalization to be met by non-corporate issuers wishing to be listed on the TSX, as follows:

1) Exchange traded products must have a minimum market capitalization of $1 million
2) Closed-end funds must have a minimum market capitalization of $20 million
3) Structured products must have a minimum market capitalization of $1 million

In addition to the minimum market capitalization requirement, closed-end funds must also have issued a minimum of one million (1,000,000) freely tradeable securities held by at least 300 board lot holders.

The Exchange also provides for certain requirements for calculating net asset value, as well as for governance. The net asset value must be calculated daily for exchange traded products and weekly for closed-end funds and structured products. In all cases, the net asset value must be posted on the issuer's website.

With respect to governance, as the Exchange does for issuers of other classes, it will assess the integrity of the directors and officers of non-corporate issuers. Issuers or managers of exchange traded products, closed-end funds and structured products must have a CEO, CFO, secretary, as well as an independent review committee (for exchange traded products and closed-end funds) or two independent directors (for structured products). However, this obligation does not apply to exchange traded products and structured products issued by financial institutions.

REQUIREMENTS FOR MAINTAINING A LISTING

Securities of a closed-end fund may be suspended or delisted if the market value of the securities listed on the Exchange is less than $3 million ($3,000,000) for 30 consecutive trading days, the fund has less than 500,000 freely-tradeable securities, or the number of security holders is less than 150. As for the securities of exchange traded products and closed-end funds, they will be delisted if maintaining their listing affects market efficiency. To do so, the Exchange will, among other things, consider the degree of liquidity and market value of the securities.

CONCLUSION

The proposed amendments were subject to a period of comments extending from last January 15 to March 16. The coming into force of these rules also remains subject to approval by the Ontario Securities Commission.

As usual, if you are considering applying for a listing of your products on the Exchange, it is always preferable to obtain a preliminary opinion on eligibility for listing by filing an application to this effect with the Exchange.

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