

## CSA Staff Notice 81-331

### *Investment Funds Investing in Bail-in Debt*

August 23, 2018

#### Purpose

The purpose of this notice is to set out the views of the Canadian Securities Administrators (CSA) staff regarding the implementation of the Canadian bail-in regime and to provide clarity on certain issues for investment fund issuers subject to National Instrument 81-102 *Investment Funds* (NI 81-102).

#### Background

On June 22, 2016, federal amendments to the *Bank Act* and the *Canada Deposit Insurance Corporation Act* that implement a bail-in regime for Canada's domestic systemically important banks (D-SIBs) received Royal Assent.<sup>1</sup> The Office of the Superintendent of Financial Institutions (OSFI) has declared the six largest domestic Canadian banks<sup>2</sup> as D-SIBs. In 2013, the Autorité des marchés financiers (AMF) designated the Desjardins Group as a domestic systemically important financial institution. On July 13, 2018, amendments to the *Deposit Insurance Act* (Québec) came into force, which established a bail-in regime that applies to the Desjardins Group. Subject to the upcoming adoption of implementing regulations, the Desjardins Group will be subject to a bail-in regime that is similar to the one applicable to D-SIBs.

If OSFI is of the opinion that a D-SIB has ceased, or is about to cease, to be viable, the Canada Deposit Insurance Corporation (CDIC) may, in certain circumstances, take temporary control or ownership of the D-SIB and convert all or a portion of the D-SIB's bail-in debt (**Bail-in Debt**) into common shares of the D-SIB. The term "Bail-in Debt" refers to certain debt issued by D-SIBs before any conversion occurs under the Canadian bail-in regime.

The details of Bail-in Debt are set out in regulations under the *Bank Act* and the *Canada Deposit Insurance Corporation Act* that were adopted by the federal government on March 26, 2018, and will come into force on September 23, 2018 (**Regulations**).<sup>3</sup> Under the Regulations, Bail-in Debt generally includes all unsubordinated unsecured debt of a D-SIB that is tradeable and transferable with an original term to maturity of over 400 days. Explicit exclusions from the bail-in regime are provided for covered bonds, derivatives and certain structured notes.<sup>4</sup> The Regulations also include certain disclosure and naming requirements in respect of Bail-in Debt.

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<sup>1</sup> *Budget Implementation Act, 2016 No. 1* (Bill C-15).

<sup>2</sup> As of the date of this Notice, the D-SIBs are the Bank of Montreal, The Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada and The Toronto-Dominion Bank.

<sup>3</sup> Bank Recapitalization (Bail-in) Conversion Regulations: SOR/2018-57; Bank Recapitalization (Bail-in) Issuance Regulations: SOR/2018-58.

<sup>4</sup> The constituents of Bail-in Debt are prescribed in the Regulations.

## CSA staff guidance

CSA staff notes that pursuant to subsection 2.18(1) of NI 81-102, a money market fund is restricted in the types of securities it may have in its portfolio. In general, a money market fund may invest in investment grade short-term debt (i.e. remaining term to maturity of 365 days or less) to achieve its investment objectives of capital preservation and liquidity. CSA staff have received inquiries as to whether Bail-in Debt could be an eligible investment for a money market fund.

Given that Bail-in Debt is different from conventional convertible debt and is convertible in certain circumstances as defined in the *Canada Deposit Insurance Corporation Act*, CSA staff's view is that money market funds are permitted to invest in Bail-in Debt so long as the Bail-in Debt continues to meet the prescribed eligibility requirements applicable to money market funds<sup>5</sup> as set out in NI 81-102. For example, investment fund managers (**IFMs**) must continually monitor their investments in Bail-in Debt to ensure that such investments are in compliance with the designated rating requirements as prescribed by NI 81-102 and are generally readily convertible to cash, among other requirements, to ensure the safety and liquidity in such a money market fund's portfolio assets.

Should an investment fund decide to invest in Bail-in Debt, the IFM must fully understand the key features and risks of such Bail-in Debt and take into consideration any risks to their funds as a result of such investment, for example, the risk that the CDIC may convert all or a portion of the Bail-in Debt into common shares.

If an IFM determines that one or more of its investment funds will or may hold Bail-in Debt CSA staff remind the IFM that:

- any such holdings must be consistent with the fund's investment objectives and strategies and be held in compliance with NI 81-102, as applicable; and
- such funds must consider their disclosure obligations to their securityholders, including, for example, appropriate risk disclosure as it relates to Bail-in Debt and distinctions between Bail-in Debt and non-Bail-in Debt.

CSA staff will continue to monitor developments with respect to the implementation of the Canadian bail-in regime for investment fund issuers and will consider whether additional guidance is needed in this area. The CSA welcomes any input or feedback with respect to the issues in this notice.

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<sup>5</sup> Subsection 2.18(1) of NI 81-102.

## Questions

Please refer your questions to any of the following:

Melody Chen  
Senior Legal Counsel  
Legal Services, Corporate Finance  
British Columbia Securities Commission  
(604) 899-6530  
[mchen@bcsc.bc.ca](mailto:mchen@bcsc.bc.ca)

Chad Conrad  
Legal Counsel  
Alberta Securities Commission  
(403) 297-4295  
[Chad.Conrad@asc.ca](mailto:Chad.Conrad@asc.ca)

Heather Kuchuran  
Senior Securities Analyst, Securities Division  
Financial and Consumer Affairs Authority of  
Saskatchewan  
(306) 787-1009  
[heather.kuchuran@gov.sk.ca](mailto:heather.kuchuran@gov.sk.ca)

Wayne Bridgeman  
Deputy Director  
The Manitoba Securities Commission  
(204) 945-4905  
toll free: 1-800-655-5244 (MB only)  
[wayne.bridgeman@gov.mb.ca](mailto:wayne.bridgeman@gov.mb.ca)

Rhonda Horte  
Securities Officer  
Government of Yukon  
(867) 633-7969  
[rhonda.horte@gov.yk.ca](mailto:rhonda.horte@gov.yk.ca)

Frederick Gerra  
Senior Legal Counsel  
Investment Funds and Structured Products  
Ontario Securities Commission  
(416) 204-4956  
[fgerra@osc.gov.on.ca](mailto:fgerra@osc.gov.on.ca)

Solange Bilodeau  
Analyst  
Investment Funds Branch  
Autorité des marchés financiers  
(514) 395-0337, extension 4483  
[solange.bilodeau@lautorite.qc.ca](mailto:solange.bilodeau@lautorite.qc.ca)

To-Linh Huynh  
Deputy Director, Operations  
Financial and Consumer Services Commission  
(New Brunswick)  
(506) 643-7856  
[to-linh.huynh@fcnb.ca](mailto:to-linh.huynh@fcnb.ca)

H. Jane Anderson,  
Acting Executive Director, Director of Policy  
and Market Regulation and Secretary to the  
Commission  
Nova Scotia Securities Commission  
(902) 424-0179  
[Jane.Anderson@novascotia.ca](mailto:Jane.Anderson@novascotia.ca)

Craig Whalen  
Manager of Compliance, Licensing and  
Registration  
Government of Newfoundland and Labrador  
(709) 729-5661  
[cwhalen@gov.nl.ca](mailto:cwhalen@gov.nl.ca)

Jeff Mason  
Superintendent of Securities  
Government of Nunavut  
(867) 975-6591  
[jmason@gov.nu.ca](mailto:jmason@gov.nu.ca)

Jeremy Walsh  
Office of the Superintendent of Securities  
Government of Northwest Territories  
(867) 767-9260, ext. 82205  
[Jeremy\\_Walsh@gov.nt.ca](mailto:Jeremy_Walsh@gov.nt.ca)

Steven Dowling  
Acting Director  
Superintendent of Securities  
Government of Prince Edward Island  
(902) 368-4551  
[sddowling@gov.pe.ca](mailto:sddowling@gov.pe.ca)