

Independent Review Committee (IRC) Members Liability and Reimbursement Insurance



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AGENDA

- ▶ **IRC Functions under National Instrument 81-107**
- ▶ **An Analysis of IRC Liability & Key Exposures**
- ▶ **Why Stand-alone IRC Limits are Most Beneficial**
- ▶ **The Executive Risk IRC Liability Solution**



Overview of National Instrument 81-107

- ▶ The Canadian Securities Administrators have instituted a new governance regime for all public investment funds, National Instrument 81-107.
- ▶ Under this new system all investment funds, with the exception of certain pooled and hedge funds, must have an independent oversight body called an Independent Review Committee (IRC).



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Overview of National Instrument 81-107

- ▶ NI 81-107 applies to all publicly offered mutual funds and non-redeemable investment funds.
- ▶ Investment funds subject to the Instrument include:
 - labour sponsored or venture capital funds;
 - scholarship plans;
 - mutual funds and closed-end funds listed and posted for trading on a stock exchange or quoted on an over-the-counter market; and
 - investment funds not governed by National Instrument 81-102 Mutual Funds (NI 81-102).
- ▶ The Instrument does not regulate mutual funds that are not reporting issuers (commonly referred to as pooled funds).



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Overview of National Instrument 81-107

Key Dates:

- ▶ November 1st, 2006 – NI 81-107 came into force
- ▶ May 1st, 2007 – Establish Initial IRC
- ▶ November 1st, 2007 – Mandatory Full Compliance



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Overview of National Instrument 81-107

- ▶ National Instrument 81-107 is designed to promote investor protection in mutual funds while fostering market efficiency.



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IRC Functions under National Instrument 81-107

The IRC will have Four primary functions:

- ▶ review all “conflict of interest matters” referred to it and recommend whether the action proposed will achieve a fair and reasonable result for the funds
- ▶ review written policies and procedures dealing with conflict of interest matters
- ▶ decide / approve whether a fund can make certain investments that are currently prohibited under securities legislation and
- ▶ approve mergers and changes in auditor



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IRC Functions under National Instrument 81-107

- ▶ “conflict of interest matter” - any matter where a **reasonable person** would consider a manager, or an entity related to the manager, to have an interest that may conflict with the manager’s ability to act in good faith and in the best interests of the investment fund.



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IRC Liability & Key Exposures

What should be included in the IRC's written charter?

- ▶ The IRC charter must include the following:
 - its mandate;
 - its responsibilities and functions;
 - its policies and procedures; and
 - other functions to be performed as agreed to between the IRC and the manager that go beyond what is required in the Instrument.

IRC Liability & Key Exposures

- ▶ IRC members may be liable for breach of securities regulation if they fail, through inadvertence or otherwise, to carry out their duties under NI 81 107.

IRC Liability & Key Exposures

▶ 2.6 Standard of care

When carrying out his or her functions, a member of a mutual fund's independent review committee must

- ▶ (a) act honestly and in good faith;
- ▶ (b) act in the best interests of the mutual fund; and
- ▶ (c) exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.



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IRC Liability & Key Exposures

Two conditions must be satisfied for an IRC member to be indemnified:

- ▶ the IRC member must have acted in a manner consistent with his or her fiduciary duty with respect to the action or matter for which the IRC member is seeking the indemnification; and
- ▶ the IRC member must have had reasonable grounds for believing that his or her conduct was lawful.



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IRC Liability & Key Exposures

- ▶ An IRC member's misrepresentation to fund investors, resulting from negligence in preparing and communicating information, could result in personal liability being assigned to that IRC member and other members of the IRC.



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IRC Liability & Key Exposures

What are the key areas of exposure for IRC members?

- ▶ Failure to abide by obligations imposed under National Instrument 81-107
- ▶ Breach of Fiduciary and Instrument-mandated Duties
- ▶ Failure to fulfill the obligations outlined in the Charter
- ▶ Negligence, Negligent Misrepresentation and Defamation
- ▶ Liability for acting outside the Instrument and/or Charter
- ▶ Liability for excessive compensation



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Benefits of Stand-alone IRC Limits

Why not just extend the fund manager's D&O policy to cover the IRC?

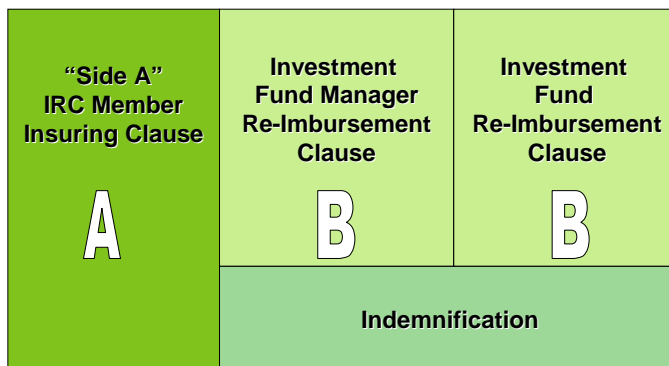
- ▶ IRC members cannot have a material relationship with the fund manager – endorsing IRC members onto the Fund Manager's corporate D&O policy may create a perception that IRC members are dependant for coverage and give rise to concerns about "independence"
- ▶ Not having appropriate insurance for IRC members would likely discourage qualified candidates.



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Executive Risk IRC Liability Solution

Stand-Alone, Independent Primary Solution



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Executive Risk IRC Liability Solution

What are the key features of the ERS IRC policy?

- ▶ Stand-alone Primary Insurance Solution, no erosion of Aggregate Limit by the Investment Fund or Investment Fund Manager
- ▶ Separate/Dedicated Aggregate Limit for IRC members
- ▶ Primary Capacity of \$10,000,000 CAN
- ▶ Informal Investigatory Expense Cost Coverage
- ▶ Broad Definition of "Wrongful Act" – coverage for responsibilities outside the instrument
- ▶ Indemnification Reimbursement for the Investment Fund Manager or the Investment Fund when indemnifying IRC members
- ▶ Optional Duty to Defend, no Panel Counsel
- ▶ Non-Rescindable for Independent IRC members
- ▶ NIL Deductible for IRC Members
- ▶ No Insured vs. Insured Exclusion



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Executive Risk IRC Liability Solution

QUESTIONS??



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