Draft Regulations

Securities Act
(R.S.Q. c. V-1.1, s. 331.1, pars. (1), (3), (4.1), (6), (8), (11), (13), (16), (17) and (34), and s. 331.2)

Regulation to amend Regulation 81-102 respecting Mutual Funds and concordant regulations

Notice is hereby given by the *Autorité des marchés financiers* (the "Authority") that, in accordance with section 331.2 of the *Securities Act*, R.S.Q. c. V-1.1, the following Regulations, the texts of which are published hereunder, may be made by the Authority and subsequently submitted to the Minister of Finance for approval, with or without amendment, after 90 days have elapsed since their publication in the Bulletin of the Authority:

- *Regulation to amend Regulation 81-102 respecting Mutual Funds.*

- *Regulation to amend Regulation 41-101 respecting General Prospectus Requirements*;

- *Regulation to amend Regulation 81-106 respecting Investment Fund Continuous Disclosure*;

- *Regulation to amend Regulation 81-107 respecting Independent Review Committee for Investment Funds*.

Draft amendments to the *Policy Statement to Regulation 81-102 respecting Mutual Funds* are also published hereunder in blackline version.

Request for comment

Comments regarding the above may be made in writing by **June 25, 2013**, to the following:

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March 27, 2013

Canadian Securities Administrators | Autorités canadiennes en valeurs mobilières

CSA Notice and Request for Comment
Draft *Regulation to Amend Regulation 81-102 respecting Mutual Funds* and Draft Amendments to *Policy Statement to Regulation 81-102 respecting Mutual Funds* and Related Consequential Amendments
-and-
Other Matters Concerning *Regulation 81-104 respecting Commodity Pools* and Securities Lending, Repurchases and Reverse Repurchases by Investment Funds

March 27, 2013

Introduction

The Canadian Securities Administrators (the CSA or we) are publishing for a 90-day comment period draft *Regulation to Amend Regulation 81-102 respecting Mutual Funds* (Regulation 81-102) (the Draft 81-102 Amendments, as set out in Annex E) to introduce core operational requirements for publicly offered non-redeemable investment funds, other than scholarship plans.[1] As described below, some of the Draft 81-102 Amendments relate to mutual funds. We are also publishing for comment draft amendments to *Policy Statement to Regulation 81-102 respecting Mutual Funds* (Policy Statement 81-102) (the Draft Policy Statement 81-102 Amendments).

Related consequential amendments are also being published for comment with this Notice:

- to reflect the proposed change in the name of Regulation 81-102; and
- to update *Regulation 41-101 respecting General Prospectus Requirements* (Regulation 41-101), including Form 41-101F2 *Information Required in an Investment Fund Prospectus* (Form 41-101F2).

The proposed rule amendments described above are collectively referred to in this Notice as the Draft Amendments. The Draft Amendments, together with the Draft Policy Statement 81-102 Amendments, are referred to as the "Proposed Provisions". The Proposed Provisions, together with the proposals relating to *Regulation 81-104 respecting Commodity Pools* (Regulation

[1] Scholarship plans are being considered by the CSA in a separate initiative. References to "non-redeemable investment funds" in this Notice do not include scholarship plans. In British Columbia, labour sponsored venture capital corporations registered under the *Employee Investment Act* (British Columbia) and venture capital corporations registered under the *Small Business Venture Capital Act* (British Columbia) would need to comply with Regulation 81-102 if the Draft 81-102 Amendments are adopted. An Annex, published in British Columbia, describes how the changes would impact these funds.

81-104) and securities lending, repurchases and reverse repurchases described below, represent the first stage in Phase 2 of the CSA's implementation of the Modernization of Investment Fund Product Regulation Project (the Modernization Project).

In addition to the Draft 81-102 Amendments, the Modernization Project also involves the creation of a more comprehensive alternative fund framework, to be effected through amendments to Regulation 81-104, that would operate in conjunction with the Draft 81-102 Amendments. The framework would govern investment funds that invest in assets, or use investment strategies, that would not be permitted by the Draft 81-102 Amendments. The framework is intended to create a more consistent, fair and functional regulatory regime across the spectrum of publicly offered investment fund products. We are seeking feedback on the appropriate parameters for the alternative fund framework.

The Modernization Project also includes the enhancement of the disclosure requirements relating to securities lending, repurchases and reverse repurchases by investment funds. We are also seeking feedback on how disclosure pertaining to these activities should be enhanced.

Background

The mandate of the Modernization Project is to review the product regulation of publicly offered investment funds and to consider whether our current regulatory approach sufficiently addresses product and market developments in the Canadian investment fund industry, and continues to adequately protect investors. The types of investment funds covered by the Modernization Project are publicly offered mutual funds (including exchange-traded mutual funds) and non-redeemable investment funds. The Project is being carried out in phases.

(i) Phase 1

In Phase 1, the CSA focused primarily on publicly offered mutual funds in amending Regulation 81-102, *Regulation 81-106 respecting Investment Fund Continuous Disclosure* (Regulation 81-106) and other investment fund rules to codify exemptive relief that had been frequently granted in recognition of market and product developments. As well, we made amendments to keep pace with developing global standards in mutual fund product regulation, notably, introducing maturity restrictions and liquidity requirements for money market mutual funds. The Phase 1 amendments came into force on April 30, 2012, except for the provisions relating to money market funds, which came into force on October 30, 2012.

(ii) Phase 2

The CSA's objective in Phase 2 is to identify and address any market efficiency, investor protection or fairness issues that arise out of the differing regulatory regimes that apply to different types of publicly offered investment funds. In May 2011, we published CSA Staff Notice 81-322 *Status Report on the Implementation of the Modernization of Investment Fund Product Regulation Project and Request for Comment on Phase 2 Proposals* (Staff Notice 81-322) to set out a two-staged approach to Phase 2 and to seek comment on our proposed approach.

First Stage of Phase 2

In the first stage of Phase 2, now underway, we are focusing on implementing an operational rule for non-redeemable investment funds. Historically, operational requirements have not been applied to non-redeemable investment funds although, like mutual funds, they are subject to the continuous disclosure and fund governance requirements set out in Regulation 81-106 and *Regulation 81-107 respecting Independent Review Committee for Investment Funds* (Regulation 81-107), respectively.

While non-redeemable investment funds are not new to the investment fund product landscape, their structure and characteristics have evolved along with the investment fund industry. Non-redeemable investment funds now use diverse investment strategies and provide investors with exposure to a variety of assets. In a time of increasing product innovation, we indicated in Staff Notice 81-322 that a staged approach will allow us to focus first on strengthening investor protection and addressing fairness issues arising out of the lack of an operational rule for non-redeemable investment funds. As well, introducing an operational rule for non-redeemable investment funds will level the playing field among non-redeemable investment funds, conventional mutual funds and exchange-traded mutual funds, providing a more consistent framework within which these funds can compete with each other.

In Staff Notice 81-322, we indicated that we were considering the adoption of core restrictions and other operational requirements, analogous to those in Regulation 81-102, for non-redeemable investment funds. These requirements could include, for example, certain conflicts of interest provisions and securityholder and regulatory approvals for fundamental changes to a non-redeemable investment fund and its management. In addition, we sought feedback on whether there were other restrictions and operational requirements that would be appropriate for non-redeemable investment funds and whether investment restrictions similar to those in Part 2 of Regulation 81-102 should apply to non-redeemable investment funds. We also sought feedback on a stand-alone operational rule for non-redeemable investment funds and the advantages and disadvantages of this approach.

Key Feedback Received on Staff Notice 81-322

In the feedback we received on Staff Notice 81-322, many commenters expressed the view that investment restrictions similar to those contained in Part 2 of Regulation 81-102 should not be adopted for non-redeemable investment funds because the primary distinction between mutual funds and non-redeemable investment funds is the flexibility to use alternative investment strategies to provide investors with exposure to different asset classes and innovative techniques. We were told this distinction is beneficial to investors and should not be eliminated. We have observed, however, that non-redeemable investment funds use a range of investment strategies that involve different levels and types of risks. Many non-redeemable investment funds invest using more conventional investment strategies similar to those used by mutual funds governed by Regulation 81-102. Others invest beyond the limits set out in Regulation 81-102.

While the CSA recognize that non-redeemable investment funds differ from mutual funds in certain key aspects, we do not agree that the differences provide a sufficient policy basis to support the absence of any investment restrictions for publicly offered non-redeemable

investment funds. Accordingly, we are proposing to include non-redeemable investment funds in the restrictions and practices in Regulation 81-102 that, in our view, represent fundamental requirements for all publicly offered investment funds.

We think that many of the investment restrictions in Part 2 of Regulation 81-102 represent fundamental requirements, as the restrictions:

- establish parameters for investment funds to meet the expectations of retail investors who invest in pooled investment products;[2]

- prohibit activities that are inconsistent with the fundamental characteristics of investment funds as passive investment vehicles;[3] or

- reflect prudent fund management practices.[4]

We recognize, however, that certain investment restrictions in Part 2 of Regulation 81-102 may need to be modified for non-redeemable investment funds because of the differences discussed below.

Taking into account the feedback on Staff Notice 81-322, we accept that investors may benefit from a wider array of investment choices. The CSA wish to preserve the flexibility for non-redeemable investment funds to provide investors with access to alternative investment strategies. Accordingly, concurrently with the Draft 81-102 Amendments, we are considering how to redesign Regulation 81-104 to expand the regulation to include both mutual funds and non-redeemable investment funds that wish to use alternative investment strategies that would go beyond the parameters of Regulation 81-102 (these investment funds are referred to as "alternative funds"). See "Modernization Project – Alternative Funds Framework" below.

We anticipate finalizing certain aspects of the Draft 81-102 Amendments in advance of others. These include the proposed conflicts of interest provisions, securityholder and regulatory approval requirements, and custodianship requirements. Other aspects, particularly certain proposed investment restrictions that are interrelated with Regulation 81-104, will require more time to consider and evaluate. We expect these components to be considered in conjunction with any related amendments to Regulation 81-104 and to come into force contemporaneously at a later date.

More detailed responses to the comments on Staff Notice 81-322 are in Annex D of this Notice.

[2] For example, diversification requirements for retail investors to benefit from greater diversification through investing in a fund as compared to investing on an individual account basis.

[3] For example, prohibitions on investing in real property or in issuers for the purpose of controlling them.

[4] For example, restrictions relating to securities lending, repurchases and reverse repurchases.

Second Stage of Phase 2
In the final stage of this initiative, the CSA will review the investment restrictions applicable to mutual funds in Part 2 of Regulation 81-102 to assess if any changes should be made in light of market and product developments.

Substance and Purpose of the Proposed Provisions

The Draft 81-102 Amendments introduce core operational requirements for non-redeemable investment funds, analogous to those applicable to mutual funds in Regulation 81-102. They will provide baseline protections for investors, regardless of whether they purchase an investment fund product structured as a mutual fund or a non-redeemable investment fund. They will also mitigate the potential for regulatory arbitrage within the current investment fund regulatory regime by levelling the playing field among non-redeemable investment funds, conventional mutual funds and exchange-traded mutual funds and providing a more consistent regulatory framework for comparable investment products.

The Draft 81-102 Amendments, together with amendments to Regulation 81-104 required in the design of an alternative funds framework, are expected to provide sufficient flexibility for mutual funds and non-redeemable investment funds to give investors access to alternative investment strategies, and to help investors differentiate amongst the various types of publicly offered investment fund products. These amendments are expected to contribute to more efficient capital markets by providing greater certainty and consistency for investment funds and their managers regarding the regulatory framework that they must follow.

The CSA, in the context of the Modernization Project, also seek to keep pace with developing global standards by enhancing the disclosure requirements relating to securities lending, repurchase and reverse repurchase transactions by investment funds.[5]

The other components of the Draft Amendments, as well as the Draft Policy Statement 81-102 Amendments, are consequential to the Draft 81-102 Amendments.

Summary of Draft Amendments

The proposed operational requirements for non-redeemable investment funds in the Draft 81-102 Amendments parallel many requirements applicable to mutual funds in Regulation 81-102. The CSA are of the view that many of the requirements in Regulation 81-102 provide core protections for investors that invest in investment funds and should not be limited only to mutual fund investors. Accordingly, we propose that similar provisions apply to non-redeemable

[5] See, for example: Financial Stability Board, Strengthening Oversight and Regulation of Shadow Banking – A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos (18 November 2012) online: <http://www.financialstabilityboard.org/publications/r_121118b.pdf>; European Securities and Markets Authority, Guidelines on ETFs and other UCITS issues – Consultation on Recallability of Repo and Reverse Repo Arrangements (25 July 2012) online: <http://www.esma.europa.eu/system/files/2012-474.pdf>; International Organization of Securities Commissions, Principles for the Regulation of Exchange Traded Funds (March 2012) online: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD376.pdf>.

investment funds. In some instances, we have proposed alternative requirements that recognize the differences between non-redeemable investment funds and mutual funds.

(i) Similarities and Differences between Mutual Funds and Non-Redeemable Investment Funds

Non-redeemable investment funds are similar to mutual funds in many ways. Under securities legislation, the primary purpose of both types of investment funds is to invest money provided by their securityholders. Both types of investment funds offer the benefits of pooled investment and portfolio management services to the public.

However, the CSA recognize that non-redeemable investment funds differ from mutual funds and, in particular, conventional mutual funds, in certain key aspects. Unlike conventional mutual funds, non-redeemable investment funds do not offer unlimited securities on a continuous basis and they do not redeem their securities at net asset value (NAV) on a regular basis. Instead, non-redeemable investment funds typically issue a fixed number of securities in an initial public offering,[6] following which the securities are generally listed and trade on an exchange at market prices which may be at a premium or discount to NAV. Many non-redeemable investment funds also give investors the right to redeem their securities annually at a price based on the NAV of the securities,[7] while others have a fixed life. Finally, while conventional mutual funds are primarily distributed by mutual fund dealers, non-redeemable investment funds are generally only distributed by investment dealers in the underwriting syndicate for the funds' public offering.

The key elements of the Draft Amendments are outlined below. A consolidated list of the specific issues in the Draft 81-102 Amendments on which we seek comment is set out in Annex A.

(ii) Investment Restrictions

As noted above, we think that many of the investment restrictions in Part 2 of Regulation 81-102 represent fundamental requirements that should apply to non-redeemable investment funds. In our review of the investment restrictions adopted by existing non-redeemable investment funds, we have observed that many non-redeemable investment funds have adopted several of the restrictions in Part 2 in their constating documents. We think that certain of the investment restrictions in Part 2 of Regulation 81-102 that impose constraints designed to limit risks for retail investors also represent prevailing industry best practices for investment funds that invest using conventional investment strategies.[8] Accordingly, we propose that those restrictions in Part 2 also apply to non-redeemable investment funds that invest using conventional investment strategies. Extending Part 2 to include these non-redeemable investment funds will result in the

[6] Non-redeemable investment funds are commonly referred to as "closed-end funds" because they issue a fixed number of securities rather than an unlimited number of securities on a continuous basis.

[7] The CSA generally take the view that where an investment fund redeems its securities based on NAV less frequently than once a year, the fund does not provide an "on demand" redemption feature and is therefore not a mutual fund subject to the requirements of Regulation 81-102. Please also see "Redemptions" below.

[8] For example, limits on short selling and cover requirements for derivative positions.

same regulatory protections for investors of all investment funds using conventional strategies, regardless of whether the fund is structured as a mutual fund or a non-redeemable investment fund.

We propose not to apply certain provisions in Part 2 of Regulation 81-102 to non-redeemable investment funds where differences between mutual funds and non-redeemable investment funds provide a basis for different requirements. Instead, we propose alternative provisions that recognize the differences and we propose limits that act as prudent safeguards.

Concentration Restriction

Many existing non-redeemable investment funds have adopted a concentration restriction that requires them to limit their investment in an issuer to an amount equal to 10% of NAV at the time of purchase, similar to the concentration restriction in section 2.1 of Regulation 81-102. Based on this prevailing practice, it appears that a 10% concentration limit is considered an industry best practice in providing a minimum level of diversification.

Therefore, we are proposing that a concentration restriction be adopted for non-redeemable investment funds, based on section 2.1 of Regulation 81-102. We also propose that the definition of "fixed portfolio ETF" in Regulation 81-102 be amended to permit a non-redeemable investment fund that has a fundamental investment objective of holding and maintaining a fixed portfolio of publicly traded equity securities of issuers named in their prospectus to exceed the 10% concentration restriction in section 2.1 of Regulation 81-102. We seek comment on whether a 10% concentration restriction is appropriate for non-redeemable investment funds and, if not, why a higher issuer concentration restriction would be appropriate for non-redeemable investment funds. We are also considering whether "alternative funds" governed by Regulation 81-104 should be permitted to have a more generous concentration restriction than in section 2.1 of Regulation 81-102. See "Modernization Project – Alternative Funds Framework" below.

Investments in Physical Commodities

We are proposing to limit investments by a non-redeemable investment fund in physical commodities and specified derivatives the underlying interests of which are physical commodities to, in the aggregate, an amount equal to 10% of NAV at the time of purchase. This limit is similar to the limit imposed in recent orders that granted exemptive relief to mutual funds to permit them to make these types of investments. Non-redeemable investment funds that wish to focus on physical commodities or derivatives that provide exposure to physical commodities may choose to be "alternative funds" regulated under Regulation 81-104. See "Modernization Project – Alternative Funds Framework" below.

Investments in Illiquid Assets

We are proposing that non-redeemable investment funds be permitted to invest a larger portion of their assets in illiquid assets than mutual funds. We note that, unlike mutual funds, non-redeemable investment funds generally do not offer regular redemptions based on NAV. Rather, most of them primarily offer liquidity through listing their securities on an exchange. We seek comment on the limit on illiquid asset investments that would be appropriate for non-redeemable investment funds.

Borrowing

We are proposing that non-redeemable investment funds be permitted to borrow cash up to an amount equal to 30% of NAV. The 30% borrowing limit generally reflects the current practice of the majority of existing non-redeemable investment funds, which limit their cash borrowings to an amount that is between 10% to 33% of NAV.

We also think that requiring borrowing from a lender that is licensed to carry on a lending business could provide additional monitoring and controls over a non-redeemable investment fund's cash borrowings that are based on the investment strategies and financial condition of the specific fund. We are proposing that non-redeemable investment funds borrow from a "Canadian financial institution" (as defined in *Regulation 14-101 respecting Definitions*), as we have observed that existing non-redeemable investment funds generally borrow from Schedule I or II banks. We seek comment on whether this requirement for non-redeemable investment fund borrowings is appropriate. We are also considering whether non-redeemable investment funds that are "alternative funds" regulated under Regulation 81-104 should be permitted to borrow more than 30% of NAV. See "Modernization Project – Alternative Funds Framework" below.

We also note that under the Draft 81-102 Amendments, non-redeemable investment funds would be able to create leverage only through cash borrowings. Non-redeemable investment funds that wish to create leverage through the use of specified derivatives (as defined in Regulation 81-102) or short selling may choose to be "alternative funds" regulated under Regulation 81-104. See "Modernization Project – Alternative Funds Framework" below.

Investments in Mortgages

We are proposing that there be no limit on a publicly offered non-redeemable investment fund's investments in guaranteed mortgages (as defined in Regulation 81-102). We are also proposing that mortgage investments by these types of funds be restricted to guaranteed mortgages. The CSA are of the view that mortgages that are not fully and unconditionally guaranteed by a government or government agency ("non-guaranteed mortgages") may not be appropriate investments for publicly offered investment funds.[9]

We have observed that there is currently a limited number of existing publicly offered non-redeemable investment funds that have investment objectives of investing in non-guaranteed mortgages. We therefore are proposing a 24 month transition period for the application of the restriction in proposed paragraph 2.3(2)(b), to give these types of funds time either to divest their holdings of non-guaranteed mortgages (which would trigger a change in investment objective if the fund's investment objectives state that the fund will be investing in non-guaranteed mortgages) or to transition into the regulatory regime for issuers that are not investment funds. We are seeking comment on the impact of the proposed restriction on non-guaranteed mortgage investments and the appropriate length of the transition period. We are also seeking comment on alternatives to a transition period, such as a grandfathering provision, and the impact of this alternative.

[9] For a discussion about the investments of mortgage investment entities, see CSA Staff Notice 31-323 *Guidance Related to the Registration Obligations of Mortgage Investment Entities*.

Fund-of-Fund Structures
We are proposing that non-redeemable investment funds be required to follow the requirements in subsection 2.5(2) of Regulation 81-102 when investing in mutual funds. We also propose that non-redeemable investment funds not be permitted to invest in other non-redeemable investment funds. Otherwise, a non-redeemable investment fund could have portfolio exposure that is greater than 130% of its NAV if it invests in an underlying non-redeemable investment fund that leverages its portfolio through cash borrowings. The CSA have also observed that non-redeemable investment funds generally do not seek to invest in other non-redeemable investment funds. Non-redeemable investment funds that wish to use greater leverage may choose to be "alternative funds" regulated under Regulation 81-104. See "Modernization Project – Alternative Funds Framework" below.

We also seek feedback on the application of proposed paragraphs 2.5(2)(a) and (c) of Regulation 81-102 to certain non-redeemable investment funds that use a fund-of-fund structure involving an underlying mutual fund.

Securities Lending, Repurchases and Reverse Repurchases
We think that non-redeemable investment funds should engage in securities lending, repurchases and reverse repurchases on the same basis as mutual funds. Therefore, we are generally proposing that the framework applicable to securities lending, repurchases and reverse repurchases by mutual funds apply to non-redeemable investment funds. We also propose to amend paragraphs 2.12(1)12 and 2.13(1)11 of Regulation 81-102 such that the aggregate market value of securities loaned under securities lending transactions or sold in repurchase transactions by an investment fund may not exceed an amount equal to 50% of the fund's NAV.

Paragraphs 2.12(1)12 and 2.13(1)11 currently state that the aggregate market value of the securities loaned under securities lending transactions or sold in repurchase transactions may not exceed 50% of the fund's total assets, not including the collateral held by the fund for the loaned securities and the cash held by the fund for the sold securities. The draft amendments to paragraph 2.12(1)12 and 2.13(1)11 would mean that non-redeemable investment funds, which are proposed to be permitted to borrow cash up to an amount equal to 30% of their NAV, may not include any borrowed cash (or portfolio assets purchased with borrowed cash) in calculating the maximum market value of their securities that may be loaned under securities lending transactions or sold in repurchase transactions. For mutual funds, the CSA consider that the impact of this proposed amendment would be minimal as mutual funds are generally not permitted to be leveraged and their liabilities are generally not significant relative to their total assets.

(iii) New Non-Redeemable Investment Funds

Seed Capital
As noted above, non-redeemable investment funds typically raise sufficient funds for investment purposes by issuing a fixed number of securities in their initial public offering, instead of engaging in a continuous distribution of securities. Because of the differences in capital raising models of mutual funds and non-redeemable investment funds, the CSA do not think that the

seed capital and minimum subscription requirements in sections 3.1 and 3.2 of Regulation 81-102 should apply to non-redeemable investment funds.

Organizational Costs

Proposed subsection 3.3(3) of Regulation 81-102 prohibits the costs of organizing a new non-redeemable investment fund from being borne by the fund. Currently, managers that launch non-redeemable investment funds do not pay any of the organizational costs; instead, the costs are paid out of the proceeds of the initial public offering of the non-redeemable investment fund. On the other hand, managers that launch mutual funds must pay the costs of establishing new mutual funds and then recoup the costs through the ongoing management fee charged to the fund. The CSA recognize that non-redeemable investment funds undertake an initial public offering that raises a fixed amount of money in a limited amount of time, rather than offering securities on a continuous basis. While this has historically accounted for the difference in organizational cost payment models between non-redeemable investment funds and mutual funds, the CSA think it is important to examine the application of proposed subsection 3.3(3) of Regulation 81-102 to non-redeemable investment funds.

Both investors and managers benefit from managers establishing investment funds that are sustainable in the long term. However, the financial risk of launching a non-redeemable investment fund that may not be sustainable appears to be borne only by investors if all of the organizational costs are paid out of the proceeds of the initial public offering. Therefore, requiring managers to pay the organizational costs of a new non-redeemable investment fund could be perceived to further align the interests of managers with those of investors.

Another potential benefit of the proposed provision is that it may increase the efficiency of non-redeemable investment fund launches. The proposed provision could further strengthen the manager's interest in minimizing organizational costs to reduce its initial outlay, resulting in cost efficiencies when launching new funds. Also, as certain organizational costs are fixed, it appears to the CSA that launching a larger fund may be more cost efficient than launching multiple smaller funds, which may have the potential disadvantages of higher per unit operational costs and lower secondary market liquidity.

Finally, the introduction of a requirement for the manager to pay the organizational costs of launching a new non-redeemable investment fund will level the playing field between mutual fund managers and non-redeemable investment fund managers and may discourage arbitrage opportunities. The CSA have observed several instances where managers launch mutual funds without paying any organizational costs by creating a non-redeemable investment fund and then converting it into a mutual fund after a short period of time.

We recognize that if managers are required to pay organizational costs, managers that cannot finance the organizational costs would not be able to launch new non-redeemable investment funds. As well, smaller non-redeemable investment funds may not be launched. We seek comment on the potential impact and the benefits and costs of proposed subsection 3.3(3) for non-redeemable investment funds. In addition, we seek comment on whether the different capital raising model followed by non-redeemable investment funds may support the fund continuing to pay some of the organizational costs out of the proceeds of the initial public offering of the fund

and whether there are specific components of organizational costs that are more appropriately borne by the non-redeemable investment fund and components that are more appropriately borne by the manager.

(iv) Conflicts of Interest

We are proposing to apply the conflicts of interest provisions in Part 4 of Regulation 81-102 to non-redeemable investment funds. The introduction of these provisions will extend key protections to non-redeemable investment fund investors. This proposal received broad support from commenters that provided feedback to Staff Notice 81-322.

(v) Fundamental Changes

We think that non-redeemable investment fund investors should have similar protections and rights as mutual fund investors relating to fundamental changes to their funds. Therefore, we are proposing to apply the provisions in Part 5 of Regulation 81-102 to non-redeemable investment funds.

Securityholder and Regulatory Approval Requirements

The CSA have observed that the constating documents of many non-redeemable investment funds incorporate investor voting rights that are similar to those in Part 5 of Regulation 81-102. However, these rights are not consistently provided by each non-redeemable investment fund offered to the public. Codifying these requirements will give all investors consistent and guaranteed voting rights on important changes that impact the fund or its management.

We propose to re-draft the requirement to obtain regulatory approval for a change in control of the manager for greater clarity and move it from subsection 5.5(2) to proposed paragraph 5.5(1)(a.1) of Regulation 81-102. While this will be a new requirement for non-redeemable investment funds, there are no substantive changes for mutual funds from the re-draft.

Proposed New Securityholder Approval Requirements

In addition to the existing requirements in Part 5, the CSA also propose that prior securityholder approval be obtained to implement a change to the nature of an investment fund. Specifically, prior securityholder approval is proposed to be required to implement any change that would convert a mutual fund into a non-redeemable investment fund, convert a non-redeemable investment fund into a mutual fund, or convert an investment fund into an issuer that is not an investment fund. In addition, the costs and expenses to implement the change (which include the costs of obtaining securityholder approval and, if applicable, the costs of filing a simplified prospectus to commence a continuous distribution) may not be borne by the investment fund.

We are proposing a limited exemption from the proposed securityholder approval requirement for a non-redeemable investment fund that is structured from inception to convert to a mutual fund upon the occurrence of a specified event. Conditions for this proposed exemption include

prospectus and sales communication disclosure of the conversion and securityholder notice prior to the conversion.

The CSA also propose an exemption to the securityholder and regulatory approval requirements for fund mergers involving specialized non-redeemable investment funds that have a limited life and that do not list or trade their securities on a secondary market. These non-redeemable investment funds are typically organized as limited partnerships and have the investment objective of providing returns through tax-assisted investments in "flow-through" shares issued by resource companies. Investors must remain invested in the funds to realize the tax benefits of their investment, with liquidity provided at the termination of the fund through a distribution of the net proceeds or a reorganization with a mutual fund under which assets are transferred on a tax-deferred basis to the mutual fund in exchange for securities issued by the mutual fund. Given the unique structure and purpose of these non-redeemable investment funds, the CSA propose that these funds be exempted from securityholder and regulatory approval requirements if they are effecting a rollover into a mutual fund, provided that certain requirements, including prospectus disclosure requirements, are met.

Proposed New Conditions for Pre-Approved Fund Mergers

In addition to the current conditions in subsection 5.6(1) of Regulation 81-102, the CSA propose that, as a condition to effect a merger of a non-redeemable investment fund with another investment fund without securityholder or regulatory approval, the non-redeemable investment fund offer to redeem its securities at their NAV at a date that is before the effective date of the merger. In our view, the ability to exit the fund at NAV helps to mitigate the need for securityholder approval.

The CSA also propose that a merger be effected at NAV as a condition for the merger to proceed without securityholder or regulatory approval. This condition helps to mitigate conflicts of interest where funds under common management are merged. The TSX Company Manual contains a similar condition for fund mergers to be implemented without securityholder approval.

Termination of Non-Redeemable Investment Funds

Proposed section 5.8.1 of Regulation 81-102 requires that non-redeemable investment funds terminate no earlier than 15 days and no later than 30 days after filing a press release to disclose the intended termination. This provision is intended to give investors sufficient time to consider the consequences of the termination and also require that money be repaid promptly to investors if a fund is terminating, as any secondary market liquidity can be expected to decline significantly after the termination of the fund is disclosed.

(vi) Custodianship Requirements

Custodianship requirements for non-redeemable investment funds that parallel the requirements for mutual funds in Part 6 of Regulation 81-102 currently exist in Part 14 of Regulation 41-101. We propose to update the drafting in Part 6 of Regulation 81-102 based on the drafting in

Regulation 41-101, and apply the updated Regulation 81-102 requirements to non-redeemable investment funds. There are no substantive changes to the custodian requirements for any investment funds, other than requiring all non-redeemable investment funds, rather than only those that file a prospectus under Regulation 41-101, to comply with the custodianship requirements. Part 14 of Regulation 41-101 will remain in order to maintain the custodianship requirements for scholarship plans.

(vii) Incentive Fees

We propose that restrictions on non-redeemable investment funds paying incentive fees apply in a similar manner as for mutual funds. Part 7 of Regulation 81-102 sets parameters for incentive fees to be charged appropriately with reference to a relevant benchmark, which we think should apply to all investment funds that use similar investment strategies. A non-redeemable investment fund that invests using alternative investment strategies permitted under Regulation 81-104 may choose to be an "alternative fund" regulated under Regulation 81-104 and pay incentive fees in accordance with that regulation. See "Modernization Project – Alternative Funds Framework" below.

(viii) Sales of Securities

The CSA do not propose to apply the provisions in Part 9 of Regulation 81-102 to non-redeemable investment funds because of the differences in the distribution models between non-redeemable investment funds and mutual funds. However, we are proposing to introduce subsections 9.3(2) and (3) to require that issuances of non-redeemable investment fund securities not cause dilution to existing securityholders. These subsections parallel the requirement that mutual fund securities be issued at NAV. We seek comment on whether proposed subsections 9.3(2) and (3) achieve the purpose of preventing dilutive issuances while taking into account how new securities are distributed.

(ix) Warrant Offerings

Proposed new Part 9.1 of Regulation 81-102 prohibits an investment fund from issuing warrants, rights or other specified derivatives the underlying interest of which is a security of the investment fund. In recent years, the CSA have observed non-redeemable investment funds issuing warrants that could potentially dilute the value of the securities held by investors who do not exercise the warrants. Steps to mitigate dilution, such as selling the warrants on the secondary market, may be ineffective or not sufficient to compensate investors who do not exercise their warrants for the loss of the value of their securities. As warrants are automatically issued to securityholders, warrants may also appear to be coercive, with securityholders obligated to make an additional investment or face the risk of dilution.

We think that investors in a non-redeemable investment fund may not expect the costs of warrant issuances to be part of their investment bargain; specifically, investors do not generally expect that the fund they invest in will seek additional capital from them after they have made the initial investment, or that they will have to incur costs for the fund to raise additional capital. The CSA are of the view that a restriction on warrant issuances will not unduly limit the ability of an

investment fund to raise additional money. A manager that wishes to raise additional money for its fund may file a prospectus to issue new securities, provided that the issuance is not dilutive to existing securityholders.

(x) Redemptions

The CSA do not propose to apply many of the provisions in Part 10 of Regulation 81-102 to non-redeemable investment funds because of the differences in redemption models between these funds and mutual funds. However, we propose similar requirements for non-redeemable investment funds that offer annual redemptions based on NAV or more regular redemptions at market value. We are proposing that:

- like mutual funds, non-redeemable investment funds that offer redemptions send investors an annual reminder of the procedures for exercising redemptions;

- non-redeemable investment funds pay redemption proceeds promptly; specifically, no more than 15 business days after the redemption is effected;

- non-redeemable investment funds not redeem securities at an amount that is greater than the NAV of the security on the redemption date, to avoid dilution to remaining securityholders; and

- non-redeemable investment funds that offer redemptions be permitted to suspend redemptions if the requirements in section 10.6 of Regulation 81-102 are met.

Many existing non-redeemable investment funds offer redemptions of their securities based on NAV once a year. The CSA have taken the view that investment funds that offer redemptions based on NAV no more than once a year are non-redeemable investment funds. We seek comment on whether to reconsider this position.

(xi) Commingling of Cash

The CSA are proposing to amend Part 11 of Regulation 81-102 so that the provisions relating to the holding of monies from sales and redemptions in a trust account will apply to non-redeemable investment funds. The Draft 81-102 Amendments would also permit cash received in respect of sales and redemptions of all investment fund securities to be held in one account.

(xii) Sales Communications

We are proposing to apply the provisions in Part 15 of Regulation 81-102 to sales communications of non-redeemable investment funds, with modifications that recognize differences between mutual funds and non-redeemable investment funds. The proposed requirements in Part 15 do not impact the restrictions applicable during the waiting period and the period between the issuance of the receipt for the final prospectus and the closing of the prospectus offering.

We are proposing to amend section 15.6 of Regulation 81-102 such that a mutual fund that was converted from a non-redeemable investment fund must, if it wishes to present performance data, present past performance data for the period when it existed as a non-redeemable investment fund. This is consistent with the continuous disclosure requirements in Regulation 81-106, as well as exemptive relief that has been granted to such funds.

(xiii) Naming Convention for Investment Funds

We are considering whether "alternative funds" regulated under Regulation 81-104 should be required to include the words "Alternative Fund" in their name to clearly differentiate "alternative funds" from investment funds subject only to Regulation 81-102. See "Modernization Project – Alternative Funds Framework" below. We seek comment on whether investment funds that are subject only to Regulation 81-102 should also be required to include specific identifiers in their name that would identify them as investment funds that use the conventional investment strategies permitted in Regulation 81-102.

(xiv) Other Provisions relating to Non-Redeemable Investment Funds

We are proposing that non-redeemable investment funds set record dates in accordance with Part 14 of Regulation 81-102, except that if a non-redeemable investment fund lists its securities on an exchange, it may follow the rules of the applicable exchange regarding record dates.

We also propose that non-redeemable investment funds maintain and make available securityholder records in accordance with Part 18 of Regulation 81-102.

(xv) Transition Period for Certain Proposed Provisions relating to Non-Redeemable Investment Funds

As noted above, we anticipate that some aspects of the Draft 81-102 Amendments, specifically, the proposed core operational requirements for non-redeemable investment funds other than certain provisions in Part 2 of Regulation 81-102, will come into force in advance of other aspects. We expect that the introduction of certain investment restrictions in Part 2 of Regulation 81-102 and their interrelation with Regulation 81-104 will take more time to consider and evaluate. Given their interconnectedness, we expect that these components will be considered together and come into effect contemporaneously at a later date.

Currently, the CSA propose an 18 month transition period for existing non-redeemable investment funds to comply with the investment restrictions in proposed amended sections 2.2, 2.3,[10] 2.4 and 2.5 of Regulation 81-102 to give existing funds sufficient time to align their portfolios with the new requirements. Any new non-redeemable investment funds established after the coming-into-force date of the Draft 81-102 Amendments pertaining to these sections would be required to comply with the investment restrictions in Part 2 of the amended Regulation 81-102 immediately. We seek comment on the transition period and alternatives to a transition period.

[10] Other than proposed paragraph 2.3(2)(b), for which a 24 month transition period is proposed.

We are also proposing an 18 month transition period for compliance with Part 7 of Regulation 81-102, and a 6 month transition period for existing non-redeemable investment funds to continue to use sales communications (other than advertisements) that were prepared prior to the coming-into-force date of the Draft 81-102 Amendments pertaining to Part 15 of Regulation 81-102.

(xvi) Related Consequential Amendments

Amendments to Regulation 41-101, including and Form 41-101F2
Where a non-redeemable investment fund is structured to convert into a mutual fund upon the occurrence of a specified event, we propose to amend Form 41-101F2 to require specific prospectus disclosure of the conversion.

We also propose to require specific prospectus disclosure of investments in physical commodities. If an investment fund invests in physical commodities, proposed Item 6.1(7) of Form 41-101F2 will require certain disclosure under the "Investment Strategies" heading, including the types of commodities the fund may purchase, whether the commodity exposure is in the form of investments in physical commodities or investments through specified derivatives the underlying interest of which are physical commodities, and how the fund will use its investment in physical commodities to achieve its investment objectives.

Many non-redeemable investment funds redeem their securities by reference to NAV annually, with the redemption proceeds being equal to the NAV per security less certain costs that may be deducted from the NAV per security. In response to the feedback received on Staff Notice 81-322, we propose to amend Item 15 of Form 41-101F2 to require disclosure of any costs or other fees that may be deducted from the NAV per security to clarify what amount will be received upon redemption.

We propose to repeal Item 21.2 of Form 41-101F2 to reflect the proposed restrictions on borrowing by non-redeemable investment funds. As proposed subparagraph 2.6(a)(i.1) of Regulation 81-102 would restrict cash borrowings to loans from a Canadian financial institution (as defined in Regulation 14-101 respecting *Definitions*), non-redeemable investment funds would not be permitted to issue debt securities to the public.

We also propose to repeal Items 21.3 and 27 of Form 41-101F2 to reflect the proposed prohibition on investment funds offering warrants or specified derivatives the underlying interest of which are securities of the investment fund.

Finally, we propose to delete references to "subsidiaries" of investment funds in Form 41-101F2 as these references would not be consistent with proposed amended section 2.2 of Regulation 81-102.

Other Consequential Amendments
We propose minor consequential amendments to Regulation 81-106, Regulation 81-107 and its commentary, and the regulations and policy statements published with this Notice to reflect proposed changes in certain definitions in Regulation 81-102 to encompass non-redeemable

investment funds and to reflect the change in the name of Regulation 81-102 from "*Regulation 81-102 respecting Mutual Funds*" to "*Regulation 81-102 respecting Investment Funds*".

(xvii) Draft 81-102 Amendments that Impact Mutual Funds

While Phase 2 focuses on introducing operational requirements for non-redeemable investment funds, there are provisions in the Draft 81-102 Amendments that would impact mutual funds, in addition to our consideration of additional requirements relating to securities lending, repurchases and reverse repurchases by investment funds in Annex C and our proposals to redesign Regulation 81-104 described below. These provisions are:

- proposed amended sections 2.11 and 2.17 will require an exchange-traded mutual fund that is not in continuous distribution to issue a news release if the fund intends to begin using specified derivatives, short selling and entering into securities lending, repurchases and reverse repurchases transactions;

- proposed amended paragraphs 2.12(1)12 and 2.13(1)11 will limit the amount of securities loaned or sold in repurchase transactions by a mutual fund to 50% of NAV, rather than 50% of total assets, excluding the collateral delivered to the fund (see "(ii) Investment Restrictions – Securities Lending, Repurchases and Reverse Repurchases" above);

- subsection 3.3(2) is proposed to be repealed, as the rationale for introducing proposed subsection 3.3(3) for non-redeemable investment funds also applies to exchange-traded mutual funds that are not in continuous distribution (see "(iii) New Non-Redeemable Investment Funds – Organizational Costs" above);

- proposed amended paragraph 5.1(1)(g) will broaden the securityholder approval requirements to require securityholder approval for a merger of a mutual fund with any issuer, rather than a merger with another mutual fund;

- proposed new paragraph 5.1(1)(h) will require that a mutual fund that wishes to implement a change that restructures the fund into a non-redeemable investment fund or an issuer that is not an investment fund to obtain prior securityholder approval, with the fund prohibited from bearing the costs of the restructuring;

- proposed new paragraph 5.6(1)(k) will include a new condition that the consideration offered to securityholders of an investment fund for a merger have a value that is equal to the NAV of the fund if the merger is to be effected without prior securityholder or regulatory approval;

- subsection 5.6(2) is proposed to be repealed, as Regulation 81-106 requires that the auditor's report that accompanies financial statements of an investment fund not contain a reservation;

- proposed section 9.1 will prohibit the issuance of warrants and similar instruments by all investment funds;

- proposed subsections 9.3(2) and (3) will apply to an exchange-traded mutual fund that is not in continuous distribution to prevent dilutive issuances of securities;

- proposed subsections 10.4(1.3) and 10.6(2) will require an exchange-traded mutual fund that is not in continuous distribution to pay redemption proceeds no more than 15 business days after the redemption is effected, unless the redemptions of the fund have been suspended in accordance with the requirements in section 10.6; and

- draft amendments to Part 11 will permit cash received in respect of sales and redemptions of all investment fund securities (and not only mutual fund securities) to be held in one trust account.

We are also considering requirements for investment funds governed only by Regulation 81-102 to include specific identifiers in their name (see "(xiii) Naming Convention for Investment Funds" above).

Adoption Procedures

We expect the Draft Amendments to be incorporated as part of rules in each of British Columbia, Alberta, Manitoba, Ontario, Nova Scotia, Prince Edward Island, New Brunswick, Newfoundland and Labrador, Northwest Territories, Yukon and Nunavut, and incorporated as part of commission regulations in Saskatchewan and regulations in Québec. The Draft Policy Statement 81-102 Amendments are expected to be adopted as part of policies in each of the CSA jurisdictions.

Alternatives Considered to the Draft Amendments

The alternative to the Draft Amendments would be not to cover non-redeemable investment funds in Regulation 81-102 and thus maintain the status quo.

Not proceeding with the Draft Amendments would continue to permit non-redeemable investment funds to operate without a set of core operational requirements, such as certain conflicts of interest prohibitions, securityholder and regulatory approval requirements for fundamental changes and custodianship requirements. We think this alternative would not be appropriate in view of the investor protection and fairness concerns arising from the lack of baseline protections for investors of non-redeemable investment funds. Without the Draft Amendments, there would also be less certainty and consistency for non-redeemable investment funds and their managers regarding the operational requirements that they must follow.

Anticipated Costs and Benefits of the Draft Amendments

We think the Draft Amendments strike the right balance between protecting investors and fostering fair and efficient capital markets. The Draft Amendments will benefit investors and the capital markets by creating a more consistent, fair and functional regulatory regime across the spectrum of investment fund products.

Core operational requirements for non-redeemable investment funds and a more comprehensive regulatory framework for alternative funds will increase the efficiency for the investment fund industry by enabling them to offer products in a more timely fashion, as the requirements applicable to all publicly offered investment funds will be more clearly delineated for managers, investors and the market generally. We also think that the Draft Amendments will level the playing field for all investment funds.

The CSA are of the view that the Draft Amendments will not create substantial costs for investment funds, their managers or securityholders. Many of the Draft Amendments codify prevailing investment parameters and limits within the non-redeemable investment fund industry. Our review of existing non-redeemable investment funds indicates that a majority of non-redeemable investment funds already follow investment restrictions that are comparable to the proposed investment restrictions in Regulation 81-102. Further, many managers either manage various types of investment fund products (including mutual funds subject to Regulation 81-102) or have already established the necessary infrastructure to monitor compliance with the investment restrictions included in the constating documents of their funds. Therefore, these managers are already equipped to monitor compliance with any additional investment restrictions.

Introducing fundamental investor rights and protections may involve additional costs for non-redeemable investment funds, their managers or their securityholders. We think that the costs associated with providing investors with fundamental rights and protections are proportionate and do not outweigh the benefits. Areas where there may be a cost burden include:

- the proposal to prohibit a non-redeemable investment fund or its securityholders from paying the organizational costs of a new non-redeemable investment fund may require managers to finance the organizational costs of new funds. Managers could reconsider how they charge fees to their funds or securityholders if they pay the costs of launching a new fund;

- the proposed application of the securityholder voting requirements in Part 5 of Regulation 81-102 to non-redeemable investment funds may result in additional costs. Similar to our view on the importance of providing mutual fund investors with the right to vote on fundamental changes, we think that Part 5 provides important protection for investors of non-redeemable investment funds that would outweigh the associated costs. We also do not expect managers to implement fundamental changes on a frequent basis; and

- the proposed prohibition on warrant issuances to protect existing investors of an investment fund from dilutive offerings may result in increased costs if managers have to look for other ways of increasing their assets under management. We expect that managers will raise additional money through offerings of new securities of the fund, rather than through warrant offerings. As managers may still raise additional money through new offerings, we think that this prohibition does not represent an undue

restriction on managers and that the investor protection benefits from this proposed prohibition outweigh the costs.

Overall, we think the potential benefits of the Draft Amendments are proportionate to their costs. We seek feedback on whether you agree or disagree with our perspective on the cost burden of the Draft Amendments, as well as your views on the cost burden of implementing other elements of the Modernization Project, including the proposed reform of Regulation 81-104 described below. Specific quantitative data in support of your views in this context would be particularly helpful.

Modernization Project – Alternative Funds Framework

Together with the CSA's introduction of core operational requirements for publicly offered non-redeemable investment funds, we are considering amendments to Regulation 81-104 to include both mutual funds and non-redeemable investment funds that focus on alternative asset classes or use alternative investment strategies not permitted by proposed amended Regulation 81-102.

Currently, Regulation 81-104 sets forth a regulatory framework that applies only to specialized mutual funds that are commodity pools by exempting them from certain restrictions in Regulation 81-102. A redesign of Regulation 81-104 to include both mutual funds and non-redeemable investment funds is intended to preserve the flexibility for non-redeemable investment funds to use alternative investment strategies that may not be permissible under the Draft 81-102 Amendments, and at the same time, create a more comprehensive regulatory framework in Regulation 81-104 for alternative funds (both mutual funds and non-redeemable investment funds). Any amendments to Regulation 81-104 will also seek to help investors more effectively differentiate between investment funds that use alternative investment strategies from investment funds that use more conventional investment strategies.

As part of our review of Regulation 81-104, we are examining the current exemptions from Regulation 81-102 that are contained in Regulation 81-104 to determine whether each exemption should remain and what, if any, new exemptions should be added. We are also considering new disclosure requirements in the prospectus, continuous disclosure and sales communications for investment funds that wish to use the alternative investment strategies in Regulation 81-104 and whether there is a need for additional proficiency requirements for the sale of alternative fund securities.

We have set out below the key elements of a proposed regulatory framework in Regulation 81-104 on which we seek feedback. This will inform the rule-making relating to Regulation 81-104 and the proposed investment restrictions in Regulation 81-102, as the two frameworks are intended to work in conjunction with each other to allow a wide variety of investment funds to be offered to the public. After reviewing your feedback, we will publish draft amendments to Regulation 81-104 for comment. Based on the feedback received, we may also publish for comment modifications to certain of the Draft 81-102 Amendments that interact with draft amendments to Regulation 81-104.

Feedback is welcome on all aspects of the proposed regulatory framework in Regulation 81-104 being considered by the CSA. A consolidated list of the specific issues on which we seek feedback is set out in Annex B.

(i) Definition of "Alternative Fund"

The CSA contemplate that Regulation 81-104 would apply to

- an "alternative fund" to which Regulation 81-102 applies, and
- a person in respect of an alternative fund to which Regulation 81-104 applies.

The CSA are considering replacing the term "commodity pool" in Regulation 81-104 with "alternative fund", a term that we think will better describe the types of investment objectives or strategies that characterize the investment funds that would be subject to the amended Regulation 81-104. Alternative funds will be permitted to invest in certain asset classes and use certain strategies not permitted by Regulation 81-102 by virtue of exemptions from Regulation 81-102 that will be contained in Regulation 81-104. We seek feedback on the use of the term "alternative fund" and whether it accurately describes the types of funds that would be expected to be captured by Regulation 81-104.

The current definition of "commodity pool" in Regulation 81-104 refers to a mutual fund that has adopted fundamental investment objectives that permit it to use or invest in specified derivatives or physical commodities in a manner not permitted by Regulation 81-102. The CSA are considering defining an "alternative fund" as an investment fund that, in its initial prospectus, states that it is an alternative fund in response to Item 1.3(1) of Form 41-101F2. Both mutual funds and non-redeemable investment funds could be alternative funds if they satisfy the definition.

(ii) Investment Restrictions

Concentration Restriction

To allow investment funds greater flexibility to engage in alternative investment strategies, we are considering permitting alternative funds to invest a larger percentage of their NAV in securities of a single issuer than the proposed 10% restriction in Regulation 81-102. Depending on the comments received on the Draft 81-102 Amendments, non-redeemable investment funds may become subject to a higher concentration restriction than 10% under Regulation 81-102, and this may impact the concentration restriction under Regulation 81-104. See "Summary of Draft Amendments" above. We seek feedback on the types of investment strategies an alternative fund may engage in that would require a fund's investment in an issuer to exceed the current 10% concentration restriction in Regulation 81-102.

Also, given that we anticipate alternative funds having more leveraged exposure than investment funds that invest within the limits in Regulation 81-102, we are considering whether the concentration measurement in section 2.1 of Regulation 81-102 based on the net asset value is a sufficient measurement to provide information about the concentration of an alternative fund's

portfolio. We seek feedback on whether there are other ways that would better describe the level of concentration of an alternative fund portfolio.

Investments in Physical Commodities

The CSA are considering maintaining the current exemptions from paragraphs 2.3(d), (e), (f), (g) and (h) of Regulation 81-102 in Regulation 81-104. We think that Regulation 81-104 should similarly permit alternative funds structured as non-redeemable investment funds to invest in physical commodities and specified derivatives linked to physical commodities in the same way as commodity pools currently do today. The CSA expect that investment funds that primarily focus on investing in physical commodities through direct holdings or through specified derivatives would be alternative funds subject to Regulation 81-104.

Currently, there are mutual funds that have received exemptive relief from Regulation 81-102 to be "precious metals funds" because their fundamental investment objectives provide that they invest primarily in gold, silver or platinum. We do not expect these funds to be impacted by our consideration of draft amendments to Regulation 81-104.

Fund-of-Fund Structures

Generally, we are considering permitting an alternative fund to invest in underlying investment funds (including underlying alternative funds) subject to similar conditions applicable to fund-of-fund investments in section 2.5 of Regulation 81-102.

The application of paragraphs 2.5(2)(a) and (c) of Regulation 81-102 to alternative funds would mean that an alternative fund that wishes to use a fund-of-fund structure may invest only in underlying mutual funds that are reporting issuers in the same jurisdictions as the alternative fund. The CSA are not at this time contemplating the inclusion of an exemption from paragraphs 2.5(2)(a) and (c) in Regulation 81-104 to permit alternative funds to invest in underlying funds that are not reporting issuers. We are of the view that fund-of-fund structures that involve investing in underlying investment funds that are not reporting issuers in the same jurisdictions as the alternative fund (e.g., underlying funds that are foreign investment funds or Canadian-based investment funds that are offered under prospectus exemptions) are more appropriately addressed through discretionary exemptive relief for each specific structure proposed to be offered.

Borrowing

The CSA are considering whether alternative funds should be permitted to borrow cash beyond the proposed 30% limit for non-redeemable investment funds in Regulation 81-102. If alternative funds are permitted to borrow a greater amount of cash, we are considering a limit that would not exceed 50% of NAV at the time of borrowing. We seek feedback on whether alternative funds that are structured as mutual funds and those that are structured as non-redeemable investment funds should have different borrowing restrictions in Regulation 81-104, in light of a mutual fund's need to fund regular redemptions.

Short Selling

The CSA are considering permitting alternative funds to sell securities short beyond the limits in Regulation 81-102 to provide these funds with more flexibility to use long/short strategies. We

are considering limiting the aggregate market value of all securities of an issuer that may be sold short by an alternative fund to 10% of the NAV of the fund, calculated at the time of the short sale. As well, we are considering restricting the aggregate market value of all securities that may be sold short by an alternative fund to 40% of the NAV of the fund, calculated at the time of a short sale. These limits would be similar to those imposed in orders that granted exemptive relief to commodity pools to permit them to short sell. We are also considering including an exemption in Regulation 81-104 from the short selling conditions in subsections 2.6.1(2) and (3) of Regulation 81-102, which require funds to hold cash cover and prohibit the use of short sale proceeds to purchase securities other than securities that qualify as cash cover. We seek feedback on whether alternative funds should be permitted to short sell on this basis.

Use of Derivatives

We contemplate maintaining the current exemption from sections 2.8 and 2.11 of Regulation 81-102 in Regulation 81-104 to permit alternative funds to create leverage through using specified derivatives. This exemption would apply to both mutual funds and non-redeemable investment funds that are alternative funds.

Leveraged Daily Tracking Alternative Funds

In recent years, the CSA have observed offerings of investment funds (Leveraged Daily Tracking Alternative Funds) that seek to provide daily investment returns that are up to two times the daily positive or inverse return of an underlying interest (e.g., an index, commodity price, interest rate or exchange rate) that they track. When held for periods longer than one day, the return of these funds may differ from the multiple or inverse multiple of the return of the relevant underlying interest over the longer period. These differences may be inconsistent with investor expectations.

The CSA are considering introducing a restriction on alternative funds from providing returns of more than two times the existing daily positive or inverse return of an underlying interest. We also seek feedback on issues relating to the marketing of Leveraged Daily Tracking Alternative Funds, as well as issues relating to the proficiency of individual dealing representatives who sell securities of Leveraged Daily Tracking Alternative Funds and dealer supervision of trades in securities of these funds.

Counterparty Credit Exposure

We are considering whether the exemption from subsections 2.7(4) and (5) of Regulation 81-102 (the Counterparty Exposure Exemption) in Regulation 81-104 should be repealed. The repeal of the Counterparty Exposure Exemption will restrict an alternative fund from having a mark-to-market exposure under its specified derivatives positions with any one counterparty other than an acceptable clearing corporation or a clearing corporation that settles transactions made on a futures exchange listed in Appendix A to Regulation 81-102 (the Clearing Corporation Exception), which exceeds, for a period of 30 days or more, 10% of the NAV of the alternative fund. The existing Clearing Corporation Exception in subsection 2.7(4) of Regulation 81-102 would permit alternative funds to continue to use investment strategies based on standardized futures.

Repealing the Counterparty Exposure Exemption would be intended to reduce the risk of exposure to a single counterparty, particularly in connection with illiquid over-the-counter

(OTC) derivatives. Where an alternative fund's exposure to a counterparty constitutes a significant amount of the fund's NAV, we think that the risks associated with such exposure, particularly the credit risk of the counterparty, may materially alter the nature and risk profile of the fund.

We also note that large counterparty exposures through OTC derivatives may be inconsistent with the restrictions on investments in illiquid assets, as Regulation 81-104 does not exempt commodity pools from the restriction in section 2.4 of Regulation 81-102.

We seek feedback on the impact of this approach to existing commodity pools that may be relying on the Counterparty Exposure Exemption and whether the repeal of this exemption would appropriately mitigate the risks of counterparty exposure, or whether there are other ways to achieve the desired outcome.

Total Leverage Limit

Limit

The CSA are considering introducing a total leverage limit for alternative funds in Regulation 81-104. Alternative funds may employ leverage through a number of ways including borrowing, short selling and derivatives transactions; also, they may obtain leveraged exposure through investing in underlying funds that employ leverage. Although the provisions relating to each investment strategy may specify limits for each strategy, we are considering creating a single cap on the total amount of leverage an alternative fund may create through leveraged investment strategies. The cap would include the leverage obtained through investing in underlying funds that employ leverage.

We are considering a total leverage limit for alternative funds of 3:1, based on the leverage calculation method currently specified in Form 41-101F2. The proposed 3:1 limit would be required to be respected by an alternative fund at all times, and not only at the time of entering into a transaction that creates leverage. We seek feedback on this proposed limit and whether the total leverage limit should be the same for mutual funds and non-redeemable investment funds, having regard to a mutual fund's need to fund regular redemptions.

Leverage Measurement Methods

Form 41-101F2 currently requires the maximum leverage an investment fund may use to be disclosed as a ratio of total long positions (including leveraged positions) plus total short positions divided by the net assets of the investment fund. This calculation has the benefit of presenting a single number that may be readily understood by retail investors. The drawback to this measure is that it may not fully express the nature of the leverage applicable to an alternative fund, as leverage created through different means may have different impact. For example, a leveraged position created through using standardized futures may be closed quickly by entering into an offsetting position, while leverage created through borrowing may be more difficult to reduce. Leverage through purchasing a call option differs from leverage through a long position

in a forward contract since the former does not create future payment obligations. Other aspects of particular investment strategies may also complicate the calculation of leverage.

We are considering whether there are other methods of measuring leverage and invite feedback on this.

Other Investment Restrictions for Alternative Funds
Other than the investment restrictions discussed above, the CSA seek feedback on whether there are additional investment strategies that Regulation 81-104 should permit or restrict for alternative funds.

(iii) New Alternative Funds

Seed Capital and Organizational Costs
The CSA are considering the requirements applicable to the launch of new alternative funds. We are considering adopting a model for alternative funds that is substantially similar to Part 3 of Regulation 81-102. We are considering a model under which sections 3.1 to 3.3 of Regulation 81-102 would apply to the launch of a new alternative fund that is a mutual fund, except that:

- the minimum amount specified in subsection 3.1(2) of Regulation 81-102 that must be received by the fund before redemptions may be processed would be raised from $500,000 to $5,000,000 for an alternative fund; and

- the manager of the alternative fund (or the persons specified in subsection 3.1(1) of Regulation 81-102, who, together with the manager of the alternative fund, are referred to as "sponsors") would be required to provide seed capital of $150,000, instead of the $50,000 in seed capital currently required for commodity pools under section 3.2 of Regulation 81-104.

Under the proposed model, sponsors that launch new alternative funds that are non-redeemable investment funds would only have to comply with proposed amended section 3.3 of Regulation 81-102 (see "Summary of Draft Amendments – (iii) New Non-Redeemable Investment Funds").

On-going Investment by Sponsors
Subsection 3.2(2) of Regulation 81-104 restricts a commodity pool from redeeming securities unless the securities issued to sponsors remain outstanding and the sponsors maintain a $50,000 investment in the commodity pool.

In recent years, exemptive relief has been granted to permit sponsors of a commodity pool to withdraw their seed capital investment in the commodity pool, provided that:

- the commodity pool has received $5,000,000 in subscriptions from investors other than the sponsors; and

- if the value of the commodity pool units subscribed to by investors other than the sponsors drops below $5,000,000 for more than 30 consecutive days, the sponsors

reinvest the seed capital amount and maintain that investment until the value of the commodity pool units subscribed to by investors other than the sponsors exceeds $5,000,000.

We are considering whether to eliminate the restriction in subsection 3.2(2) of Regulation 81-104 and permit sponsors to withdraw their seed capital investment in alternative funds, subject to the same conditions for the exemptive relief described above. We are also seeking feedback on whether sponsors should be required to maintain an on-going investment in alternative funds.

(iv) Proficiency

Currently, Part 4 of Regulation 81-104 requires mutual fund restricted individuals (as defined in Regulation 81-104) who sell commodity pool securities to have qualifications in addition to those for selling mutual fund securities. In particular, a mutual fund restricted individual may only trade in a security of a commodity pool if that individual meets the additional proficiency standards set out in subsection 4.1(1) of Regulation 81-104. Part 4 also imposes proficiency requirements for dealer supervision of trades in commodity pool securities.

Given the unique features that will characterize alternative funds such as the increased flexibility to create leverage and engage in potentially more complex strategies, the CSA are considering whether further proficiency requirements should apply to all individual dealing representatives who sell alternative fund securities. For example, these individuals could be required to have additional experience or to have passed additional courses. We seek feedback on whether and what additional proficiency requirements could apply.

(v) Enhanced Disclosure and Transparency

A key element of the CSA's proposal for a more robust framework for alternative funds is to provide clarity for investors and the market by more effectively differentiating between alternative funds and investment funds subject only to Regulation 81-102. To achieve this, we are considering the introduction of specific requirements relating to the naming, prospectus disclosure, sales communications, and continuous disclosure of alternative funds, as set out below.

Naming Convention

We are considering requiring all alternative funds to have the words "Alternative Fund" in their name. This requirement would apply to existing commodity pools and other investment funds that wish to gain access to the Regulation 81-104 framework, subject to a transition period. We seek feedback on whether there are identifiers other than including "Alternative Fund" in the name of the alternative fund that would achieve the same purpose. In addition, we are considering whether alternative funds that list and trade their securities on an exchange should be required to use trading symbols or a suffix to the symbol that would more readily identify the fund as an alternative fund.

Prospectus Disclosure
The CSA anticipate that alternative funds would file a prospectus using Form 41-101F2. To further differentiate alternative funds from conventional investment funds, the CSA are considering introducing a disclosure item in Form 41-101F2 that would require the inclusion of a prescribed text box in bold text in a specified font size on the cover page of the prospectus of an alternative fund, as follows:

> This fund is an alternative fund. This fund may use investment strategies or invest in assets in a different manner than other investment funds. The risks of investing in this fund may differ significantly from the risks associated with other investment funds.
>
> These brief statements do not disclose all the risks and other significant aspects of investing in this fund. You should carefully read this prospectus, including the description of the principal risk factors before you decide to invest.

In addition, we are considering requiring an alternative fund to disclose in its prospectus under the "Investment Strategies" heading how its investment strategies differ from those of a conventional investment fund under Regulation 81-102.

Finally, we are also considering prohibiting an alternative fund from being offered in the same prospectus document with investment funds that are not alternative funds.

Sales Communications
The CSA are considering introducing specific sales communication disclosure requirements to Regulation 81-104 to assist investors and market participants in distinguishing alternative funds from other types of investment funds. Similar to the text box disclosure on the cover page of the prospectus, we are considering a requirement for all sales communications for alternative funds to include a text box at the top of the first page of any sales communication or at the beginning of a sales communication that is not in printed form, with the following content:

> This fund is an alternative fund. This fund may use investment strategies or invest in assets in a different manner than other investment funds. The risks of investing in this fund may differ significantly from the risks associated with other investment funds.

We are also considering prohibiting alternative funds from comparing themselves to other types of investment funds in their sales communications. The CSA have observed comparisons between commodity pools and mutual funds, for example, that do not present a fair and balanced picture of the respective benefits and risks associated with each type of fund.

Continuous Disclosure
As alternative funds will have more flexibility to generate leverage and engage in more complex strategies, the CSA are considering whether investors may benefit from more frequent financial reporting and tailored disclosure of how specific investment strategies have affected the returns

of an alternative fund. Increased transparency could also help investors and their advisers monitor the risks of the funds they have chosen.

Monthly Website Disclosure

To supplement the existing quarterly information required under Regulation 81-106, we are considering requiring an alternative fund to disclose publicly on its or its fund manager's website, on a monthly basis (with an appropriate time lag for the manager to prepare the information), the largest monthly and annual NAV drawdowns of the alternative fund in the past five years, or since inception if the alternative fund has been in existence for less than five years.

We are also considering whether to require an alternative fund to disclose its maximum and average daily leverage amounts during the most recent 12 month period. These reports would be updated on a monthly basis (also with an appropriate time lag for the manager to update the information) and be posted on the fund's or its manager's website.

We seek feedback on whether the proposed monthly disclosure of NAV drawdown and leverage information for alternative funds will be useful to investors or the market generally. We also seek feedback on whether there is other information that could be provided regularly on an alternative fund's or its manager's website that would be meaningful for investors.

Semi-Annual and Annual Disclosure

In addition to the disclosure regarding borrowing under subsection 3.6(2) of Regulation 81-106, we are also considering amending the semi-annual and annual disclosure requirements in Regulation 81-106 to require tailored disclosure relating to an alternative fund's use of investment strategies that create leverage. For example, alternative funds could be required to disclose the maximum amount of leverage and the average amount of leverage used during the reporting period. The additional disclosure could also contain a qualitative explanation of how leverage was employed during the reporting period.

(vi) Transition

The CSA recognize that existing commodity pools, as well as non-redeemable investment funds that currently use investment strategies that may not be permitted under the Draft 81-102 Amendments, may seek to become alternative funds under the new definition. We think that existing investment funds should disclose to their investors and the market their intent to become alternative funds under Regulation 81-104. We seek feedback on the steps that existing investment funds should take for transitioning into the alternative funds framework provided in the revised Regulation 81-104.

We anticipate that existing investment funds that wish to transition into the alternative funds framework will be given sufficient time to take the necessary steps to make the transition. We anticipate that there would be a transition period proposed for comment, the design of which will depend on feedback received on the requirements for transition.

Securities Lending, Repurchases and Reverse Repurchases by Investment Funds

In connection with our proposal to apply the framework for securities lending, repurchases and reverse repurchases in Regulation 81-102 to non-redeemable investment funds, we also reviewed the existing requirements in Regulation 81-102 and Regulation 81-106 relating to securities lending, repurchases and reverse repurchases in light of the recent international focus on these activities to examine whether the existing requirements continue to keep pace with international standards.[11] While we think that the current operational requirements are generally comparable to existing standards in other international jurisdictions, as a result of this review, we are considering additional rules to enhance the transparency of the returns, costs and risks of securities lending, repurchases and reverse repurchases by investment funds, particularly where conflicts of interest may arise in connection with these activities.

Please refer to Annex C for specific questions for which we seek feedback to inform our consideration of amendments to the requirements relating to securities lending, repurchases and reverse repurchases by investment funds.

We will also continue to monitor global regulatory developments relating to securities lending, repurchases and reverse repurchases by investment funds.

Local Matters

An Annex is being published in any local jurisdiction that is making related changes to local securities laws, including local notices or other policy instruments in that jurisdiction. It also includes any additional information that is relevant to that jurisdiction only.

Unpublished Materials

In developing the Proposed Provisions, we have not relied on any significant unpublished study, report or other written materials.

Request for Comments and Feedback

We are soliciting comment on the Draft Amendments. As well, we are seeking feedback on the proposals being considered for an alternative fund regime under Regulation 81-104 and the proposals being considered in relation to securities lending, repurchases and reverse repurchases by investment funds. We have identified specific issues in Annexes A to C to this Notice.

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. All comments will be posted on the OSC website at www.osc.gov.on.ca.

Please submit your comments in writing on or before June 25, 2013. If you are not sending your comments by email, please send a CD containing the submissions (in Microsoft Word format).

[11] See note 5 above.

Where to Send Your Comments

Address your submission to all of the CSA as follows:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Please send your comments only to the addresses below. Your comments will be forwarded to the other CSA members.

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Fax: 514-864-6381
Email: consultation-en-cours@lautorite.qc.ca

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
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Questions

Please refer your questions to any of the following people:

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Contents of Annexes

The text of the Proposed Provisions is contained in the following annexes to this Notice and is available on the websites of members of the CSA:

Annex A: Specific Questions of the CSA relating to the Draft 81-102 Amendments

Annex B: Specific Questions of the CSA relating to the Alternative Funds Framework in Regulation 81-104

Annex C: Specific Questions of the CSA relating to Securities Lending, Repurchases and Reverse Repurchases by Investment Funds

Annex D: Summary of Public Comments on Phase 2 Proposals for the Modernization Project

Annex A

Specific Questions of the CSA relating to the Proposed 81-102 Amendments

Annual Redemptions of Securities Based on NAV

1. Securities legislation defines a "mutual fund" as, among other things, an issuer whose securities entitle the holder to receive on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest of the net assets of the issuer.

The CSA have historically taken the view that "on demand, or within a specified period after demand" in the definition of "mutual fund" means that the securities of the fund entitle the holders to request that their securities be redeemed by the fund more frequently than once a year. This view has permitted investment funds to redeem their securities once a year based on their NAV and still be considered non-redeemable investment funds. We seek feedback on whether the CSA should reconsider its present view and consider an investment fund to be a mutual fund if it offers any redemptions based on NAV.

Investment Restrictions

Concentration Restriction

2. Do you agree with the 10% issuer concentration restriction for non-redeemable investment funds set out in proposed amended section 2.1 of Regulation 81-102? If not, please provide reasons why non-redeemable investment funds should be permitted to have a higher concentration limit, and how non-redeemable investment funds would benefit from a higher limit. Please also propose a higher limit and provide reasons for the limit.

If Regulation 81-102 provides for a concentration limit that is greater than 10% for non-redeemable investment funds, should Regulation 81-104 provide an even higher concentration limit for non-redeemable investment funds that are alternative funds subject to Regulation 81-104? Or should the concentration limits be the same for non-redeemable investment funds in both Regulation 81-102 and Regulation 81-104? We invite feedback on the appropriate balance of the concentration limit in Regulation 81-102 for non-redeemable investment funds and the concentration limit for non-redeemable investment funds under the alternative funds framework in Regulation 81-104.

Investments in Illiquid Assets

3. As non-redeemable investment funds do not redeem their securities regularly based on NAV, the CSA propose that they be permitted to purchase and hold more illiquid assets than the levels currently permitted by subsections 2.4(1) to (3) of Regulation

81-102. However, we are concerned that a portfolio containing a significant amount of illiquid assets could lead to difficulties in valuing the NAV of the fund. It is critical that the NAV of an investment fund be accurately valued; for example, non-redeemable investment funds typically pay management and other fees based on the NAV of the fund, NAV is used to measure performance, and many non-redeemable investment funds offer annual redemptions based on NAV.

We have observed that many non-redeemable investment funds do not invest in a substantial amount of illiquid assets; in fact, the majority of non-redeemable investment funds, like mutual funds, hold minimal amounts of illiquid assets. Would the ability to purchase and hold more illiquid assets than the levels currently permitted by subsections 2.4(1) to (3) of Regulation 81-102 be beneficial for non-redeemable investment funds? What types of illiquid assets do non-redeemable investment funds wish to invest in, and why?

The CSA invite comment on the amount of illiquid assets that would be appropriate for non-redeemable investment funds to purchase and hold, and whether non-redeemable investment funds should be given more time than 90 days to divest illiquid assets (please refer to the mutual fund divestment requirements in subsections 2.4(2) and (3) of Regulation 81-102). Is there a minimum amount of liquid assets that non-redeemable investment funds should be required to hold to meet ongoing liquidity needs (e.g., to pay management fees and operational expenses)? Should the limit on illiquid asset investments be different for non-redeemable investment funds that do not offer any redemptions and non-redeemable investment funds that offer annual redemptions?

Borrowing

4. We seek comment on whether the proposed requirement for non-redeemable investment funds to borrow from a "Canadian financial institution" is appropriate. For example, if the majority of an investment fund's assets are held outside Canada because it focuses on investing in foreign securities, should there be more flexibility to borrow from lenders other than those that are "Canadian financial institutions"? If so, what conditions should the other lenders have to meet?

Investments in Mortgages

5. We invite comment on the impact of the proposed restriction on investments in non-guaranteed mortgages for publicly offered non-redeemable investment funds. We also seek feedback on the transition period for the proposed restriction. If you consider that a transition period longer than 24 months is required, please explain why. Alternatively, if you think that a grandfathering provision is warranted to exempt these types of funds from the application of the proposed restriction on investments in non-guaranteed mortgages, please comment on the impact such a provision could have on fairness to new market participants and investor understanding.

Fund-of-Fund Structures

6. Certain non-redeemable investment funds (top funds) use a forward agreement to obtain exposure to an underlying mutual fund that is not subject to Regulation 81-102. The underlying mutual fund in this fund-of-fund structure is established solely for the purpose of facilitating the investments of the top fund and it invests in accordance with the restrictions adopted by the top fund.

Under the Proposed 81-102 Amendments, an underlying mutual fund in a fund-of-fund structure would be required to be subject to Regulation 81-102. The investment restrictions in Regulation 81-102 applicable to mutual funds are generally more restrictive than the proposed investment restrictions for non-redeemable investment funds. The CSA are considering measures to enable top funds that are non-redeemable investment funds to continue to use the fund-of-fund structure described in the preceding paragraph, such that the underlying mutual fund may continue to invest in accordance with the investment restrictions applicable to the top fund. We seek comment on whether a carve-out from proposed paragraph 2.5(2)(a) of Regulation 81-102 would be effective for this purpose and if so, what conditions should attach to the use of the carve-out. Are there appropriate alternative measures to enable an underlying fund that is a mutual fund to follow the investment restrictions applicable to the top fund (a non-redeemable investment fund)?

7. Currently, many managers of non-redeemable investment funds that invest using the fund-of-fund structure described in question 6 have only filed prospectuses for the underlying fund in Ontario and/or Québec even though the prospectuses for the top fund (the non-redeemable investment fund) were filed in all of the jurisdictions of Canada.

Under proposed amended paragraph 2.5(2)(c) of Regulation 81-102, the underlying fund must be a reporting issuer in all the jurisdictions in which the non-redeemable investment fund is a reporting issuer. This is intended to prevent an indirect distribution of the securities of the underlying fund in jurisdictions where the underlying fund has not filed a prospectus and to ensure that the local jurisdiction has authority over both the top fund and the underlying fund. Should proposed amended paragraph 2.5(2)(c) apply to non-redeemable investment funds that use a fund-of-fund structure? If not, why not? What other parameters could be used to address the CSA's objectives?

Organizational Costs of New Non-Redeemable Investment Funds

8. We seek comment on the impact and the benefits and costs of proposed subsection 3.3(3) of Regulation 81-102. Are there other parameters that could be developed that would achieve benefits similar to the benefits from proposed subsection 3.3(3)? Please also comment on whether the capital raising model followed by non-redeemable investment funds could support the payment of some of the organizational costs out of the proceeds of the initial public offering. Are there specific components of organizational costs that are more appropriately borne by the non-redeemable investment fund and components that are more appropriately borne by the

manager? Please provide information about these cost components and what fraction each component typically constitutes of the total organizational costs for launching a new fund, and explain why it is appropriate for the fund or the manager to pay the specific cost components.

Dilutive Issuances of Securities

9. The CSA propose to introduce subsection 9.3(2) to prevent issuances of securities that cause dilution to the NAV of other outstanding securities of a non-redeemable investment fund. Proposed subsection 9.3(3) recognizes that a non-redeemable investment fund that raises additional money from the public through a new issuance of securities must include the price of the securities in the prospectus. We invite comment on whether proposed subsections 9.3(2) and (3) achieve the purpose of preventing dilutive issuances while taking into account how new securities are distributed.

Naming Convention for Investment Funds

10. Please see question 13 in Annex B.

Transition Period for Investment Restrictions in Proposed Amended Regulation 81-102 and Alternatives

11. We are proposing that existing non-redeemable investment funds be required to comply with the investment restrictions in proposed amended sections 2.2, 2.3,[1] 2.4 and 2.5 of Regulation 81-102 18 months after the first coming-into-force date of the Proposed 81-102 Amendments pertaining to these sections. We invite feedback on whether the proposed transition period is sufficient. If not, please provide reasons for a longer transition period or provide alternatives to a transition period.

If you think that a grandfathering provision is warranted for existing non-redeemable investment funds, please comment on the scope of a grandfathering provision and explain why existing non-redeemable investment funds should not have to comply with specific sections in Part 2 of Regulation 81-102. Please also comment on the impact a grandfathering provision could have on fairness to new market participants and investor understanding.

Anticipated Costs of the Proposed Amendments and of Implementing the Alternative Funds Framework

12. Do you agree or disagree that the costs of the Proposed Amendments and the proposals relating to Regulation 81-104 are proportionate to the benefits? We seek specific data from non-redeemable investment funds and commodity pools on the anticipated costs and benefits of complying with the regulatory framework set out in the proposed amendments to Regulation 81-102 and the alternative funds regulatory framework being contemplated in Regulation 81-104.

[1] Other than proposed paragraph 2.3(2)(b). See question 5 above.

Annex B

Specific Questions of the CSA relating to the Alternative Funds Framework in Regulation 81-104

Definition of "Alternative Fund"

1. Does the use of the term "alternative fund" appropriately describe the types of investment funds that should be captured by Regulation 81-104? If not, please propose other terms that better describe the types of investment funds that use investment strategies that should be permitted under a revised version of Regulation 81-104.

Investment Restrictions

Concentration Restriction

2. We seek feedback on the types of investment strategies an alternative fund may engage in that would require a fund's investment in an issuer to exceed the current 10% concentration restriction in proposed amended Regulation 81-102. If you think that the concentration restriction under Regulation 81-104 should be higher than the current 10% issuer concentration limit in Regulation 81-102, please provide feedback on what an appropriate concentration restriction would be for alternative funds. See also question 2 in Annex A.

3. Given that we anticipate alternative funds having more leveraged exposure than is permissible under Regulation 81-102, should we consider other measurements for an alternative fund's concentration? Should issuer concentration for alternative funds be based on the total notional exposure of the fund? We seek feedback on this and other measurements that would better describe the level of concentration in an alternative fund portfolio.

Borrowing

4. Should alternative funds that are structured as mutual funds and alternative funds that are structured as non-redeemable investment funds have different borrowing restrictions in Regulation 81-104? Would a mutual fund's need to fund regular redemptions mean that the amount of leverage through cash borrowings could increase rapidly and cause difficulties in maintaining the 3:1 total leverage limit we are considering?

Short Selling

5. Should Regulation 81-104 include exemptions from subsections 2.6.1(2) and (3) of Regulation 81-102 to permit the creation of leverage through short selling and increase flexibility for alternative funds to engage in long/short strategies?

Leveraged Daily Tracking Alternative Funds

6. Are there specific issues relating to the marketing of Leveraged Daily Tracking Alternative Funds that the CSA should consider? Are there specific issues relating to the proficiency of individual dealing representatives who sell Leveraged Daily Tracking Alternative Fund securities and dealer supervision of trades in Leveraged Daily Tracking Alternative Fund securities that the CSA should consider?

Counterparty Credit Exposure

7. We seek feedback on the impact to existing commodity pools that are relying on the Counterparty Exposure Exemption if this exemption in Regulation 81-104 were to be repealed.

Would repealing the Counterparty Exposure Exemption sufficiently mitigate the risk of exposure to a single counterparty, particularly in connection with illiquid OTC derivatives? Are there other ways we should consider to mitigate counterparty risk; for example, by requiring the posting of collateral by the counterparty? If so, what requirements should apply to the use of collateral? If an alternative fund receives collateral from a counterparty to a specified derivatives transaction, should the collateral be considered in determining the alternative fund's exposure to the counterparty?

Total Leverage Limit

8. Do you agree with a total leverage limit for alternative funds of 3:1 based on the leverage calculation method currently specified in Item 6.1 of Form 41-101F2? If not, what should the total leverage limit of an alternative fund be, and why? Should the total leverage limit be lower for mutual funds that are alternative funds because of the need to fund regular redemptions?

9. What other leverage measurement methods could be used to inform investors of the amount of leverage used by alternative funds, other than the method currently specified in Item 6.1 of Form 41-101F2? Please also explain why the alternative leverage measurements you propose provide investors with a better understanding of the amount of leverage used by alternative funds.

Other Investment Restrictions for Alternative Funds

10. Are there other specific investment strategies that Regulation 81-104 should permit or restrict?

On-going Investment by Sponsors

11. Should the sponsors of an alternative fund be permitted to withdraw their seed capital investment in the alternative fund if the fund reaches a sufficient size? Or should the sponsors be required to maintain an investment in the alternative fund? We invite

feedback on why sponsors should be required to maintain an on-going investment in an alternative fund and the amount of on-going investment that would be appropriate.

Proficiency

12. Should additional proficiency requirements for all individual dealing representatives who sell securities of alternative funds be introduced? If yes, please provide specific examples of the courses or experience that should apply. If no, please explain.

Enhanced Disclosure and Transparency

Naming Convention

13. Would requiring an alternative fund to include the words "Alternative Fund" in its name achieve the purpose of distinguishing alternative funds from other investment funds for investors and the market? If not, please propose other ways to facilitate the ready identification of alternative funds.

In addition, would requiring investment funds governed only by Regulation 81-102 to include specific words (e.g., "Conventional Fund") in their name further this purpose? If not, why not? Would the diversity of investment funds that are governed only by Regulation 81-102 and their different risk levels impede the creation of a uniform descriptor for such funds?

Monthly Website Disclosure

14. We seek feedback on whether there are any impediments for an alternative fund to disclose on its or its manager's website on a monthly basis (with appropriate time lag for the manager to prepare the information) the fund's largest monthly NAV drawdown for the past five years and the maximum and average daily leverage employed during the most recent 12 month period. We further invite feedback on whether this information will be useful to investors or the market generally.

Is there other information that could be provided regularly on the website of the alternative fund or its manager that would be meaningful for investors or for the market?

Transition

15. How should the disclosure of an existing investment fund's intent to transition into the alternative fund regime in Regulation 81-104 be made? For example, should investors be provided with written notice or would a press release be sufficient? In addition to disclosing their intent to transition into the alternative fund regime, what other measures should be required for existing investment funds to transition into the alternative fund regime?

Costs and Benefits of Implementing Alternative Funds Framework

16. Please see question 12 in Annex A.

Annex C

Specific Questions of the CSA relating to Securities Lending, Repurchases and Reverse Repurchases by Investment Funds

The CSA are considering measures to enhance the transparency of the benefits, costs and risks of securities lending, repurchase and reverse repurchase transactions conducted by investment funds. We seek feedback on the following issues.

The CSA understand that it is common practice for securities lending agents to be compensated through receiving a share of the revenue generated from lending securities, repurchases and, if a lending agent is used, reverse repurchases. We also understand that some managers have established revenue-sharing arrangements under which revenue is shared between the investment fund and a lending agent related to the manager or between the investment fund and the manager. As the investment fund bears all the risks from securities lending, repurchases and reverse repurchases, the CSA are of the view that the revenue from engaging in these activities, after the payment of costs for conducting the activities, should be received only by the investment fund.

Currently, depending on the terms of the securities lending agreement, the financial statements of an investment fund that engages in securities lending may disclose the revenue from securities lending net of the lending agent's share. Further, in such cases, the amount paid to the lending agent does not appear in the financial statements as a cost of conducting the activities.

While the amount of revenue generated by securities lending and repurchases may be relatively small, the CSA are of the view that because mutual funds (and, under the Proposed 81-102 Amendments, all investment funds) may lend, or sell in repurchase transactions, up to 50% of total assets,[1] information about the returns, costs and risks of securities lending and repurchase activity is relevant to investors.

The CSA think that it is important for investors to understand the returns from securities lending and how such revenue has contributed to the performance of the investment funds. We also think it is important for investors to be aware of the costs, the profitability and the scope of an investment fund's securities lending activities, so that they can assess the efficiency of the lending. Transparency of the revenue and cost is particularly important if the investment fund uses a lending agent that is related to the manager, which may give rise to conflicts of interest. Further, if the related lending agent shares in the revenue from securities lending, the manager could market its funds to investors as having a management fee that is lower than it would otherwise be, without investors being aware of the additional compensation paid to the affiliated lending agent through the revenue sharing arrangement.

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[1] The CSA are proposing to change the limit on the amount of securities loaned, or sold in repurchases, by all investment funds from 50% of total assets (excluding collateral delivered to the fund) to 50% of NAV. See "Summary of Proposed Amendments – (ii) Investment Restrictions – Securities Lending, Repurchases and Reverse Repurchases".

Accordingly, we are considering measures to enhance the transparency of the benefits from securities lending and the costs paid to earn the returns. We are of the view that disclosure of the gross returns from, and the costs of, securities lending would provide additional transparency.

We seek feedback on approaches that would achieve the outcome of providing disclosure of the gross returns and the costs of securities lending.

1. Are there other costs of conducting securities lending, other than the fee paid to the lending agent?

2. What approaches could the CSA consider to ensure that the financial statements of an investment fund disclose the revenue from securities lending inclusive of the share paid to the agent? What approaches could the CSA consider to ensure that the financial statements of an investment fund disclose the costs of securities lending?

3. What approaches could the CSA consider to ensure that the costs of securities lending are included in either the management expense ratio or the trading expense ratio of the investment fund?

4. We think that the disclosure of the returns and the costs of repurchases should be the same as the disclosure of securities lending, since both activities are substantively similar. Should the same type of disclosure for reverse repurchases be provided? Should the returns and costs of securities lending and repurchases be aggregated, rather than disclosed separately?

5. In order to provide investors with transparency on the profitability and scope of an investment fund's securities lending and repurchase activities, the CSA are considering requiring the following additional disclosure, in the investment fund's management reports of fund performance, regarding such activities:

- The average daily aggregate dollar value of securities lent (or sold in repurchase transactions) obtained by

    (i) adding together the aggregate dollar value of portfolio securities that were lent (or sold) in the securities lending (or repurchase) transactions of the investment fund that are outstanding as at the end of each day during the financial year or interim period; and

    (ii) dividing the amount obtained under (i) by the number of days during the financial year or interim period.

- The percentage profitability of securities lending (or repurchase transactions) obtained by

    (i) dividing the revenue from securities lending (or repurchase) transactions during the financial year or interim period by the average daily aggregate dollar value of securities lent (or sold in repurchase transactions); and

(ii) multiplying the amount obtained under (i) by 100.

- The percentage return from securities lending (or repurchase transactions) obtained by

  (i) dividing the securities lending (or repurchase) revenue by the average net asset value of the investment fund during the financial year or interim period; and

  (ii) multiplying the amount obtained under (i) by 100.

- The percentage of net asset value lent (or sold) obtained by

  (i) dividing the average daily aggregate dollar value of securities lent (or sold in repurchase transactions) by the average net asset value of the investment fund during the financial year or interim period; and

  (ii) multiplying the amount obtained under (i) by 100.

- The maximum amount of securities lent (and sold in repurchase transactions) in any day during the financial year or interim period, both as a dollar amount and as a percentage of net asset value on that date.

Do you agree that these disclosure items are useful in increasing transparency regarding the profitability and scope of a fund's securities lending and repurchases? Are any of these items less useful to investors, in light of the costs to the investment fund of calculating and disclosing them?

6. Are there any other measurements regarding securities lending, repurchases or reverse repurchases that would provide useful information to investors in addition to, or in lieu of, the items described in question 5?

7. Items 3.4 and 19 of Form 41-101F2, Item 5 of Part A and Item 4 of Part B of Form 81-101F1, and Item 10 of Form 81-101F2 require disclosure in an investment fund's prospectus or annual information form (AIF), as applicable, regarding certain service providers to the fund. The CSA are considering adding the agent in respect of securities lending, repurchases and, if applicable, reverse repurchases to the list of service providers detailed in these Items. Another outcome of adding the agent to these Items would be that the agent's relationship to the manager would also be disclosed in the prospectus or AIF, so that investors can assess whether amounts are being paid to entities affiliated with the manager in connection with the investment fund's securities lending, repurchase or reverse repurchase activities. Is this disclosure useful? Should any additional details regarding the agent be provided in an investment fund's prospectus or AIF?

8. We understand that investment funds may seek different indemnities from their lending agent, which provide varying degrees of protection from losses that could arise from securities lending. Would disclosure of the indemnities obtained by an investment fund from its lending

agent in the AIF or prospectus of the investment fund be useful for investors in assessing the risks from securities lending?

9. Generally, investment funds do not file the agreements that they enter into with their lending agent on SEDAR. Currently, these agreements are not listed in the AIF under Item 16 of Form 81-101F2 or the prospectus under Item 31 of Form 41-101F2. Should these agreements be required to be included as material contracts and filed on SEDAR?

Annex D

Summary of Public Comments on Phase 2 Proposals for the Modernization Project

Table of Contents	
PART	**TITLE**
Part I	**Background**
Part II	**Comments on Phase 2 Proposals for the Modernization Project**
Part III	**List of commenters**

Part I – Background

Summary of Comments

On May 26, 2011, the Canadian Securities Administrators (CSA) published CSA Staff Notice 81-322 *Status Report on the Implementation of the Modernization of Investment Fund Product Regulation Project and Request for Comment on Phase 2 Proposals* to provide an update on the implementation of the Modernization of Investment Fund Product Regulation Project (the Modernization Project). In addition to providing an update on the status of finalizing Phase 1 of the Modernization Project, the CSA set out its proposed approach to Phase 2. The proposal included proceeding with Phase 2 of the Modernization Project in stages: first, developing a stand-alone operational rule for non-redeemable investment funds that would adopt certain core restrictions and operational requirements analogous to those in ~~NI~~Regulation 81-102 (~~NI~~Regulation 81-102 or the ~~Instrument~~Regulation) for mutual funds; and second, re-examining the investment restrictions applicable to open-end mutual funds and exchange-traded mutual funds under Part 2 of ~~NI~~Regulation 81-102 to assess what, if any, changes should be made in recognition of market and product developments.

The CSA sought feedback from investors and industry stakeholders on the CSA's proposal to focus next on developing an operational rule for non-redeemable investment funds as part of a staged approach to proceeding with the Modernization Project. The comment period expired on July 25, 2011. We received submissions from 8 commenters, which are listed in Part III.

We have considered all comments received and have made some changes to the proposed approach in response to the comments. We

wish to thank all those who took the time to comment. The comments we received, and our responses, are summarized below.

Part II - Comments on Phase 2 Proposals for the Modernization Project		
Question	**Comments**	**Responses**
1. Do you agree with our view that certain consistent, core investor protection requirements should apply equally to all types of publicly offered investment funds?	All of the commenters agreed that certain consistent rules and core investor protection requirements should apply equally to all publicly offered investment funds, including non-redeemable investment funds. Several commenters noted that the rules and restrictions identified in the notice (i.e., conflict of interest restrictions, securityholder and regulatory approval requirements and custodianship requirements) represent industry standards and best practices with which most managers of non-redeemable investment funds already comply. We were also told that investor protection rules and requirements should generally be harmonized unless there are policy reasons that support the limited application of certain protections. One commenter remarked that disclosure alone is an insufficient regulatory tool. One commenter added that retail investors are	The CSA are committed to applying consistent rules and core investor protection requirements to all publicly offered investment funds. In addition to the core investor protection requirements identified in the notice, namely, conflict of interest provisions, securityholder and regulatory approval requirements, and custodianship requirements, we have reviewed each of the rules and restrictions in ~~NI~~Regulation 81-102 to determine whether they are key operational requirements that provide a foundation for a base level of protection for investors. We considered whether there are investor protection issues that would support applying other requirements, such as investment restrictions, restrictions on the payment of organizational costs, and sales communications presentation requirements, equally to non-redeemable investment funds, or whether there are policy reasons to limit their application to mutual funds only. After reviewing the comments received and

	often unaware of the nuances between different types of investment funds and their associated regulatory protections. This commenter expressed that it is essential that all available retail investment funds have basic investor protection requirements and that proposed regulatory requirements cover existing as well as future product types.	carrying out the above review, we propose that generally, the same rules and restrictions should apply to all publicly offered investment funds except where distinctive features of conventional mutual funds or non-redeemable investment funds justify a difference in treatment. For example, the CSA think the different distribution models and redemption features may justify different restrictions on borrowing, illiquid assets, and requirements for the sale of investment fund securities.
	One commenter also suggested that in addition to making certain core investor protection requirements uniform across all publicly offered investment funds, there should be specific, stricter rules designed for certain types of funds (particularly complex and/or structured investment products) to ensure unsuitable products are not sold or made available to investors.	Along with our proposed amendments to ~~NI~~Regulation 81-102 to apply operational requirements to non-redeemable investment funds, we are considering how to redesign the current regulatory regime under ~~*National Instrument*~~*Regulation 81-104 respecting Commodity Pools* (~~NI~~ Regulation 81-104) so that it could apply to both mutual funds and non-redeemable investment funds that wish to use investment strategies that would go beyond the parameters of ~~NI~~Regulation 81-~~-~~102. The CSA have observed that many non-redeemable investment funds invest within the limits permitted for mutual funds in ~~NI~~Regulation 81-102 (i.e., they use more conventional investment strategies), while others make extensive use of strategies not

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		permitted by ~~NI~~Regulation 81-102 (referred to as alternative investment strategies). We think it is important to provide clarity for investors and the market by more effectively differentiating between conventional investment funds (whether they are structured as mutual funds or non-redeemable investment funds) and investment funds that use more complex investment strategies such as leveraged derivative strategies that are not permitted in ~~NI~~Regulation 81-102 (referred to as alternative funds). In that regard, we are seeking feedback on elements of a regulatory framework for alternative funds that would be governed by ~~NI~~Regulation 81-~~-~~104, including disclosure requirements, naming conventions, and potential additional proficiency requirements for alternative funds. See Annex B.
	We were asked to ensure that we take into account the entire regulatory landscape, including the interrelationship of ~~National Instrument~~ *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations*, ~~*National Instrument*~~*Regulation 81-106 respecting Investment Fund Continuous Disclosure*, and ~~*National Instrument*~~*Regulation 81-107 respecting Independent Review Committee for Investment Funds*, when developing further	Our proposed amendments aim to address arbitrage opportunities between different types of investment funds, which the CSA believe result from the differing regulatory regimes for mutual funds and non-redeemable investment funds. We continue to be of the view that all publicly offered investment funds should be treated more fairly and consistently, as both mutual funds and non-redeemable investment

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	rules for non-redeemable investment funds. One commenter noted that as non-redeemable investment funds are subject to these ~~instrument~~regulations, they already operate under securities regulations and industry standards that are more stringent than other investment options available to retail investors such as direct investments in stocks and bonds, segregated funds and linked notes, where equivalent regulations do not currently exist. This commenter urged us to consider that by introducing new regulations for non-redeemable investment funds, the CSA may unintentionally exacerbate, rather than reduce the potential for regulatory arbitrage. As such, any new regulations should also be considered in the larger context of all investment options available to retail investors. Another commenter added that we should be mindful of not simply mapping over rules currently applied to conventional mutual funds without considering the fundamental differences between these forms of investment funds. Considerations should include differences in redemption features, distribution models, leveragability, liquidity, and whether units are traded at net asset value (NAV).	funds offer investors the benefits of pooled investing and portfolio management services. It is outside the scope of this project to consider similar requirements for other types of investment products. We also think it would be beneficial for non-redeemable investment funds to be subject to key operational requirements as soon as possible. The CSA disagree that the proposed requirements for non-redeemable investment funds would result in investors being sold other types of investment products. We would expect dealers to continue to recommend non-redeemable investment funds where they present a suitable investment option for investors. The CSA agree that certain provisions should not apply equally to non-redeemable investment funds based on their unique features. We have considered the differences between conventional mutual funds and non-redeemable investment funds and proposed allowances to accommodate the unique features of non-redeemable investment funds. See the proposed amendments.

2. Do you agree with our approach to develop a stand-alone operational rule for non-redeemable investment funds? If not, what approach would you propose? What are the advantages and disadvantages of this approach?	Two commenters expressed their support for developing a stand-alone operational rule for non-redeemable investment funds. These commenters believe that the advantages of this approach include: • focused regulation of non-redeemable investment funds; • clarity to fund managers as to what rules apply, since all regulation will be from a single source; • that a stand-alone rule will be the best mechanism for "borrowing" other important regulatory protections from ~~NI~~Regulation 81-~~-~~102. One commenter noted that a disadvantage of the stand-alone rule approach would be that it may result in a larger number of stand-alone rules for investment funds, rather than a single "trunk" of basic operational rules. This allows a greater potential for funds or products to slip through the cracks between each of the stand-alone rules and escape necessary regulation. One commenter recommended that any such stand-alone operational rule supersede all existing positions expressed by the CSA in notices or other publications regarding non-	After reviewing the comments received, the CSA have decided to amend ~~NI~~Regulation 81-~~-~~102 to include non-redeemable investment funds in applicable provisions of ~~NI~~Regulation 81-102, rather than to create a stand-alone rule for non-redeemable investment funds. Under this approach, ~~NI~~Regulation 81-102 will impose key operational requirements for all publicly offered investment funds, and where appropriate, will provide for exemptions for non-redeemable investment funds. Similar to the current structure of ~~NI~~Regulation 81-104, the revised version of ~~NI~~Regulation 81-104 we are contemplating will exempt alternative funds from certain provisions of ~~NI~~Regulation 81-102, such as the limits on derivatives use and investing in physical commodities. We are also contemplating, however, that other requirements specific to alternative funds would apply, such as naming conventions and specific disclosure requirements. Please see Annex B. In the course of the CSA's review of the provisions in ~~NI~~Regulation 81-102 that may be relevant to the operations of a non-redeemable investment fund, the CSA have

	redeemable investment funds, for example OSC Staff Notice 81-711 *Closed-End Investment Fund Conversions to Open-End Mutual Funds.* Three commenters, on the other hand, proposed that instead of having a stand-alone operational rule for non-redeemable investment funds, we introduce a universal operational rule that applies to all publicly offered investment funds including mutual funds and non-redeemable investment funds. Under this approach, the various categories of investment funds would be distinguished and the provisions that apply to each category would be clearly identified. Further, the universal operational rule could be supplemented with certain specific rules that only apply to non-redeemable investment funds. These commenters believe that the advantages of this approach include: • user-friendliness for industry participants such as lawyers, accountants and investment fund managers who advise or manage numerous types of investment funds; • consistency in the interpretation and application of the core investor protection	observed that many of the requirements in the ~~Instrument~~Regulation are base level protections, including certain investment restrictions, conflicts prohibitions, voting rights for fundamental changes, and sales communications presentation requirements. It was also observed that the majority of non-redeemable investment funds already follow a substantial portion of ~~NI~~Regulation 81-102, as many of the provisions reflect fund management best practices. Accordingly, the CSA are of the view that a single operational rule for all investment funds is a better approach to ensure the regulatory framework is more consistent, fair and functional for all types of investment funds. We accept the commenters' submissions regarding the advantages of a single operational rule. The CSA are seeking comment on whether to reconsider its current policy position of classifying an investment fund as a non-redeemable investment fund if it does not offer redemptions at NAV more than once a year. See Annex A. In light of new proposed requirements for non-redeemable investment funds, we will

	requirements that will apply to all investment funds; • simplification of the rule amendment process by reducing the need to make conforming changes across two or more rules; • automatic application of the rule to any new category of publicly offered investment fund which may develop in the future; • continuing the single rule approach for regulating all publicly offered investment funds, for example, taken in ~~NI~~Regulation 81-~~-~~106 and ~~NI~~Regulation 31-103, which have been successful; and • the prevention of regulatory arbitrage by issuers. It was suggested by one commenter that although a single rule for all investment funds is preferable, if the CSA intend to limit the regulation of non-redeemable investment funds to the initial rules and restrictions identified in the notice and not extend it to other aspects of ~~NI~~Regulation 81-102 in the future, then a separate stand-alone rule may be best.	consider withdrawing OSC Staff Notice 81-~~-~~711 *Closed-End Investment Fund Conversions to Open-End Mutual Funds*.

	This commenter also suggested that the rule, whether stand-alone or universal, clarify our policy regarding when a fund is considered a non-redeemable investment fund rather than a conventional open-end mutual fund.	
3. We seek feedback on the initial restrictions and operational requirements we have identified for non-redeemable investment funds. If you disagree, what restrictions and operational requirements would be appropriate for non-redeemable investment funds and why? If you think no requirements are needed, please explain why.	Generally, all commenters agreed that the initial restrictions and operational requirements we identified for non-redeemable investment funds are core investor protections that should be codified. Some commenters, however, identified several issues regarding the current requirements that apply to conventional mutual funds and requested that we focus on rationalizing these provisions before we extend them to non-redeemable investment funds. ***Conflict of Interest Provisions*** One commenter noted the importance of extending the self-dealing requirements to non-redeemable investment funds because while there is a mechanism under ~~NI~~Regulation 81-107 for the independent review of conflict of interest matters by a fund's independent review committee (IRC), ~~NI~~Regulation 81-107 is not sufficient in ensuring that non-redeemable investment fund managers will appropriately deal with conflicts, since the onus rests with the manager to identify the conflict in the first place and present it to the IRC for its review.	We propose to apply many of the core requirements in ~~NI~~Regulation 81-102 to non-redeemable investment funds in their current form. The CSA will not at this time make any substantial amendments to the ~~Instrument~~Regulation that would affect mutual funds. We will consider whether specific provisions in ~~NI~~Regulation 81-102 should be amended in the next stage of the Modernization Project. Pursuant to the proposed amendments, Part 4 will apply to non-redeemable investment funds to prohibit the same self-dealing transactions and investments in related entities in which mutual funds are currently prohibited from engaging.

	Two commenters expressed significant concerns regarding the complexity of the current conflicts of interest regime, which includes the securities regulations of many provinces, ~~NI~~Regulation 81-102, ~~NI~~Regulation 81-~~–~~107 and ~~NI~~Regulation 31-103. This has resulted in a compliance maze where a single transaction often must consider multiple conflict of interest regulations (and on occasion, seek multiple discretionary exemptions) that ultimately address the same issue. These commenters urged us not to extend this complexity to non-redeemable investment funds, and encouraged us to instead rationalize the myriad of existing conflict of interest regulations for all investment funds.	We currently do not propose any substantial amendments to the conflicts of interest requirements under ~~NI~~Regulation 31-103 or ~~NI~~Regulation 81-107. We will consider rationalizing the conflicts of interest regime in the context of future amendments to ~~NI~~Regulation 81-107.
	One commenter expressed support for extending the following restrictions to non-redeemable investment funds (subject to the provisions in ~~NI~~Regulation 81-107): • purchases by funds of securities of related issuers (e.g., sections 111(2)(a) and 111(2)(c) of the *Securities Act* (Ontario)); • purchases by funds of securities of an issuer within 60 days after that class of securities is distributed by a dealer related to the fund's manager (e.g., section 4.1(1) of	Under the proposed amendments, a non-redeemable investment fund will be subject to all the prohibitions in Part 4, including the purchase of securities of certain related issuers and the purchase of securities of an issuer within 60 days after that class of securities is distributed by a dealer related to the fund's manager.

	~~NI~~Regulation 81-102). This same commenter suggested that it is not necessary to extend the following restrictions to non-redeemable investment funds: • fund-of-fund investing where a fund is held substantially by related funds (e.g., section 111(2)(b) of the *Securities Act* (Ontario)), since principles of fund-of-fund investing adopted by ~~NI~~Regulation 81-102 are already observed by non-redeemable investment funds in accordance with industry practice, and non-redeemable investment funds are by definition prohibited from investing for the purpose of exercising control of an issuer; • purchases of an issuer in which a responsible person of the fund is a partner, director, or officer (e.g., section 4.1(2) of ~~NI~~Regulation 81-102), since this prohibition is already in ~~NI~~Regulation 31-103; and • trades of securities with related persons as principal (e.g., section 4.2 of ~~NI~~Regulation 81-~~-~~102), since this prohibition is already in ~~NI~~Regulation 31-103. Another commenter expressed concerns with	We propose to apply the fund-of-fund requirements in section 2.5 to non-redeemable investment funds investing in mutual funds so that conflict of interest requirements that may apply in the context of a fund-of-fund investment would not apply if the requirements of section 2.5 are complied with. Although certain prohibitions in Part 4 are also provided for in other ~~instrument~~regulations, the CSA are not considering the rationalization of the different conflicts of interest provisions at this time. As noted above, we will consider rationalizing the conflicts of interest regime in the context of future amendments to ~~NI~~Regulation 81-107. The review of the IRC model under

	the governance structure, transparency and accountability of the IRC model and the role played by the IRC in dealing with conflict of interest matters. This commenter recommended that we reconsider the IRC model across the spectrum of publicly offered investment funds.	~~NI~~Regulation 81-107 is not within the scope of the Modernization Project.
	This same commenter, however, generally agreed that Part 4 of ~~NI~~Regulation 81-102 was a useful model in regulating conflicts of interest. In particular, this commenter believes that the liability and indemnification provisions in section 4.4 of ~~NI~~Regulation 81-102 should be included in any proposed rule, as it is a basic investor protection measure to prevent placing investors at risk for the negligence of service providers.	As noted in the response above, section 4.4 will apply to non-redeemable investment funds pursuant to the proposed amendments.
	Securityholder and regulatory approval requirements Most commenters agreed that investors in non-redeemable investment funds should be entitled to vote on certain fundamental changes to the fund. Some further noted that current industry practice, as well as related corporate or listing requirements, already provide such entitlements.	Pursuant to the proposed amendments, ~~Part~~ Part 5 will apply to non-redeemable investment funds so that investors of non-redeemable investment funds will have the same statutory rights as mutual fund investors to vote on fundamental changes to the fund.
	One commenter would support the fundamental changes that require unitholder approval to include a change to the fund's	We propose to apply the securityholder approval requirement in ~~NI~~Regulation 81-

	fundamental investment objective only if fund managers of non-redeemable investment funds retain their current flexibility to articulate the fund's investment objective in a manner that the manager considers most suitable. In particular, this commenter does not think the requirement that conventional mutual funds disclose in their investment objectives the types of securities or key investment strategies the fund intends to invest in or utilize should be extended to non-redeemable investment funds. One commenter remarked that Part 5 of ~~NI~~Regulation 81-102 is an ideal model to adopt for non-redeemable investment funds. This commenter believes that voting rights for fund investors are key elements of investor protection and provide a check and balance on fund governance for significant transactions of the fund. In particular, this commenter would support a provision that requires fund managers rather than investors to bear the costs associated with reorganizing funds.	102 for a change of investment objective by the non-redeemable investment fund. Form 41-~~-~~101F2 currently requires a non-redeemable investment fund to disclose in its investment objective the type or types of securities the investment fund will primarily invest in, as well as any investment strategy that is an essential aspect of the investment fund. This requirement is similar to the requirement for mutual funds in Form 81-101F1. We do not propose to change these requirements, as we think all investment funds should articulate their investment objectives with the same degree of specificity. We agree that Part 5 should be adopted for non-redeemable investment funds. We propose to apply substantially all the securityholder approval requirements to non-redeemable investment funds other than in limited circumstances. We also propose to add an additional requirement that prior securityholder approval be obtained where there is a change in the nature of the fund, i.e., from a non-redeemable investment fund to a mutual fund, from a mutual fund to a non-redeemable investment fund, or from an investment fund to an issuer that is not an investment fund. The merger pre-approval

		requirements applicable to mutual funds, including that mutual funds not bear the costs of the reorganization, are proposed to also apply to reorganizations of non-redeemable investment funds. We also propose to prohibit an investment fund from paying the costs of restructuring the fund. Given that reorganizations and restructurings permit managers to retain the fund's assets under management, these transactions are beneficial to managers and managers should accordingly bear the costs of these transactions.
	One commenter asked us to consider the realities of investment fund securityholder meetings and the current level of investor behaviour. Since most investors are passive, we were encouraged to consider less costly alternatives to holding securityholder meetings such as enhanced disclosure and advance notice of proposed changes, as well as the role played by the IRC.	We have proposed alternatives to the securityholder approval requirement, for example, obtaining IRC approval in cases where securityholders will not experience a significant impact from a fund merger, but we do not propose any amendments to the securityholder approval regime generally. We think it serves as an important check and balance on implementing fundamental changes to the fund.
	Another commenter noted, however, that even though many retail investors may not exercise their right to vote, it is significant that the voting rights outlined in ~~NI~~Regulation 81-102 entitle them to receive a management information circular outlining the proposed change and that unitholders have an	The CSA agree with the importance of providing sufficient disclosure to investors of fundamental changes made to the investment fund. We do not propose to remove any such requirements.

	opportunity to vote. This same commenter expressed the view that non-redeemable investment funds should not be required to obtain regulatory approval of fundamental changes if securityholder approval had been obtained. This commenter believes that the additional cost and time required to obtain regulatory approval would not provide significant additional benefits to securityholders.	We do not propose any amendments to the regulatory approval requirements at this time.
	Another commenter, on the other hand, had concerns with the exemptions set out in ~~NI~~Regulation 81-102 that permit significant reorganizations of funds without prior regulatory approval. This commenter believes that all fundamental transactions could benefit by being reviewed by the regulatory authorities.	See response above.
	Custodianship requirements Most commenters agreed that the segregation and security of investment fund assets is a paramount concern for investors and that these requirements should extend to all non-redeemable investment funds. It was also noted that it would make sense to move these requirements that are currently set out in a prospectus disclosure rule (~~NI~~Regulation 41-101) to an operational rule, as the requirements	Pursuant to the proposed amendments, Part 6 of ~~NI~~Regulation 81-102 will apply to non-redeemable investment funds. Part 14 of ~~NI~~Regulation 41-101 will no longer apply to these funds.

	may have been overlooked by some industry participants who may expect ~~NI~~Regulation 41-~~-~~101 to relate mainly to prospectus content. One commenter suggested that the current rule in ~~NI~~Regulation 41-101 is too restrictive for non-redeemable investment funds because these funds often have investment mandates that require their assets to be deposited with a prime broker rather than a custodian. As well, the requirement that the custodian be a Canadian financial institution limits price competition between service providers. We were asked to amend these requirements so that non-redeemable investment funds may deposit assets with prime brokers in accordance with industry practice and permit funds to access a broader universe of available custodians.	The CSA do not propose any substantive amendments to the custodianship requirements at this time.
4. Are there other investor protection principles and/or requirements of ~~NI~~Regulation 81-102 which the CSA should consider for non-redeemable investment funds at this time? If so, please explain.	One commenter believed that rules and requirements beyond those identified by the CSA were not necessary, while a few commenters proposed additional investor protection principles that should be considered. ***Sales Communications***	As noted above, the CSA believe there are key operational requirements in ~~NI~~Regulation 81-102 in addition to the core protections identified in the notice that would provide a base level of protection for investors in non-redeemable investment funds. Imposing similar operational requirements would also level the playing field for all investment funds, providing a more consistent framework within which they can compete with each other.

	Three commenters believed the regulation of sales communications to be a key value in promoting investor confidence and investor protection and recommended that we consider adopting an equivalent to Part 15 of ~~NI~~Regulation 81-102 that applies to non-redeemable investment funds. These provisions would provide certainty as to what type of disclosure is permissible and would ensure that marketing materials prepared for non-redeemable investment funds contain relevant information and do not include misleading or unsubstantiated claims. One commenter remarked, however, that these restrictions should not prevent non-redeemable investment funds from providing meaningful disclosure regarding new investment strategies or products which do not have a proven history or track record, provided that there is legitimate evidentiary support for such disclosure. ***Redemption of Securities of a Mutual Fund*** One commenter recommended that we adopt a requirement for non-redeemable investment funds to provide greater transparency to investors regarding the calculation of proceeds	We propose to apply Part 15 to non-redeemable investment fund sales communications. The CSA are of the view that the sales communications requirements provide guidelines for investment funds to ensure that disclosure is relevant, consistent, and not misleading. The sales communication presentation requirements also ensure that disclosure of certain information such as performance data is standardized so that investors can make meaningful comparisons among similar investment funds. The requirements of Part 15 do not specifically prohibit disclosure regarding new investment strategies or products which do not have a proven history or track record. However, similar to mutual funds, we propose that sales communications for non-redeemable investment funds that present performance data present performance data based on actual historical performance, and not on hypothetical or back-tested data. We propose to make a consequential amendment to Form 41-101F2 that requires a non-redeemable investment fund to disclose in its prospectus the amount, or the

	payable upon redemption of investment fund securities, particularly for investment funds that pay redemption proceeds that are less than the NAV per unit of the fund.	maximum amount or percentage that may be deducted from the net asset value per security, if the proceeds payable upon redemption of a fund's securities are based on the NAV per security. See proposed amendments to Form 41-101F2.
	This commenter also suggested that we adopt rules similar to Part 10 of ~~NI~~Regulation 81-102 that require funds to have adequate procedures for processing redemption requests in a fair and timely manner and to suspend redemptions only when it is commercially reasonable to do so. This commenter added that most non-redeemable investment funds already comply with these provisions since they reflect industry best practices.	We also propose to apply certain provisions in Part 10 to ensure fair and timely administration of redemption requests and to limit when a non-redeemable investment fund may suspend redemptions. Similar to mutual funds, non-redeemable investment funds will be required to mail a notice to securityholders annually, reminding investors of their redemption rights and how they may be exercised. See proposed amendments to Part 10.
	Another commenter urged us to address the gradual trend within the investment fund industry to make redemption options less and less attractive to investors of non-redeemable investment funds, especially because these investors already face thin markets for selling their units. This commenter suggested that where a redemption feature is part of a non-redeemable investment fund, we limit the allowable fraction of NAV at which non-redeemable investment funds may redeem units to no less than 95% of NAV.	We do not propose any requirements relating to the amount of redemption proceeds at this time. As mentioned above, we are requiring a non-redeemable investment fund to disclose in its prospectus the maximum amount of any costs or other fees that may be deducted from the net asset value per security when securities are redeemed, so that the amount received by an investor will be clarified.

	Disclosure requirements A few commenters expressed support for the adoption of point-of-sale delivery and disclosure requirements for non-redeemable investment funds. One commenter recommended that non-redeemable investment funds be required to provide plain language disclosure as to how proceeds will be utilized. ***Conversions*** One commenter requested that we consider adopting rules for the conversion of non-redeemable investment funds to open-end mutual funds.	The adoption of a point-of-sale disclosure regime for non-redeemable investment funds is not within the scope of the Modernization Project. Non-redeemable investment funds are required under Form 41-101F2 to disclose the principal purposes for which the net proceeds will be used by the investment fund and to disclose their fundamental investment objectives and the strategies used to invest the money received from the public. The Form also requires that disclosure in the prospectus be understandable to readers and presented in an easy-to-read format, as well as comply with plain language principles. Under the proposed amendments, a non-redeemable investment fund will have to obtain securityholder approval before increasing the frequency of redemptions and converting into a mutual fund. If the fund manager proposes to merge the non-redeemable investment fund with a mutual fund such that securityholders of the non-redeemable investment fund become securityholders of the mutual fund, prior approval of the securityholders of the non-

		redeemable investment fund must be obtained, unless the merger meets specified criteria in proposed subsection 5.3(2) of ~~NI~~Regulation 81-102. A non-redeemable investment fund that has a built-in conversion feature that triggers regular redemptions based on NAV may be exempt from the securityholder approval requirement if it meets specified criteria, including prospectus disclosure of the event that will cause it to convert into a mutual fund. See proposed amendments to Part 5.
	Principles that should not be adopted for non-redeemable investment funds One commenter identified several provisions in ~~NI~~Regulation 81-102 that would not be appropriate for non-redeemable investment funds due to their different investment strategies and distribution models: • seed capital requirements for establishing new mutual funds, since non-redeemable investment funds are generally distributed by a syndicate of dealers pursuant to a "best efforts" agency agreement (Sections 3.1 and 3.2 of ~~NI~~Regulation 81-102); • restrictions on incentive and performance fees paid to fund managers, since the ability	The CSA agree that the specific requirements identified under Parts 3, 9, and 12 would not be applicable for non-redeemable investment funds. The CSA disagree, however, that the provisions under Parts 7, 11 and 14 should not apply to non-redeemable investment funds. The CSA are of the view that the provisions in Part 7 represent a fair basis for the payment of incentive fees. Since the CSA propose to apply comparable investment restrictions to non-redeemable investment funds that use conventional investment strategies, we are of the view that similar

	to enter all sorts of fee arrangements may encourage innovation of non-redeemable investment funds, so long as clear disclosure is provided in their prospectuses and continuous disclosure documents (~~Part~~ Part 7 of ~~NI~~Regulation 81-102); • rules regarding the sale of fund securities as they relate to the sale of mutual funds, since non-redeemable investment funds are generally distributed by a syndicate of Investment Industry Regulatory Organization of Canada (IIROC) dealers who are already subject to rules governing the sales process (Part 9 of ~~NI~~Regulation 81-~~-~~102); • commingling of cash restrictions, since IIROC dealers generally distributing securities of non-redeemable investment funds are already subject to rules governing the commingling of cash (Part 11 of ~~NI~~Regulation 81-102); • compliance reports other than in relation to compliance with redemption requirements, since Parts 9 and 11 are not applicable to non-redeemable investment funds (Part 12 of ~~NI~~Regulation 81-102); and	rules should apply to the payment of incentive fees by non-redeemable investment funds. As noted above, the CSA propose that investment funds that use alternative investment strategies be regulated under an amended ~~NI~~Regulation 81-~~-~~104, which allows for a wider range of incentive fee arrangements. While the CSA recognize that dealers of non-redeemable investment funds will be exempt from the requirements in Part 11 because they are members of IIROC, the CSA note that the provisions in Part 11 also apply to service providers of funds who receive cash on behalf of the investment fund for investment or redemption purposes. As the requirements in Part 11 ensure that investor cash is appropriately segregated, we are of the view that there is no policy rationale to support applying the requirements to service providers of mutual funds, but not to service providers of non-redeemable investment funds. See proposed amendments to Part 11. The CSA are of the view that the record date requirements in Part 14 should apply to non-redeemable investment funds on a similar basis as mutual funds, as there is no policy rationale to support different

	• record date requirements, since non-redeemable investment funds should have the flexibility to determine appropriate record dates for establishing the rights of securityholders to receive distributions, provided that the process for making these determinations is clearly disclosed in their prospectuses and continuous disclosure documents (Part 14 of ~~NI~~Regulation 81-102).	treatment. Currently, the record date requirements only apply to conventional mutual funds and not to exchange-traded mutual funds because exchanges impose rules on listed issuers in respect of setting record dates. Similarly, we propose to provide an exemption for non-redeemable investment funds that list their securities on an exchange. See proposed amendments to Part 14.
5. In addition to the initial requirements the CSA has identified for non-redeemable investment funds, we are considering the possibility of imposing certain investment restrictions, similar to those set out under Part 2 of ~~NI~~Regulation 81-102. Please identify those core investment restrictions that, in your view, should apply to these funds and explain why. If you think no investment restrictions are needed, please explain why.	Most commenters generally agreed that investment restrictions similar to Part 2 of ~~NI~~Regulation 81-102 should not be adopted for non-redeemable investment funds because the flexibility to implement alternative investment strategies in order to provide investors with exposure to different asset classes and innovative techniques is the primary distinction between conventional mutual funds and non-redeemable investment funds. These commenters feel that this distinction is beneficial to investors and should not be collapsed. Some commenters stressed that the liquidity and diversification requirements imposed on public mutual funds should not also apply to non-redeemable investment funds. This is because investors of non-redeemable investment funds generally have access to daily	The CSA are of the view that a number of the investment restrictions in Part 2 are core investment restrictions that aim to promote prudent management (for example, limiting counterparty risks under derivatives contracts) or define the fundamental characteristics of investment funds (for example, the control restrictions in section 2.2). We are also of the view that investment restrictions should apply in order to: (i) clarify the types of investments or investment strategies that the CSA do not view to be consistent with the passive investment nature of an investment fund; and (ii) more clearly delineate the types of investment strategies the fund is engaging in.

	liquidity by trading their securities over a stock exchange and receive sufficient information regarding the NAV of the fund through various forms of disclosure. Further, requiring diversification to mitigate investment risks and volatility of the alternative investment strategies adopted by non-redeemable investment funds would be inconsistent with the purpose of investing in these funds. We were asked by one commenter to recognize the reliance placed by non-redeemable investment fund investors on the financial advisors and dealing representatives who sell these funds. These representatives are employed by full-service dealers that are members of the IIROC, and must satisfy higher proficiency requirements in order to understand the features of such funds and recommend them in suitable circumstances. A few commenters suggested that the additional investment risks and volatility associated with the investment strategies of non-redeemable investment funds could be addressed through disclosure. For example, one commenter suggested that any point-of-sale documents distributed by a non-redeemable investment fund disclose how the investment strategies of the fund differ from the investment restrictions set out in Part 2 of	However, we recognize that certain of the investment restrictions in Part 2 of ~~NI~~Regulation 81-102 could be modified because of the differences in offering models, liquidity for securityholders, ~~-~~and distribution channels. For example, we seek comment on whether different issuer concentration limits and illiquid asset limits could apply for non-redeemable investment funds. See Annex A. We have observed that there is a wide spectrum of non-redeemable investment funds, ranging from non-redeemable investment funds that invest in a similar manner as conventional mutual funds within the restrictions of ~~NI~~Regulation 81-102 and non-redeemable investment funds that engage in more complex investment strategies. Non-redeemable investment funds may currently operate with a wide range of investment strategies with potentially very different levels of risk and complexity, but are all sold through the same distribution channel and subject to the same disclosure requirements. The CSA think it is important that investors can readily differentiate between investment funds that use conventional investment strategies set out in Part 2 of ~~NI~~Regulation 81~~-~~-102 and alternative funds that use

	~~NI~~Regulation 81-102. One commenter urged us to consider investment restrictions for non-redeemable investment funds at the same time as any review of investment restrictions for open-end mutual funds. Specifically, any proposal to impose investment restrictions on non-redeemable investment funds should be deferred to Stage 2 of Phase 2 of the Modernization Project.	investment strategies and invest in asset classes that are not permitted in ~~NI~~Regulation 81-102. In order to continue to provide flexibility for non-redeemable investment funds to use alternative investment strategies, we are considering how to redesign ~~NI~~Regulation 81-~~-~~104 so that it will encompass both mutual funds and non-redeemable investment funds that wish to utilize alternative investment strategies. We agree that one way to address the additional investment risks and volatility associated with alternative investment strategies is through increased transparency. We are contemplating that a fund be permitted to have more flexibility in utilizing alternative investment strategies if it complies with the contemplated regulatory framework in ~~NI~~Regulation 81-~~-~~104, which would include enhanced disclosure requirements to help inform investors about the differences in investment restrictions and the potential for increased complexity and higher degrees of risk associated with investing in alternative funds. We also invite comment on the proficiency requirements for the sale of

	One commenter proposed that investment restrictions for non-redeemable investment funds be limited to the investment restrictions set out in sections 2.12 to 2.17 of Part 2 of ~~NI~~Regulation 81-102. These requirements on securities lending, repurchase and reverse repurchase transactions, in particular requirements regarding documentation, supervision, controls and records, reflect industry best practices and would not be unduly restrictive on the transactions. Another commenter recommended that we impose an anti-tiering provision on non-redeemable investment funds. This commenter expressed concerns regarding the potential tiering of fees that could result from fund-of-fund arrangements, as well as the replacement of one fund manager's judgment with another, which does not provide any additional benefit to the investor. This commenter, however, would exclude money market funds, index participation units or other static, low-fee funds from such anti-tiering provision.	alternative fund securities. In the next stage of the Modernization Project, the CSA plan to review the investment restrictions in Part 2 for mutual funds. We propose to apply sections 2.12 to 2.17 to non-redeemable investment funds. The CSA propose that similar to mutual funds, non-redeemable investment funds investing in underlying mutual funds be prohibited from the duplication of fees in fund-of-fund structures.

	Another commenter noted that while some investment restrictions should apply to non-redeemable investment funds including scholarship plans, the current investment restrictions that apply specifically to the subset of scholarship plans are far too restrictive and work to the detriment of plan holders.	The proposed amendments for non-redeemable investment funds do not affect scholarship plans. Amendments for scholarship plans are outside the scope of the Modernization Project.
6. What do you foresee as the anticipated cost burdens in complying with the initial restrictions and operational requirements we are proposing for non-redeemable investment funds? Specifically, we request data from the investment fund industry and service providers on the anticipated costs of complying with the Phase 2 proposals.	One commenter noted that they would not be in a position to comment on the cost burden associated with the initial proposals until they have an opportunity to review the extent of changes under consideration. Several other commenters believed that the cost burden associated with the compliance of non-redeemable investment funds with the initial proposed restrictions and operational requirements would only be incremental and therefore not significant since these funds are already subject to the same requirements as conventional mutual funds under ~~NI~~Regulation 81-106 and ~~NI~~Regulation 81-107. One of these commenters also noted that any principal costs may be non-monetary, as additional regulations will hinder the ability of investors to access Canadian–based investment fund alternatives to conventional mutual funds.	The CSA have considered the anticipated costs and benefits of the proposed amendments to ~~NI~~Regulation 81-102 to impose operational requirements on non-redeemable investment funds. We invite further comments on the costs associated with the proposed amendments. We think that the proposed amendments, together with a reformed ~~NI~~Regulation 81-104 framework, will continue to permit fund managers to create alternatives to conventional mutual funds.

Other suggestions for Phase 2	We also received several suggestions from commenters regarding other issues to address in Phase 2 of the Modernization Project. These recommendations include: • modernization of the regulation of mortgage funds, as National Policy No. 29 has not been re-considered by the CSA since the coming into force of ~~NI~~Regulation 81-102; • reconsideration of National Policy No. 15 and the regulation of scholarship plans, and how this regulation would fit into the regulation of non-redeemable investment funds; • greater access by mutual funds to investments in physical commodities, especially through commodity-based exchange-traded funds and derivatives, to allow investors to benefit from preservation of capital, greater performance in inflationary environments, and improved portfolio diversification; • review of derivatives requirements, as several requirements that apply to specified derivatives require greater guidance (for example, terms such as "a high degree of negative correlation" found in the definition	We thank all commenters for suggestions on additional issues to consider in Phase 2 of the Modernization Project. We have reconsidered the exemption to the rule preventing the reimbursement of organizational costs for exchange-traded mutual funds not in continuous distribution. The CSA propose to apply section 3.3 to all investment funds. We think imposing organizational costs on all fund managers could further align a manager's interest with those of investors and, at the same time, level the playing field for mutual fund and non-redeemable fund managers and discourage arbitrage opportunities. See proposed amendments to Part 3. We may consider some of the other suggested changes in the next stage of the Modernization Project. At this time, we will continue to consider requests for exemptive relief from ~~NI~~Regulation 81-102 on a case-by-case basis. Some of the issues identified, including the regulation of scholarship plans, promotion and sales of investment funds, and exempt markets, are outside the scope of the Modernization Project.

	of "hedge" in ~~NI~~Regulation 81-102 lead to inconsistent interpretations in the industry); • reconsideration of the definition of "illiquid asset" in ~~NI~~Regulation 81-102, as the current definition may not necessarily address a mutual fund's need to fund redemptions on demand (e.g., one commenter believes that the current definition captures securities that are in fact liquid, and amendments should be made so that the definition contemplates not only the type of security held, but also the size of each security position in a fund and trading volumes in the market); • increased flexibility for fund-of-fund structures, particularly involving multi-layered structures, Canadian pooled funds, and non-Canadian investment funds, to increase diversification opportunities and improve cost efficiency for investment funds; • reforms in the promotion and sales of investment funds; • reconsideration of exemptions to the rules preventing the reimbursement of organizational costs for all non-redeemable	

	investment funds, as there may be price discrimination issues between initial and subsequent investors; and • implementation of a "Clients First Model", a principle requiring industry participants to put the best interests of their clients first, which would require further tightening of rules related to conflicts of interest, advertising and marketing of investment funds, exempt markets and accredited investors, and the training of exempt market dealers.	
Other general comments	One commenter asked us to consider establishing an ongoing process for reviewing ~~NI~~Regulation 81-102, soliciting industry comments and amending ~~NI~~Regulation 81-102 on a more frequent basis to ensure that the regulatory framework evolves and keeps pace with product innovations, evolving capital markets and the needs of investors. A few commenters noted that the Modernization Project should not be allowed to delay other important initiatives of the CSA, including the final stages of implementing the point-of-sale disclosure project.	Noted. Noted.

Part III – List of commenters

Commenters

- Borden Ladner Gervais LLP
- Canadian Foundation for Advancement of Investor Rights (FAIR)
- Fasken Martineau DuMoulin LLP
- Fidelity Investments Canada ULC
- IGM Financial Inc.
- Kenmar & Associates
- Periscope Capital Inc.
- RESP Dealers Association of Canada

REGULATION TO AMEND REGULATION 81-102 RESPECTING MUTUAL FUNDS

Securities Act
(chapter V-1.1, s. 331.1, par. (1), (3), (4.1), (6), (8), (11), (13), (16), (17) and (34))

1. Regulation 81-102 respecting Mutual Funds is amended by replacing the title with the following:

"**REGULATION 81-102 RESPECTING INVESTMENT FUNDS**".

2. Section 1.1 of the Regulation is amended:

1) by replacing, wherever they occur in the definitions of the expressions "approved credit rating", "borrowing agent", "cash cover", "clone fund" and "currency cross hedge", the words "mutual fund" with the words "investment fund", and making the necessary changes;

2) by replacing the definition of the expression "custodian" with the following:

""custodian" means the institution appointed by an investment fund to hold portfolio assets of the investment fund in accordance with Part 6;";

3) by inserting, after the definition of the expression "custodian", the following:

""dealer managed investment fund": means an investment fund the portfolio adviser of which is a dealer manager;";

4) by replacing, wherever they occur in the definition of the expression "debt-like security", the words "mutual fund" with the words "investment fund", and making the necessary changes;

5) by replacing the definition of the expression "fixed portfolio ETF" with the following:

""fixed porfolio fund": means an exchange-traded mutual fund not in continuous distribution, or a non-redeemable investment fund, that

(a) has fundamental investment objectives which include holding and maintaining a fixed portfolio of publicly traded equity securities of one or more issuers the names of which are disclosed in its prospectus, and

(b) trades securities referred to in paragraph (a) only in the circumstances disclosed in its prospectus;";

6) by replacing paragraph (b) of the definition of the expression "floating rate evidence of indebtedness" with the following:

"(b) the evidence of indebtedness is issued, or fully and unconditionally guaranteed as to principal and interest, by any of the following:

(i) the government of Canada or the government of a jurisdiction of Canada;

(ii) the government of the United States of America, the government of one of the states of the United States of America, the government of another

sovereign state or a permitted supranational agency, if, in each case, the evidence of indebtedness has an approved credit rating;";

7) by replacing, wherever they occur in the definition of the expression "fundamental investment objectives", the words "mutual fund" with the words "investment fund", and making the necessary changes;

8) by replacing, wherever they occur in the definition of the expression "illiquid asset", the words "mutual fund" with the words "investment fund", and making the necessary changes;

9) by inserting, after the definition of the expression "index participation unit", the following:

""investment fund conflict of interest investment restrictions" means any provisions of securities legislation that

(a) prohibit an investment fund from knowingly making or holding an investment in any person who is a substantial security holder, as defined in securities legislation, of the investment fund, its management company, manager or distribution company;

(b) prohibit an investment fund from knowingly making or holding an investment in any person in which the investment fund, alone or together with one or more related investment funds, is a substantial security holder, as defined in securities legislation;

(c) prohibit an investment fund from knowingly making or holding an investment in an issuer in which any person who is a substantial security holder of the investment fund, its management company, manager or distribution company, has a significant interest, as defined in securities legislation;

(d) prohibit an investment fund, a responsible person as defined in securities legislation, a portfolio adviser or a registered person acting under a management contract from knowingly causing any investment portfolio managed by it, or an investment fund, to invest in, or prohibit an investment fund from investing in, any issuer in which a responsible person, as defined in securities legislation, is an officer or director unless the specific fact is disclosed to the investment fund, securityholder or client, and where securities legislation requires it, the written consent of the client to the investment is obtained before the purchase;

(e) prohibit an investment fund, a responsible person as defined in securities legislation, or a portfolio adviser from knowingly causing any investment portfolio managed by it to purchase or sell, or prohibit an investment fund from purchasing or selling, the securities of any issuer from or to the account of a responsible person, as defined in securities legislation, an associate of a responsible person or the portfolio adviser; and

(f) prohibit a portfolio adviser or a registered person acting under a management contract from subscribing to or buying securities on behalf of an investment fund, where his or her own interest might distort his or her judgment, unless the specific fact is disclosed to the client and the written consent of the client to the investment is obtained before the subscription or purchase;

"investment fund conflict of interest reporting requirements" means any provisions of securities legislation that require the filing of a report with the securities regulatory authority in prescribed form that discloses every transaction of purchase or sale of portfolio assets between the investment fund and specified related persons;";

10) by replacing the definition of "investor fees" with the following:

““investor fees” means, in connection with the purchase, conversion, holding, transfer or redemption of securities of an investment fund, all fees, charges and expenses that are or may become payable by a securityholder of the investment fund to,

(a) in the case of a mutual fund, a member of the organization of the mutual fund other than a member of the organization acting solely as a participating dealer, or

(b) in the case of a non-redeemable investment fund, the manager of the non-redeemable investment fund;”;

11) by replacing, wherever they occur in the definitions of the expressions “long position” and “management expense ratio”, the words “mutual fund” with the words “investment fund”, and making the necessary changes;

12) by replacing the definition of the expression “manager” with the following:

““manager” means an investment fund manager;”;

13) by deleting the definitions of the expressions “mutual fund conflict of interest investment restrictions” and “mutual fund conflict of interest reporting requirements”;

14) by replacing, wherever they occur in the definitions of the expressions “non-resident sub-adviser”, “performance data”, “portfolio adviser”, “portfolio asset”, “public quotation” and “purchase”, the words “mutual fund” with the words “investment fund”, and making the necessary changes;

15) by deleting the definition of “redemption payment date”;

16) by replacing the definition of the expression “report to securityholders” with the following:

““report to securityholders” means a report that includes annual or interim financial statements, or an annual or interim management report of fund performance, and that is delivered to securityholders of an investment fund;”;

17) by replacing, wherever they occur in the definitions of the expressions “restricted security” and “sales communication”, the words “mutual fund” with the words “investment fund”, and making the necessary changes;

18) by inserting, after the definition of the expression “sales communication”, the following:

““scholarship plan” has the meaning ascribed to that term in section 1.1 of Regulation 81-106 respecting Investment Fund Continuous Disclosure;”;

19) by replacing, wherever they occur in the definition of the expression “short position”, the words “mutual fund” with the words “investment fund”, and making the necessary changes;

20) by deleting, at the end of paragraph (a) of the definition of the expression “specified dealer”, the word “or”;

21) by replacing the definition of the expression “sub-custodian” with the following:

““sub-custodian” means, for an investment fund, an entity that has been appointed to hold portfolio assets of the investment fund in accordance with Part 6 by either the custodian or a sub-custodian of the investment fund;”;

22) by replacing, wherever they occur in the definition of the expression “underlying market exposure”, the words “mutual fund” with the words “investment fund”, and making the necessary changes.

3. The Regulation is amended by replacing section 1.2 with the following:

“**1.2. Application**

(1) This Regulation applies only to

(a) a mutual fund that offers or has offered securities under a prospectus for so long as the mutual fund remains a reporting issuer;

(a.1) a non-redeemable investment fund that is a reporting issuer; and

(b) a person in respect of activities pertaining to an investment fund referred to in paragraphs (a) and (a.1) or pertaining to the filing of a prospectus to which subsection 3.1(1) applies.

(2) Despite subsection (1), this Regulation does not apply to a scholarship plan.”.

4. Section 2.1 of the Regulation is amended:

(1) by replacing, in paragraph (1), the words « A mutual fund shall” with the words “An investment fund must”;

(2) in paragraph (2):

(a) by replacing, in subparagraphs (c) and (d), the words “a mutual fund” with the words “an investment fund”;

(b) by replacing, in subparagraph (e), the word “ETF” with the word “fund”;

(3) by replacing, in paragraph (3), the words “a mutual fund’s compliance with the restrictions contained in this section, the mutual fund shall, for each long position in a specified derivative that is held by the mutual fund for purposes other than hedging and for each index participation unit held by the mutual fund” with the words “an investment fund’s compliance with the restrictions contained in this section, the investment fund must, for each long position in a specified derivative that is held by the investment fund for purposes other than hedging and for each index participation unit held by the investment fund”;

(4) by replacing, in paragraph (4), the words “the mutual fund shall not” with the words “the investment fund must not”.

5. Section 2.2 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in the part preceding subparagraph (a), the words “A mutual fund shall” with the words “An investment fund must”;

(b) by replacing, in subparagraph (a), the words “mutual fund” with the word “investment fund”;

(2) in paragraph (1.1):

(a) by replacing, in subparagraph (a), the words “a mutual fund” with the words “an investment fund”;

(b) by replacing, in subparagraph (b), the words “a mutual fund” with the words “an investment fund”;

(3) by replacing paragraph (2) with the following:

“(2) If an investment fund acquires a security of an issuer other than as the result of a purchase, and the acquisition results in the investment fund exceeding the limits described in paragraph (1)(a), the investment fund must as quickly as is commercially reasonable, and in any event no later than 90 days after the acquisition, reduce its holdings of those securities so that it does not hold securities exceeding those limits.”;

(4) by replacing, in paragraph (3), the words “a mutual fund shall” with the words “an investment fund must”.

6. Section 2.3 of the Regulation is replaced with the following:

“**2.3. Restrictions Concerning Types of Investments**

(1) A mutual fund must not

(a) purchase real property;

(b) purchase a mortgage, other than a guaranteed mortgage;

(c) purchase a guaranteed mortgage if, immediately after the purchase, more than 10% of its net asset value would be made up of guaranteed mortgages;

(d) purchase a gold certificate, other than a permitted gold certificate;

(e) purchase gold or a permitted gold certificate if, immediately after the purchase, more than 10% of its net asset value would be made up of gold and permitted gold certificates;

(f) except to the extent permitted by paragraphs (d) and (e), purchase a physical commodity;

(g) purchase, sell or use a specified derivative other than in compliance with sections 2.7 to 2.11;

(h) purchase, sell or use a specified derivative the underlying interest of which is

(i) a physical commodity other than gold, or

(ii) a specified derivative of which the underlying interest is a physical commodity other than gold; or

(i) purchase an interest in a loan syndication or loan participation if the purchase would require the mutual fund to assume any responsibilities in administering the loan in relation to the borrower.

(2) A non-redeemable investment fund must not

(a) purchase real property;

(b) purchase a mortgage, other than a guaranteed mortgage;

(c) purchase a gold certificate, other than a permitted gold certificate;

(d) purchase a physical commodity or a permitted gold certificate or purchase, sell or use a specified derivative the underlying interest of which is a physical commodity or a permitted gold certificate if, immediately after the purchase, sale or use, the non-redeemable investment fund's holdings of physical commodities and permitted gold certificates would exceed an amount equal to 10% of its net asset value;

(e) purchase, sell or use a specified derivative other than in compliance with sections 2.7 to 2.11; or

(f) purchase an interest in a loan syndication or loan participation if the purchase would require the non-redeemable investment fund to assume any responsibilities in administering the loan in relation to the borrower.

(3) In determining a non-redeemable investment fund's holdings of physical commodities and permitted gold certificates for the purposes of paragraph (2)(d), the non-redeemable investment fund must

(a) for each long position and short position in a specified derivative that is held, consider that it holds directly the equivalent quantity of the underlying interest of that specified derivative; and

(b) aggregate each holding determined in accordance with paragraph (a).".

7. Section 2.4 of the Regulation is amended by replacing, wherever they occur, the words "mutual fund" with the words "investment fund", and making the necessary changes, and the word "shall" with the word "must".

8. Section 2.5 of the Regulation is replaced with the following:

"**2.5. Investments in Other Investment Funds**

(1) For the purposes of this section, an investment fund is considered to be holding a security of another investment fund if

(a) it holds securities issued by the other investment fund; or

(b) it is maintaining a position in a specified derivative for which the underlying interest is a security of the other investment fund.

(2) An investment fund must not purchase or hold a security of another investment fund unless,

(a) the other investment fund is a mutual fund that is subject to this Regulation and,

(i) if the investment fund is a mutual fund, the other investment fund offers or has offered securities under a simplified prospectus in accordance with Regulation 81-101 respecting Mutual Fund Prospectus Disclosure (chapter V-1.1, r. 38);

(ii) if the investment fund is a non-redeemable investment fund, the other investment fund is not a commodity pool as defined in Regulation 81-104 respecting Commodity Pools (chapter V-1.1, r. 40);

(b) at the time of the purchase of that security, the other investment holds no more than 10% of its net asset value in securities of other investment funds;

(c) the investment fund and the other investment fund are reporting issuers in the local jurisdiction;

(d) no management fees or incentive fees are payable by the investment fund that, to a reasonable person, would duplicate a fee payable by the other investment fund for the same service;

(e) no sales fees or redemption fees are payable by the investment fund in relation to its purchases or redemptions of the securities of the other investment fund if the other investment fund is managed by the manager or an affiliate or associate of the manager of the investment fund; and

(f) no sales fees or redemption fees are payable by the investment fund in relation to its purchases or redemptions of securities of the other investment fund that, to a reasonable person, would duplicate a fee payable by an investor in the investment fund.

(3) Paragraphs (2)(a) and (c) do not apply if the security is

(a) an index participation unit issued by an investment fund; or

(b) issued by another investment fund established with the approval of the government of a foreign jurisdiction and the only means by which the foreign jurisdiction permits investment in the securities of issuers of that foreign jurisdiction is through that type of investment fund.

(4) Paragraph (2)(b) does not apply if the other investment fund

(a) is a clone fund; or

(b) in accordance with this section purchases or holds securities

(i) of a money market fund; or

(ii) that are index participation units issued by an investment fund.

(5) Paragraphs (2)(e) and (f) do not apply to brokerage fees incurred for the purchase or sale of an index participation unit issued by an investment fund.

(6) An investment fund that holds securities of another investment fund that is managed by the same manager or an affiliate or associate of the manager

(a) must not vote any of those securities; and

(b) may, if the manager so chooses, arrange for all of the securities it holds of the other investment fund to be voted by the beneficial holders of securities of the investment fund.

(7) The investment fund conflict of interest investment restrictions and the investment fund conflict of interest reporting requirements do not apply to an investment fund which purchases or holds securities of another investment fund if the purchase or holding is made in accordance with this section.”.

9. Section 2.6 of the Regulation is amended:

(1) by replacing, in the part preceding paragraph (a), the words “A mutual fund shall not” with the words “An investment fund must not”;

(2) in paragraph (a):

(a) by replacing subparagraph (i) with the following:

"(i) in the case of a mutual fund, the transaction is a temporary measure to accommodate requests for the redemption of securities of the mutual fund while the mutual fund effects an orderly liquidation of portfolio assets, or to permit the mutual fund to settle portfolio transactions and, after giving effect to all transactions undertaken under this subparagraph, the outstanding amount of all borrowings of the mutual fund does not exceed 5% of its net asset value at the time of the borrowing;

(i.1) in the case of a non-redeemable investment fund, the cash is borrowed from a Canadian financial institution and the outstanding amount of all borrowings of the investment fund does not exceed 30% of its net asset value at the time of the borrowing;";

(b) by replacing, in subparagraph (ii), the words "mutual fund" with the words "investment fund" and the word "made" with the word "provided";

(c) by inserting, after subparagraph (ii), the following:

"(ii.1) in the case of a non-redeemable investment fund, the security interest is required to enable the non-redeemable investment fund to effect cash borrowings under subparagraph (i.1), is provided in accordance with industry practice for the loan and relates only to obligations arising under the loan;";

(d) by replacing, in subparagraph (iii), the words "mutual fund" with the words "investment fund";

(3) by replacing, in paragraph (d), the words "mutual fund" with the words "investment fund".

10. Section 2.10 of the Regulation is amended by replacing, wherever they occur, the words "mutual fund" with the words "investment fund", and making the necessary changes, and the word "shall" with the word "must".

11. Section 2.11 of the Regulation is replaced with the following:

"**2.11. Commencement of Use of Specified Derivatives and Short Selling by an Investment Fund**

(1) An investment fund that has not used specified derivatives must not begin using specified derivatives, and an investment fund that has not sold a security short in accordance with section 2.6.1 must not sell a security short, unless

(a) in the case of a mutual fund, other than an exchange-traded mutual fund that is not in continuous distribution, its prospectus contains the disclosure required for a mutual fund intending to engage in the activity;

(a.1) in the case of an exchange-traded mutual fund that is not in continuous distribution or a non-redeemable investment fund, the investment fund issues a news release that contains both of the following:

(i) the disclosure required in a prospectus for an exchange-traded mutual fund that is not in continuous distribution, or a non-redeemable investment fund, intending to engage in the activity;

(ii) the date on which the activity is intended to begin; and";

(2) A mutual fund, other than an exchange-traded mutual fund that is not in continuous distribution, is not required to provide the notice referred to in paragraph (1)(b)

if each prospectus of the mutual fund since its inception has contained the disclosure referred to in paragraph (1)(a).

(3) Paragraphs (1)(a.1) and (b) do not apply to an exchange-traded mutual fund that is not in continuous distribution, or a non-redeemable investment fund, if each prospectus of the investment fund since its inception has contained the disclosure referred to in paragraph (1)(a.1).".

12. Section 2.12 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in the part preceding point 1, the words "a mutual fund" with the words "an investment fund";

(b) by replacing, in point 3, the words "mutual fund" with the words "investment fund";

(c) by replacing, in point 4, the words "mutual fund or to the mutual fund" with the words "investment fund or to the investment fund";

(d) by replacing, wherever they occur in point 5, the words "mutual fund" with the words "investment fund";

(e) by replacing, wherever they occur in point 6, the words "mutual fund" with the words "investment fund";

(f) by replacing, wherever they occur in point 7, the words "mutual fund" with the words "investment fund";

(g) by replacing, in point 8, the words "mutual fund" with the words "investment fund";

(h) by replacing, in point 9, the words "mutual fund" with the words "investment fund";

(i) by replacing, in point 11, the words "mutual fund" with the words "investment fund";

(j) by replacing point 12 with the following:

"12. Immediately after the investment fund enters into the transaction, the aggregate market value of all securities loaned by the investment fund in securities lending transactions and not yet returned to it or sold by the investment fund in repurchase transactions under section 2.13 and not yet repurchased does not exceed 50% of the net asset value of the investment fund.".

(2) by replacing, in paragraph (2), the words "A mutual fund" with the words "An investment fund";

(3) by replacing, in paragraph (3), the words "A mutual fund" with the words "An investment fund", and the words "shall hold all, and shall" with the words "must hold all, and must".

13. Section 2.13 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in the part preceding point 1, the words "a mutual fund" with the words "an investment fund";

(b) by replacing, wherever they occur in point 3, the words “mutual fund” with the words “investment fund”;

(c) by replacing, in point 4, the words “mutual fund” with the words “investment fund”;

(d) by replacing, wherever they occur in point 5, the words “mutual fund” with the words “investment fund”;

(e) by replacing, wherever they occur in point 6, the words “mutual fund” with the words “investment fund”;

(f) by replacing, in point 7, the words “mutual fund” with the words “investment fund”;

(g) by replacing, in point 8, the words “mutual funds” with the words “investment fund”;

(h) by replacing, in point 10, the words “mutual fund” with the words “investment fund”;

(i) by replacing point 11 with the following:

“11. Immediately after the investment fund enters into the transaction, the aggregate market value of all securities loaned by the investment fund in securities lending transactions under section 2.12 and not yet returned to it or sold by the investment fund in repurchase transactions and not yet repurchased does not exceed 50% of the net asset value of the investment fund.”.

14. Section 2.17 of the Regulation is replaced with the following:

“**2.17. Commencement of Securities Lending, Repurchase and Reverse Repurchase Transactions by an Investment Fund**

(1) An investment fund must not enter into securities lending, repurchase or reverse repurchase transactions, unless

(a) in the case of a mutual fund, other than an exchange-traded mutual fund that is not in continuous distribution, its prospectus contains the disclosure required for mutual funds entering into those types of transactions;

(a.1) in the case of an exchange-traded mutual fund that is not in continuous distribution or a non-redeemable investment fund, the investment fund issues a news release that contains both of the following:

(i) the disclosure required in a prospectus for an exchange-traded mutual fund that is not in continuous distribution, or a non-redeemable investment fund, entering into those types of transactions;

(ii) the date on which the investment fund intends to begin entering into those types of transactions; and”;

(b) the investment fund has provided to its securityholders, not less than 60 days before it begins entering into those types of transactions, written notice that discloses its intent to begin entering into those types of transactions and the disclosure referred to in paragraph (a) or (a.1), as applicable.

(2) Paragraph (1)(b) does not apply to a mutual fund that has entered into reverse repurchase agreements as permitted by a decision of the regulator, except in

Québec, or the securities regulatory authority.

(3) Paragraph (1)(b) does not apply to a mutual fund, other than an exchange-traded mutual fund that is not in continuous distribution, if each prospectus of the mutual fund since its inception contains the disclosure referred to in paragraph (1)(a).

(4) Paragraphs (1)(a.1) and (b) do not apply to an exchange-traded mutual fund that is not in continuous distribution, or a non-redeemable investment fund, if each prospectus of the investment fund since its inception contains the disclosure referred to in paragraph (1)(a.1).".

15. Section 2.18 of the Regulation is amended:

(1) by inserting, in clause A of subparagraph (iv) of subparagraph (a) of paragraph (1) and after the words "floating interest rate", the words "of the indebtedness";

(2) by adding, after paragraph (2), the following:

"(3) A non-redeemable investment fund must not describe itself as a "money market fund".".

16. Section 3.1 of the Regulation is amended:

(1) by replacing, in paragraph (1), the words "No person shall" with the words "A person must not";

(2) by replacing, in paragraph (2), the word "shall" with the word "must".

17. Section 3.3 of the Regulation is amended:

(1) by replacing, in paragraph (1), the words "initial prospectus or annual information form of the mutual fund shall" with the words "preliminary fund facts document, initial prospectus, annual information form or fund facts document of the mutual fund may";

(2) by deleting paragraph (2);

(3) by adding, after paragraph (2), the following:

"(3) None of the costs of incorporation, formation or initial organization of a non-redeemable investment fund, or of the preparation and filing of the initial preliminary prospectus and initial prospectus of the non-redeemable investment fund or documents that must be filed concurrently with the initial preliminary prospectus or initial prospectus, may be borne by the non-redeemable investment fund or its securityholders.".

18. Section 4.1 of the Regulation is replaced with the following:

"**4.1. Prohibited Investments**

(1) A dealer managed investment fund must not knowingly make an investment in a class of securities of an issuer during, or for 60 days after, the period in which the dealer manager of the investment fund, or an associate or affiliate of the dealer manager of the investment fund, acts as an underwriter in the distribution of securities of that class of securities, except as a member of the selling group distributing 5% or less of the securities underwritten.

(2) A dealer managed investment fund must not knowingly make an investment in a class of securities of an issuer of which a partner, director, officer or employee of the dealer manager of the investment fund, or a partner, director, officer or employee of an

affiliate or associate of the dealer manager, is a partner, director or officer, unless the partner, director, officer or employee

(a) does not participate in the formulation of investment decisions made on behalf of the dealer managed mutual fund;

(b) does not have access before implementation to information concerning investment decisions made on behalf of the dealer managed investment fund; and

(c) does not influence, other than through research, statistical and other reports generally available to clients, the investment decisions made on behalf of the dealer managed investment fund.

(3) Subsections (1) and (2) do not apply to an investment in a class of securities issued or fully and unconditionally guaranteed by the government of Canada or the government of a jurisdiction.

(4) Subsection (1) does not apply to an investment in a class of securities of an issuer if, at the time of each investment

(a) the independent review committee of the dealer managed investment fund has approved the transaction under subsection 5.2(2) of Regulation 81-107 respecting Independent Review Committee for Investment Funds (chapter V-1.1, r. 43);

(b) in a class of debt securities of an issuer other than a class of securities referred to in subsection (3), the security has been given, and continues to have, an approved rating by an approved credit rating organization;

(c) in any other class of securities of an issuer,

(i) the distribution of the class of equity securities is made by prospectus filed with one or more regulators, except in Québec, or securities regulatory authorities in Canada, and;

(ii) during the 60-day period referred to in subsection (1) the investment is made on an exchange on which the class of equity securities of the issuer is listed and traded; and

(d) no later than the time the dealer managed investment fund files its annual financial statements, the manager of the dealer managed investment fund files the particulars of each investment made by the dealer managed investment fund during its most recently completed financial year.

(4.1) In paragraph (4)(b), “approved rating” has the meaning ascribed to it in Regulation 44-101 respecting Short Form Prospectus Distributions (chapter V-1.1, r. 16).

(5) The corresponding provisions contained in securities legislation referred to in Appendix C do not apply with respect to an investment in a class of securities of an issuer referred to in subsection (4) if the investment is made in accordance with that subsection.”.

19. Section 4.3 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing the part preceding subparagraph (a) with the following:

“(1) Section 4.2 does not apply to a purchase or sale of a security by an investment fund if the price payable for the security is:”;

(b) by replacing, in subparagraphs (a) and (b), the words “mutual fund” with the words “investment fund”;

(2) by replacing, wherever they occur in paragraph (2), the words “mutual fund” with the words “investment fund”, and making the necessary changes.

20. Section 4.4 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing the part preceding subparagraph (a) with the following:

“(1) An agreement or declaration of trust by which a person acts as manager of an investment fund must provide that the manager is responsible for any loss that arises out of the failure of the manager, or of any person retained by the manager or the investment fund to discharge any of the manager’s responsibilities to the investment fund,”;

(b) by replacing, in subparagraph (a), the words “mutual fund” with the words “investment fund”;

(2) in paragraph (2):

(a) by replacing the part preceding subparagraph (a) with the following:

“(2) An investment fund must not relieve the manager of the investment fund from liability for loss that arises out of the failure of the manager, or of any person retained by the manager or the investment fund to discharge any of the manager’s responsibilities to the investment fund,”;

(b) by replacing, in subparagraph (a), the words “mutual fund” with the words “investment fund”;

(3) in paragraph (3):

(a) by replacing, in the part preceding subparagraph (a), the words « A mutual fund » with the words “An investment fund” and the words “the mutual fund” with the words “the investment fund”;

(b) by replacing, in subparagraph (b), the words “the mutual fund has” with the words “the investment fund has” and the words “of the mutual fund” with the words “of the investment fund”;

(4) by replacing, in paragraph (4), the words “A mutual fund shall” with the words “An investment fund must”;

(5) in paragraph (5):

(a) by replacing, in the part preceding subparagraph (a), the words “a mutual fund” with the words “an investment fund” and the word “by” with “by any of the following:”;

(b) by replacing, in subparagraph (a), “mutual fund; or” with “investment fund;”;

(c) by replacing, in subparagraph (b), the words “mutual fund” with the words “investment fund”;

(6) by replacing paragraph (6) with the following:

"(6) This section applies to any losses to an investment fund or securityholder arising out of an action or inaction by a custodian or sub-custodian acting as agent of the investment fund in administering the securities lending, repurchase or reverse repurchase transactions of the investment fund.".

21. Section 5.1, 5.2 and 5.3 of the Regulation are replaced with the following:

"**5.1. Matters Requiring Securityholder Approval**

(1) The prior approval of the securityholders of an investment fund, given as provided in section 5.2, is required before the occurrence of each of the following:

(a) the basis of the calculation of a fee or expense that is charged to the investment fund or directly to its securityholders by the investment fund or its manager in connection with the holding of securities of the investment fund is changed in a way that could result in an increase in charges to the investment fund or to its securityholders;

(a.1) a fee or expense, to be charged to the investment fund or directly to its securityholders by the investment fund or its manager in connection with the holding of securities of the investment fund that could result in an increase in charges to the investment fund or to its securityholders, is introduced;

(b) the manager of the investment fund is changed, unless the new manager is an affiliate of the current manager;

(c) the fundamental investment objectives of the investment fund are changed;

(d) *(paragraph revoked)*

(e) the investment fund decreases the frequency of the calculation of its net asset value per security;

(f) the investment fund undertakes a reorganization with, or transfers its assets to, another issuer, if

(i) the investment fund ceases to continue after the reorganization or transfer of assets, and

(ii) the transaction results in the securityholders of the investment fund becoming securityholders in the other issuer;

(g) the investment fund undertakes a reorganization with, or acquires assets from, another issuer, if

(i) the investment fund continues after the reorganization or acquisition of assets,

(ii) the transaction results in the securityholders of the other issuer becoming securityholders in the investment fund, and

(iii) the transaction would be a material change to the investment fund;

(h) the investment fund implements a change that restructures the investment fund from

(i) a non-redeemable investment fund into a mutual fund;

(ii) a mutual fund into a non-redeemable investment fund; or

(iii) an investment fund into an issuer that is not an investment fund.

(2) An investment fund must not bear any of the costs or expenses associated with a change referred to in subparagraphs (1)(h)(i), (ii) or (iii).

"**5.2. Approval of Securityholders**

(1) Unless a greater majority is required by the constating documents of the investment fund, the laws applicable to the investment fund or an applicable agreement, the approval of the securityholders of the investment fund to a matter referred to in subsection 5.1(1) must be given by a resolution passed by at least a majority of the votes cast at a meeting of the securityholders of the investment fund duly called and held to consider the matter.

(2) Despite subsection (1), the holders of securities of a class or series of a class of securities of an investment fund must vote separately as a class or series of a class on a matter referred to in subsection 5.1(1) if that class or series of a class is affected by the action referred to in subsection 5.1(1) in a manner different from holders of securities of other classes or series of a class.

(3) Despite subsection 5.1(1) and subsections (1) and (2), if the constating documents of the investment fund so provide, the holders of securities of a class or series of a class of securities of an investment fund must not be entitled to vote on a matter referred to in subsection 5.1(1) if they, as holders of the class or series of a class, are not affected by the action referred to in subsection 5.1(1).

"**5.3. Circumstances in Which Approval of Securityholders Not Required**

(1) Despite subsection 5.1(1), the approval of securityholders of an investment fund is not required to be obtained for a change referred to in paragraphs 5.1(1)(a) and (a.1)

(a) if

(i) the investment fund is at arm's length to the person charging the fee or expense to the investment fund referred to in paragraphs 5.1(1)(a) and (a.1),

(ii) the prospectus of the investment fund discloses that, although the approval of securityholders will not be obtained before making the changes, securityholders will be sent a written notice at least 60 days before the effective date of the change that is to be made that could result in an increase in charges to the investment fund, and

(iii) the notice referred to in subparagraph (ii) is actually sent 60 days before the effective date of the change; or

(b) if

(i) the investment fund is permitted by this Regulation to be described as a "no-load" fund,

(ii) the prospectus of the investment fund discloses that securityholders will be sent a written notice at least 60 days before the effective date of a change that is to be made that could result in an increase in charges to the investment fund, and

(iii) the notice referred to in subparagraph (ii) is actually sent 60 days before the effective date of the change.

(2) Despite subsection 5.1(1), the approval of securityholders of an investment fund is not required to be obtained for a change referred to in paragraph 5.1(1)(f) if either of the following paragraphs apply:

(a) all of the following apply:

(i) the independent review committee of the investment fund has approved the change under subsection 5.2(2) of Regulation 81-107 respecting Independent Review Committee for Investment Funds (chapter V-1.1, r. 43);

(ii) the investment fund is being reorganized with, or its assets are being transferred to, another investment fund to which this Regulation and Regulation 81-107 respecting Independent Review Committee for Investment Funds apply and that is managed by the manager, or an affiliate of the manager, of the investment fund;

(iii) the reorganization or transfer of assets of the investment fund complies with the criteria in paragraphs 5.6(1)(a), (b), (c), (d), (g), (h), (i), (j) and (k);

(iv) the prospectus of the investment fund discloses that, although the approval of securityholders may not be obtained before making the change, securityholders will be sent a written notice at least 60 days before the effective date of the change;

(v) the notice referred to in subparagraph (iv) to securityholders is sent 60 days before the effective date of the change;

(b) all of the following apply:

(i) the investment fund is a non-redeemable investment fund that is being reorganized with, or its assets are being transferred to, a mutual fund that is

(A) a mutual fund to which this Regulation and Regulation 81-107 respecting Independent Review Committee for Investment Funds apply,

(B) managed by the manager, or an affiliate of the manager, of the investment fund,

(C) not in default of any requirement of securities legislation, and

(D) a reporting issuer in the local jurisdiction and has a current prospectus in the local jurisdiction;

(ii) the transaction is a tax-deferred transaction under subsection 85(1) of the ITA;

(iii) the securities of the investment fund do not give securityholders of the investment fund the right to request that the investment fund redeem the securities;

(iv) there is no market through which securityholders of the investment fund may sell securities of the investment fund during the existence of the investment fund;

(v) the prospectus of the investment fund discloses that

(A) securityholders of the investment fund, other than the manager, promoter or an affiliate of the manager or promoter, will cease to be

securityholders of the investment fund within 30 months following the completion of the initial public offering by the investment fund, and

(B) the investment fund will, within 30 months following the completion of the initial public offering by the investment fund, undertake a reorganization with, or transfer its assets to, a mutual fund that is managed by the manager of the investment fund or by an affiliate of the manager of the investment fund;

(vi) the mutual fund bears none of the costs and expenses associated with the transaction;

(vii) the reorganization or transfer of assets of the investment fund complies with subparagraphs 5.3(2)(a)(i), (iv) and (v) and paragraphs 5.6(1)(d) and (k).

(3) Despite subsection 5.1(1), the approval of securityholders of an investment fund is not required to be obtained for a change referred to in subparagraph 5.1(1)(h)(i) if all of the following conditions apply:

(a) the prospectus of the investment fund contains a description of the change and the event that will cause the change to occur;

(b) the prospectus of the investment fund discloses that, although the approval of securityholders will not be obtained before making the change, securityholders will be sent a written notice at least 60 days before the effective date of the change;

(c) the notice referred to in paragraph (b) is sent 60 days before the effective date of the change;

(d) each sales communication of the investment fund discloses that

(i) if the event that causes the change occurs, the investment fund will become a mutual fund,

(ii) if applicable, the investment strategies of the investment fund will change after the investment fund becomes a mutual fund,

(iii) if applicable, the securities of the investment fund will not be listed on the stock exchange on which they trade as a result of the change, and

(iv) additional information regarding the change is available in the prospectus of the investment fund.”.

22. Section 5.3.1 of the Regulation is amended:

(1) by replacing, in the title, the words “**Mutual fund**” with the words “**Investment Fund**”;

(2) by replacing, in the part preceding subparagraph (a), the words “mutual fund may” with the words “investment fund must”;

(3) by replacing, in subparagraph (a), the words “the mutual fund has approved the change” with the words “the investment fund has approved the change of auditor”;

(4) by replacing, in subparagraph (b), the words “mutual funds” with the words “investment funds” and the words “may not” with the words “will not”.

23. Section 5.4 of the Regulation is amended:

(1) by replacing, in paragraph (1), the words “a mutual fund” with the words “an investment fund” and the words “section 5.1 shall” with the words “subsection 5.1(1) must”;

(2) in paragraph (2):

(a) by replacing, in the part preceding subparagraph (a), the word “shall” with the word “must”;

(b) by replacing, in subparagraph (a), the words “paragraphs 5.1(a)” with the words “paragraphs 5.1(1)(a)”, the words “the mutual fund had” with the words “the investment fund had” and the words “throughout the mutual fund’s” with the words “throughout the investments fund’s”.

24. Section 5.5 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in subparagraph (a), the words “a mutual fund” with the words “”an investment fund”;

(b) by inserting, after subparagraph (a), the following:

“(a.1) a change in the control of the manager of an investment fund is made;”;

(c) by replacing subparagraph (b) with the following:

“(b) a reorganization or transfer of assets of an investment fund is implemented, if the transaction will result in the securityholders of the investment fund becoming securityholders in another issuer;”;

(d) by replacing, in subparagraph (c), the words “a mutual fund” with the words “”an investment fund”;

(e) by replacing, in subparagraph (d), the words “a mutual fund” with the words “an investment fund” and the words “the mutual fund” with the words “the investment fund”;

(2) by deleting paragraph (2).

25. The title of section 5.6 of the Regulation is replaced, in the French text, with the following:

“**5.6. Les restructurations et transferts agréés**”.

26. Section 5.6 of the Regulation is amended:

(1) by replacing paragraph (1) with the following:

“(1) Despite subsection 5.5(1), the approval of the regulator, except in Québec, or the securities regulatory authority is not required to implement a transaction referred to in paragraph 5.5(1)(b) if all of the following paragraphs apply:

(a) the investment fund is being reorganized with, or its assets are being transferred to, another investment fund to which this Regulation applies and that

(i) is managed by the manager, or an affiliate of the manager, of the investment fund;

(ii) a reasonable person would consider to have substantially similar fundamental investment objectives, valuation procedures and fee structure as the investment fund;

(iii) is not in default of any requirement of securities legislation;

(iv) is a reporting issuer in the local jurisdiction and, if the other investment fund is a mutual fund, that mutual fund also has a current prospectus in the local jurisdiction;

(b) the transaction is a "qualifying exchange" within the meaning of section 132.2 of the ITA or is a tax-deferred transaction under subsection 85(1), 85.1(1), 86(1) or 87(1) of the ITA;

(c) the transaction contemplates the wind-up of the investment fund as soon as reasonably possible following the transaction;

(d) the portfolio assets of the investment fund to be acquired by the other investment fund as part of the transaction

(i) may be acquired by the other investment fund in compliance with this Regulation; and

(ii) are acceptable to the portfolio adviser of the other investment fund and consistent with the other investment fund's fundamental investment objectives;

(e) the transaction is approved

(i) by the securityholders of the investment fund in accordance with paragraph 5.1(1)(f), unless subsection 5.3(2) applies; and

(ii) if required, by the securityholders of the other investment fund in accordance with paragraph 5.1(1)(g);

(f) the materials sent to securityholders of the investment fund in connection with the approval under paragraph 5.1(1)(f) include

(i) a circular that, in addition to other requirements prescribed by law, describes the proposed transaction, the investment fund into which the investment fund will be reorganized, the income tax considerations for the investment funds participating in the transaction and their securityholders, and, if the investment fund is a corporation and the transaction involves its shareholders becoming securityholders of an investment fund that is established as a trust, a description of the material differences between being a shareholder of a corporation and being a securityholder of a trust;

(ii) if the other investment fund is a mutual fund, the current prospectus or the most recently filed fund facts document; and

(iii) a statement that securityholders may obtain all of the following documents in respect of the reorganized investment fund at no cost by contacting the reorganized investment fund at an address or telephone number specified in the statement, or by accessing the documents at a website address specified in the statement:

(A) if the reorganized investment fund is a mutual fund, the current prospectus;

(B) the most recently filed annual information form, if one has been filed;

(C) if applicable, the most recently filed fund facts document;

(D) the most recently filed annual and interim financial statements;

(E) the most recently filed annual and interim management reports of fund performance;

(g) the investment fund has complied with Part 11 of Regulation 81-106 respecting Investment Fund Continuous Disclosure (chapter V-1.1, r. 42) in connection with the making of the decision to proceed with the transaction by the board of directors of the manager of the investment fund or of the investment fund;

(h) the investment funds participating in the transaction bear none of the costs and expenses associated with the transaction;

(i) if the investment fund is a mutual fund, securityholders of the investment fund continue to have the right to redeem securities of the investment fund up to the close of business on the business day immediately before the effective date of the transaction;

(j) if the investment fund is a non-redeemable investment fund, all of the following apply:

(i) the investment fund issues and files a news release that discloses the transaction;

(ii) securityholders of the investment fund may redeem securities of the investment fund at a date that is after the date of the news release referred to in subparagraph (i) and before the effective date of the reorganization or transfer of assets;

(iii) the securities submitted for redemption in accordance with subparagraph (ii) are redeemed at a price equal to their net asset value per security on the redemption date;

(k) the consideration offered to securityholders of the investment fund for the transaction has a value that is equal to the net asset value of the investment fund.

(1.1) Despite subsection 5.5(1), the approval of the regulator, except in Québec, or the securities regulatory authority is not required to implement a transaction referred to in paragraph 5.5(1)(b) if all the conditions in paragraph 5.3(2)(b) are satisfied and the independent review committee of the mutual fund involved in the transaction has approved the transaction in accordance with subsection 5.2(2) of Regulation 81-107 respecting Independent Review Committee for Investment Funds (chapter V-1.1, r. 43).";

(2) by deleting paragraph (2).

27. Section 5.7 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in the part preceding subparagraph (a), the word "shall" with the word "must";

(b) in subparagraph (a):

(i) by replacing, in the part preceding subparagraph (i), the words “subsection 5.5(2)” with “(a.1)”;

(ii) by replacing, in clauses (C) and (D) of subparagraph (iii), the words “mutual fund” with the words “investment fund”;

(iii) by replacing, in subparagraph (vi), the words “mutual fund” with the words “investment fund”;

(d) in subparagraph (b):

(i) by replacing, in subparagraph (ii), the words “each of the mutual funds” with the words “the investment fund an the other issuer”;

(ii) by replacing subparagraph (iii) with the following:

“(iii) a description of the differences between, as applicable, the fundamental investment objectives, investment strategies, valuation procedures and fee structure of the investment fund and the other issuer and any other material differences between the investment fund and the other issuer; and”;

(e) by replacing, in subparagraph (d), the words “for the mutual fund” with the words “for the investment fund” and the words “of the mutual fund” with the words “of the investment fund”;

(2) in subparagraph (2):

(a) by replacing, in the part preceding subparagraph (a), the words “A mutual fund” with the words “An investment fund” and the word “shall” with the word “must”;

(b) by replacing, in subparagraph (a), the words “mutual fund is situate” with the words “investment fund is situated”;

(c) by replacing, in subparagraph (b), the words “mutual fund” with the words “investment fund”;

(3) in paragraph (3):

(a) by replacing, in the part preceding subparagraph (a), the words “A mutual fund” with the words “An investment fund” and the words “the mutual fund” with the words “the investment fund”;

(b) by replacing, in subparagraph (a), the words “mutual fund is situate” with the words “investment fund is situated”;

(c) in subparagraph (b):

(i) by replacing, in the part preceding subparagraph (i), the words “mutual fund” with the words “investment fund”;

(ii) by replacing, in subparagraph (ii), the words “mutual fund” with the words “investment fund”.

28. Section 5.8 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in the part preceding subparagraph (a), the words “a mutual fund” with the words “an investment fund” and the words “the mutual fund” with the words “the investment fund”;

(b) by replacing, in subparagraph (a), the words “mutual fund” with the words “investment fund”;

(2) by replacing, in paragraph (2), the word “shall” with the word “may”;

(3) by replacing, in paragraph (3), the word “shall” with the word “must”.

29. The Regulation is amended by inserting, after section 5.8, the following:

“**5.8.1. Termination of Non-Redeemable Investment Fund**

(1) A non-redeemable investment fund must not terminate unless the investment fund issues and files a news release that discloses the termination.

(2) A non-redeemable investment fund must be terminated no earlier than 15 days and no later than 30 days after the filing of the news release referred to in subsection (1).

(3) Subsections (1) and (2) do not apply to a non-redeemable investment fund that ceases to continue under a transaction referred to in paragraph 5.1(1)(f).”.

30. Section 6.1 of the Regulation is replaced with the following:

“**6.1. General**

(1) Except as provided in sections 6.8, 6.8.1 and 6.9, all portfolio assets of an investment fund must be held under the custodianship of one custodian that satisfies the requirements of section 6.2.

(2) Except as provided in subsection 6.5(3) and sections 6.8, 6.8.1 and 6.9, portfolio assets of an investment fund must be held

(a) in Canada by the custodian or a sub-custodian of the investment fund; or

(b) outside Canada by the custodian or a sub-custodian of the investment fund, if appropriate to facilitate portfolio transactions of the investment fund outside Canada.

(3) The custodian or a sub-custodian of an investment fund may appoint one or more sub-custodians to hold portfolio assets of the investment fund, if

(a) where the appointment is by the custodian, the investment fund gives written consent to each appointment;

(a.1) where the appointment is by a sub-custodian, the investment fund and the custodian of the investment fund give written consent to each appointment;

(b) the sub-custodian that is to be appointed is an entity described in section 6.2 or 6.3, as applicable;

(c) the arrangements under which a sub-custodian is appointed are such that the investment fund may enforce rights directly, or require the custodian or a sub-custodian to enforce rights on behalf of the investment fund, to the portfolio assets held by the appointed sub-custodian; and

(d) the appointment is otherwise in compliance with this Regulation.

(4) The written consent referred to in paragraphs (3)(a) and (a.1) may be in the form of a general consent, contained in the agreement governing the relationship between the investment fund and the custodian, or the custodian and the sub-custodian, to the appointment of entities that are part of an international network of sub-custodians within the organization of the appointed custodian or sub-custodian.

(5) A custodian or sub-custodian must provide to the investment fund a list of all entities that are appointed sub-custodians under a general consent referred to in subsection (4).

(6) Despite any other provisions of this Part, the manager of an investment fund must not act as custodian or sub-custodian of the investment fund.".

31. Section 6.2 of the Regulation is amended:

(1) by replacing the part preceding point 1 with the following:

"If portfolio assets are held in Canada by a custodian or sub-custodian, the custodian or sub-custodian must be one of the following:";

(2) by deleting, in point 2, the word "shareholders'";

(3) in point 3:

(a) by deleting, in subparagraph (a), the word "shareholders'";

(b) by replacing, in subparagraph (b), the words "in respect of that mutual fund" with the words "for that investment fund".

32. Section 6.3 of the Regulation is amended:

(1) by replacing the part preceding point 1 with the following:

"If portfolio assets are held outside of Canada by a sub-custodian, the sub-custodian must be one of the following:";

(2) by deleting, in subparagraph (c) of point 2, the word "shareholders'";

(3) in point 3:

(a) by deleting, in subparagraph (a), the word "shareholders'";

(b) by replacing, in subparagraph (b), the words "in respect of that mutual fund" with the words "for that investment fund".

33. Sections 6.4 and 6.5 of the Regulation are replaced with the following:

"**6.4. Contents of Custodian and Sub-Custodian Agreements**

(1) All custodian agreements and sub-custodian agreements of an investment fund must provide for

(a) the location of portfolio assets;

(b) any appointment of a sub-custodian;

(c) a list of all sub-custodians;

(d) the method of holding portfolio assets;

(e) the standard of care and responsibility for loss; and

(f) review and compliance reports.

(2) A sub-custodian agreement concerning the portfolio assets of an investment fund must provide for the safekeeping of portfolio assets on terms consistent with the custodian agreement of the investment fund.

(2.1) The provisions of an agreement referred to under subsections (1) or (2) must comply with the requirements of this Part.

(3) A custodian agreement or sub-custodian agreement concerning the portfolio assets of an investment fund must not

(a) provide for the creation of any security interest on the portfolio assets of the investment fund except for a good faith claim for payment of the fees and expenses of the custodian or a sub-custodian for acting in that capacity or to secure the obligations of the investment fund to repay borrowings by the investment fund from the custodian or a sub-custodian for the purpose of settling portfolio transactions; or

(b) contain a provision that would require the payment of a fee to the custodian or a sub-custodian for the transfer of the beneficial ownership of portfolio assets of the investment fund, other than for safekeeping and administrative services in connection with acting as custodian or sub-custodian.

"**6.5. Holding of Portfolio Assets and Payment of Fees**

(1) Except as provided in subsections (2) and (3) and sections 6.8, 6.8.1 and 6.9, portfolio assets of an investment fund not registered in the name of the investment fund must be registered in the name of the custodian or a sub-custodian of the investment fund or any of their respective nominees with an account number or other designation in the records of the custodian sufficient to show that the beneficial ownership of the portfolio assets is vested in the investment fund.

(2) The custodian or a sub-custodian of an investment fund or an applicable nominee must segregate portfolio assets issued in bearer form to show that the beneficial ownership of the property is vested in the investment fund.

(3) The custodian or a sub-custodian of an investment fund may deposit portfolio assets of the investment fund with a depository, or a clearing agency, that operates a book-based system.

(4) The custodian or a sub-custodian of an investment fund arranging for the deposit of portfolio assets of the investment fund with, and their delivery to, a depository, or clearing agency, that operates a book-based system must ensure that the records of any of the applicable participants in that book-based system or the custodian contain an account number or other designation sufficient to show that the beneficial ownership of the portfolio assets is vested in the investment fund.

(5) An investment fund must not pay a fee to the custodian or a sub-custodian for the transfer of beneficial ownership of portfolio assets of the investment fund other than for safekeeping and administrative services in connection with acting as custodian or sub-custodian.".

34. Section 6.6 of the Regulation is amended:

(1) by replacing, in paragraph (1), the words “a mutual fund” with the words “an investment fund” and the words “the mutual fund, shall” with the words “the investment, must”;

(2) by replacing, in paragraph (2), the words “A mutual fund shall” with the words “An investment fund must”, the words “the mutual fund from liability to the mutual fund” with the words “ the investment fund from liability to the investment fund”, and the words “the mutual fund for” with the words “the investment fund for”;

(3) by replacing, in paragraph (3), the words “A mutual fund” with the words “An investment fund”, the words “a custodian or sub-custodian” with the words “the custodian or a sub-custodian”, and the words “the mutual fund” with the words “the investment fund”;

(4) by replacing, in paragraph (4), the words “A mutual fund shall” with the words “An investment fund must” and the words “a custodian or sub-custodian” with the words “the custodian or a sub-custodian”.

35. Section 6.7 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in the part preceding subparagraph (a), the words “a mutual fund shall” with the words “an investment fund must”;

(b) by replacing, in subparagraph (a), the words “mutual fund” with the word “investment fund”;

(c) by replacing, in subparagraph (c), the words “mutual fund” with the word “investment fund”;

(2) in paragraph (2):

(a) by replacing the part preceding subparagraph (a) with the following:

“(2) The custodian of an investment fund must, within 60 days after the end of each financial year of the investment fund, advise the investment fund in writing”;

(b) by replacing, in subparagraph (a), the words “mutual fund” with the words “investment fund”;

(c) by replacing subparagraph (c) with the following:

“(c) whether, to the best of the knowledge and belief of the custodian, each sub-custodian is an entity that satisfies section 6.2 or 6.3, as applicable.”;

(3) by replacing paragraph (3) with the following:

“(3) A copy of the report referred to in subsection (2) must be delivered by or on behalf of the investment fund to the securities regulatory authority within 30 days after the filing of the annual financial statements of the investment fund.”.

36. Section 6.8 of the Regulation is amended:

(1) by replacing, in paragraph (1), the words “A mutual fund” with the words “An investment fund” and the words “the mutual fund, exceed 10% of the net asset value of the mutual fund” with the words “the investment fund, exceed 10% of the net asset value of the investment fund”;

(2) in paragraph (2):

(a) by replacing, in the part preceding subparagraph (a), the words “A mutual fund” with the words “An investment fund”;

(b) by replacing, in subparagraph (c), the words “the mutual fund, exceed 10% of net asset value of the mutual fund” with the words “the investment fund, exceed 10% of the net asset value of the investment fund”;

(3) by replacing, in paragraph (3), the words “A mutual fund” with the words “An investment fund”;

(4) by replacing paragraph (4) with the following:

“(4) The agreement by which portfolio assets are deposited in accordance with subsection (1), (2) or (3) must require the person holding the portfolio assets to ensure that its records show that the investment fund is the beneficial owner of the portfolio assets.”;

(5) by replacing, in paragraph (5), the words “A mutual fund” with the words “An investment fund”, the words “delivered to the mutual fund” with the words “delivered to the investment fund”, and the words “sub-custodian of the mutual fund” with the words “sub-custodian of the investment fund”.

37. Section 6.9 of the Regulation is replaced with the following:

“**6.9. Separate Account for Paying Expenses**

An investment fund may deposit cash in Canada with an entity referred to in paragraph 1 or 2 of section 6.2 to facilitate the payment of regular operating expenses of the investment fund.”.

38. Section 7.1 of the Regulation is amended:

(1) by replacing the part preceding paragraph (a) with the following:

“An investment fund must not pay, or enter into arrangements that would require it to pay, and securities of an investment fund must not be sold on the basis that an investor would be required to pay, a fee that is determined by the performance of the investment fund, unless”;

(2) by replacing, in subparagraphs (i) and (ii) of paragraph (a), the words “mutual fund” with the words “investment fund”;

(3) by replacing, in paragraphs (b) and (c), the words “mutual fund” with the words “investment fund”.

39. Section 7.2 of the Regulation is amended by replacing, wherever they occur, the words “mutual fund” with the words “investment fund”, and making the necessary changes.

40. Section 8.1 of the Regulation is amended by replacing, in the part preceding subparagraph (a), the word “shall” with the word “may”.

41. Section 9.0.1 of the Regulation is replaced with the following:

“**9.0.1. Application**

This Part, other than subsections 9.3(2) and (3), does not apply to an exchange-traded mutual fund that is not in continuous distribution.”.

42. Section 9.1 of the Regulation is amended:

(1) by replacing, in paragraph (1), the word “shall” with the word “must”;

(2) by replacing, in paragraph (2), the words “by the principal distributor of the mutual fund or by a person providing services to the participating dealer or principal distributor” with the words “a person providing services to the participating dealer, or by the principal distributor of the mutual fund”, and the word “shall” with the word “must”;

(3) by replacing, in paragraph (7), the word “shall” with the word “must”.

43. Section 9.3 of the Regulation is replaced with the following:

“**9.3. Issue Price of Securities**

(1) The issue price of a security of a mutual fund to which a purchase order pertains must be the net asset value per security of that class, or series of a class, next determined after the receipt by the mutual fund of the order.

(2) The issue price of a security of an exchange-traded mutual fund that is not in continuous distribution or a non-redeemable investment fund must not be a price that is less than the net asset value per security of that class, or series of a class, determined on the date of issuance.

(3) Despite subsection (2), if the securities of an exchange-traded mutual fund that is not in continuous distribution or a non-redeemable investment fund are distributed under a prospectus, the issue price of each security must not,

(a) as far as reasonably practicable, be a price that causes dilution of the net asset value of other outstanding securities of the investment fund; and

(b) be a price that is less than the net asset value per security of that class, or series of a class, determined on the date that is one business day before the date of the prospectus.”.

44. The Regulation is amended by inserting, after Part 9, the following:

“**PART 9.1 WARRANTS AND SPECIFIED DERIVATIVES**

9.1.1. Issuance of Warrants or Specified Derivatives

An investment fund must not issue conventional warrants or rights, or a specified derivative the underlying interest of which is a security of the investment fund.”.

45. The Regulation is amended by replacing, in the title of Part 10, the words “**A MUTUAL FUND**” with the words “**AN INVESTMENT FUND**”.

46. Section 10.1 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing the part preceding subparagraph (a) with the following:

“(1) An investment fund must not pay redemption proceeds unless”;

(b) by replacing, in subparagraph (a), the words “the mutual fund to be redeemed is represented by a certificate, the mutual fund” with “the investment fund to be redeemed is represented by a certificate, the investment fund”;

(c) in subparagraph (b):

(i) by replacing, in subparagraph (i), the words “mutual fund” with the word “investment fund”;

(ii) by replacing, in subparagraph (ii), the words “the mutual fund permits” with the word “the investment fund permits” and the words “with the mutual fund” with the words “with the investment fund”;

(2) by replacing paragraph (2) with the following:

“(2) An investment fund may establish reasonable requirements applicable to securityholders who wish to have the investment fund redeem securities, not contrary to this Regulation, as to procedures to be followed and documents to be delivered by the following times:

(a) in the case of a mutual fund, other than an exchange-traded mutual fund that is not in continuous distribution, by the time of delivery of a redemption order to an order receipt office of the mutual fund;

(a.1) in the case of an exchange-traded mutual fund that is not in continuous distribution or a non-redeemable investment fund, by the time of delivery of a redemption order;

(b) by the time of payment of redemption proceeds.”;

(3) by replacing paragraph (3) with the following:

“(3) A manager of an investment fund must provide to securityholders of the investment fund at least annually a statement containing the following:

(a) a description of the requirements referred to in subsection (1);

(b) a description of the requirements established by the investment fund under subsection (2);

(c) a detailed reference to all documentation required for redemption of securities of the investment fund;

(d) detailed instructions on the manner in which documentation is to be delivered to participating dealers, the investment fund, or person providing services to the investment fund to which a redemption order may be made;

(e) a description of all other procedural or communication requirements;

(f) an explanation of the consequences of failing to meet timing requirements.”;

(4) by replacing, in paragraph (4), the words “a document that is sent to all securityholders” with the words “any document that is sent to all securityholders in that year”.

47. Section 10.3 of the Regulation is amended:

(1) by replacing, in paragraph (1), the word “shall” with the word “must”;

(2) by replacing, in paragraph (3), the word “calculated” with the word “computed”;

(3) by adding, after paragraph (3), the following:

"(4) The redemption price of a security of a non-redeemable investment fund must not be a price that is more than the net asset value of the security determined on a redemption date specified in the prospectus or annual information form of the investment fund.".

48. Section 10.4 of the Regulation is amended:

(1) by replacing paragraph (1.1) with the following:

"(1.1) Despite subsection (1), an exchange-traded mutual fund that is not in continuous distribution must pay the redemption proceeds for securities that are the subject of a redemption order no later than 15 business days after the valuation date on which the redemption price was established.

(1.2) A non-redeemable investment fund must pay the redemption proceeds for securities that are the subject of a redemption order no later than 15 business days after the valuation date on which the redemption price was established.";

(2) by replacing, in paragraph (2), the words "of a security" with the words "for a redeemed security" and the word "shall" with the word "must";

(3) by replacing, in the part preceding subparagraph (a) of paragraph (3), the words "A mutual fund" with the words "An investment fund";

(4) in paragraph (5):

(a) by replacing, in the part preceding subparagraph (a), the word "redeemed" with the words "a redeemed" and the words "a mutual fund" with the words "an investment fund";

(b) by replacing, in subparagraph (a), the words "mutual fund" with the words "investment fund";

(c) by replacing, in subparagraph (b), the words "the mutual fund delivers" with the words "the investment fund delivers" and the words "mutual fund for" with the words "investment fund for";

49. Section 10.6 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in the part preceding subparagraph (a), the words "A mutual fund" with the words "An investment fund" and the words "the mutual fund" with the words "the investment fund";

(b) by replacing, in subparagraph (a), the words "of the mutual fund" with the words "of the investment" and the words "for the mutual fund" with the words "for the investment fund";

(c) by replacing, in the subparagraph (b) , the words "mutual fund" with the words "investmetn fund";

(2) by replacing, in paragraph (2), the words "A mutual fund" with the words "An investment fund" and "10.4(1)" with "10.4(1), (1.1) or (1.2)";

(3) by replacing, in paragraph (3), the words "A mutual fund shall" with the words "An investment fund must" and the words "the mutual fund" with the words "the investment fund".

50. Section 11.1 of the Regulation is amended:

(1) by replacing the title with the following:

"**11.1. Principal Distributors and Service Providers**";

(2) by replacing paragraphs (1) and (2) with the following:

"(1) Cash received by a principal distributor of a mutual fund, by a person providing services to the mutual fund or the principal distributor, or by a person providing services to a non-redeemable investment fund, for investment in, or on the redemption of, securities of the investment fund, or on the distribution of assets of the investment fund, until disbursed as permitted by subsection (3),

(a) must be accounted for separately and be deposited in a trust account or trust accounts established and maintained in accordance with the requirements of section 11.3; and

(b) may be commingled only with cash received by the principal distributor or service provider for the sale or on the redemption of other investment fund securities.

"(2) Except as permitted by subsection (3), the principal distributor, a person providing services to the mutual fund or principal distributor, or a person providing services to the non-redeemable investment fund, must not use any of the cash referred to in subsection (1) to finance its own or any other operations in any way.";

(3) in paragraph (3):

(a) by replacing, in the part preceding subparagraph (a), the words "a mutual fund" with the words "an investment fund" and the words "for the purpose of" with the words "for any of the following purposes:";

(b) by replacing subparagraphs (a) and (b) with the following:

"(a) remitting to the investment fund the amount or, if subsection (5) applies, the net amount, to be invested in the securities of the investment fund;

"(b) remitting to the relevant persons redemption or distribution proceeds being paid on behalf of the investment fund;";

(c) by replacing, in paragraph (c), the words "mutual fund" with the words "investment fund";

(4) in paragraph (4):

(a) by replacing, in the part preceding subparagraph (a), the word "shall" with the word "must" and the words "mutual fund" with the words "investment fund";

(b) by replacing, in subparagraph (a), the words "a mutual fund" with the words "an investment fund";

(5) by replacing paragraph (5) with the following:

"(5) When making payments to an investment fund, the principal distributor or service provider may offset the proceeds of redemption of securities of the investment fund or amounts held for distributions to be paid on behalf of the investment

fund held in the trust account against amounts held in the trust account for investment in the investment fund.”.

51. Section 11.3 of the Regulation is amended:

(1) by replacing the part preceding subparagraph (a) with the following:

“A principal distributor or participating dealer, a person providing services to the principal distributor or participating dealer, or a person providing services to an investment fund, that deposits cash into a trust account in accordance with section 11.1 or 11.2 must”;

(2) in subparagraph (a):

(a) by inserting, in subparagraph (iii) and after the words “participating dealer”, “, or a person providing services to the investment fund”;

(b) by replacing, in subparagraph (iv), the words “or of a person providing services to the principal distributor or participating dealer” with the words “of a person providing services to the principal distributor or participating dealer, or of a person providing services to the investment fund”.

52. Section 11.4 of the Regulation is amended by deleting, in paragraph (1), the words “or The Montreal Exchange”.

53. The title of Part 14 of the Regulation is replaced, in the French text, with the following:

“**PARTIE 14 LA DATE DE CLÔTURE DES REGISTRES**”.

54. Section 14.0.1 of the Regulation is replaced with the following:

“**14.0.1 Application**

This Part does not apply to

(a) an exchange-traded mutual fund; or

(b) a non-redeemable investment fund if its securities are listed or quoted on an exchange.”.

55. Section 14.1 of the Regulation is amended:

(1) by replacing the French text of the title with the following:

“**14.1. La date de clôture des registres**”;

(2) by replacing the part preceding subparagraph (a) with the following :

“The record date for determining the right of securityholders of an investment fund to receive a dividend or distribution by the investment fund must be one of”;

(3) by replacing, in subparagraphs (b) and (c), the words “mutual fund” with the words “investment fund”.

56. Section 15.1 of the Regulation is replaced with the following:

“**15.1. Ability to Make Sales Communications**

Sales communications pertaining to an investment fund must be made by a person in accordance with this Part.”.

57. Section 15.2 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in the part preceding subparagraph (a), the words “no sales communications shall” with the words “a sales communication must not”;

(b) in subparagraph (b):

(i) by adding, at the end of the part preceding subparagraph (i), “, as applicable,”

(ii) by replacing, in subparagraph (i), the words “a mutual fund” with the words “an investment fund”;

(2) by replacing, in paragraph (2), the word “shall” with the word “must”.

58. Section 15.3 of the Regulation is amended:

(1) by replacing, in paragraph (1), the word “shall” with the word “must” and the words “a mutual fund” with the words “an investment fund”;

(2) by replacing, in paragraph (2), the word “shall” with the word “must”;

(3) by inserting, after paragraph (2), the following:

“(2.1) A sales communication for a non-redeemable investment fund that is prohibited by paragraph 15.6(1)(a) from disclosing performance data must not provide performance data for any benchmark or investment other than a non-redeemable investment fund under common management with the non-redeemable investment fund to which the sales communication pertains.”;

(4) in paragraph (5):

(a) by replacing, in the part preceding subparagraph (a), the word “shall” with the word “must” and the words “a mutual fund” with the words “an investment fund”;

(b) by replacing, in subparagraph (b), the words “mutual fund” with the words “investment fund”;

(5) by replacing, in paragraph (6), the word “shall” with the word “must” and “, either under National Policy Statement No. 39 or under this Regulation” with the words “or under this Regulation”;

(6) by replacing, in paragraph (7), the word “shall” with the word “must” and the words “mutual fund” with the words “investment fund”.

59. Section 15.4 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in the part preceding subparagraph (a), the word “shall” with the word “must”;

(b) by deleting, in subparagraph (a), the words “principal distributor or participating”;

(2) by replacing, in paragraph (2), the word “shall” with the word “must”, and “of [the mutual fund]” with “of [the investment fund]” and “[in the mutual fund]” with “[in the investment fund]”;

(3) by replacing, in paragraph (3), the word “shall” with the word “must”;

(4) by inserting, after paragraph (3), the following:

“(3.1.) A sales communication, other than a report to securityholders, of a non-redeemable investment fund that does not contain performance data must contain a warning in substantially the following words:

[If the securities of the non-redeemable investment fund are listed or quoted on an exchange or other market, state the following:] “You will usually pay brokerage fees to your dealer if you purchase or sell [units or shares] of the investment fund on [state the exchange or other market on which the securities of the investment fund are listed or quoted]. If the [units or shares] are purchased or sold on [state the exchange or other market], investors may pay more than the current net asset value when buying [units or shares] of the investment fund and may receive less than the current net asset value when selling them.”

[State the following in all cases:] “There are ongoing fees and expenses associated with owning [units or shares] of an investment fund. An investment fund must prepare disclosure documents that contain key information about the fund. You can find more detailed information about the fund in these documents. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated.”;

(5) by replacing, in paragraphs (4), (5) and (6), the word “shall” with the word “must”;

(6) by inserting, after paragraph (6), the following:

“(6.1) A sales communication, other than a report to securityholders, of a non-redeemable investment fund that contains performance data must contain a warning in substantially the following words:

[If the securities of the non-redeemable investment fund are listed or quoted on an exchange or other market, state the following:] “You will usually pay brokerage fees to your dealer if you purchase or sell [units or shares] of the investment fund on [state the exchange or other market on which the securities of the investment fund are listed or quoted]. If the [units or shares] are purchased or sold on [state the exchange or other market], investors may pay more than the current net asset value when buying [units or shares] of the investment fund and may receive less than the current net asset value when selling them.”

[State the following in all cases:] “There are ongoing fees and expenses associated with owning [units or shares] of an investment fund. An investment fund must prepare disclosure documents that contain key information about the fund. You can find more detailed information about the fund in these documents. The indicated rate[s] of return is [are] the historical annual compounded total return[s] including changes in [share or unit] value and reinvestment of all [dividends or distributions] and does [do] not take into account [state the following, as applicable:] [certain fees such as redemption fees or optional charges or] income taxes payable by any securityholder that would have reduced returns. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated.”

(7) by replacing, in paragraphs (7), (8) and (9), the word “shall” with the word “must”;

(8) in paragraph (10):

(a) by replacing the part preceding subparagraph (a) with the following:

"(10) A sales communication for an investment fund or asset allocation service that purports to arrange a guarantee or insurance in order to protect all or some of the principal amount of an investment in the investment fund or asset allocation service must";

(b) by replacing, in subparagraph (c), the words "mutual fund" with the words "investment fund";

(9) by replacing, in paragraph (11), the word "shall" with the word "must".

60. Section 15.5 of the Regulation is amended:

(1) by replacing, in paragraph (1), the words "No person shall" with the words "A person must not";

(2) in paragraph (2):

(a) by replacing, in the part preceding subparagraph (a), the word "shall" with the word "must";

(b) by replacing, in the French text of subparagraph (a), the word "épargnants" with the word "investisseurs";

(3) by replacing, in paragraphs (3) and (4), the word "shall" with the word "must".

61. Section 15.6 of the Regulation is replaced with the following:

"**15.6. Performance Data - General Requirements**

(1) A sales communication pertaining to an investment fund or asset allocation service must not contain performance data of the investment fund or asset allocation service unless all of the following paragraphs apply:

(a) one of the following subparagraphs applies:

(i) in the case of a mutual fund,

(A) the mutual fund has distributed securities under a prospectus in a jurisdiction for 12 consecutive months; or

(B) the mutual fund previously existed as a non-redeemable investment fund and has been a reporting issuer in a jurisdiction for a period of at least 12 consecutive months;

(i.1) in the case of a non-redeemable investment fund, the non-redeemable investment fund has been a reporting issuer in a jurisdiction for at least 12 consecutive months;

(i.2) in the case of an asset allocation service, the asset allocation service has been operated for at least 12 consecutive months and has invested only in participating funds each of which has distributed securities under a prospectus in a jurisdiction for at least 12 consecutive months;

(ii) if the sales communication pertains to an investment fund or asset allocation service that does not satisfy subparagraph (a)(i), (i.1), or (i.2), the sales communication is sent only to

(A) securityholders of the investment fund or participants in the asset allocation service, or

(B) securityholders of an investment fund or participants in an asset allocation service under common management with the investment fund or asset allocation service;

(b) the sales communication includes standard performance data of the investment fund or asset allocation service and, in the case of a written sales communication, the standard performance data is presented in type size that is equal to or larger than that used to present the other performance data;

(c) the performance data reflects or includes references to all elements of return;

(d) except as permitted by subsection 15.3(3), the sales communication does not contain performance data for a period that is

(i) in the case of a mutual fund, before the time when the mutual fund offered its securities under a prospectus;

(ii) in the case of a non-redeemable investment fund, before the non-redeemable investment fund was a reporting issuer; or

(iii) before the asset allocation service commenced operation.

(2) Despite subparagraph (1)(d)(i), a sales communication pertaining to a mutual fund referred to in clause (1)(a)(i)(B) that contains performance data of the mutual fund must include performance data for the period that the fund existed as a non-redeemable investment fund and was a reporting issuer.”.

62. The Regulation is amended by inserting, after section 15.7, the following:

“**15.7.1. Advertisements for Non-Redeemable Investment Funds**

An advertisement for a non-redeemable investment fund must not compare the performance of the non-redeemable investment fund with any benchmark or investment other than the following:

(a) one or more non-redeemable investment funds that are under common management or administration with the non-redeemable investment fund to which the advertisement pertains;

(b) one or more non-redeemable investment funds that have fundamental investment objectives that a reasonable person would consider similar to the non-redeemable investment fund to which the advertisement pertains;

(c) an index.”.

63. Section 15.8 of the Regulation is amended:

(1) by deleting, in the French text of paragraph (1), the words “de titres”;

(2) by replacing paragraphs (2) and (3) with the following:

“(2) A sales communication, other than a report to securityholders, that relates to an asset allocation service, or to an investment fund other than a money market fund, must not provide standard performance data unless

(a) to the extent applicable, the standard performance data has been calculated for the 10, 5, 3 and one year periods;

(a.1) in the case of a mutual fund that has been offering securities by way of prospectus for more than one and less than 10 years, the standard performance data has been calculated for the period since the inception of the mutual fund;

(a.2) in the case of a non-redeemable investment fund that has been a reporting issuer for more than one and less than 10 years, the standard performance data has been calculated for the period since the inception of the non-redeemable investment fund; and

(b) the periods referred to in paragraphs (a), (a.1) and (a.2) end on the same calendar month end that is

(i) not more than 45 days before the date of the appearance or use of the advertisement in which it is included; and

(ii) not more than 3 months before the date of first publication of any other sales communication in which it is included.

(3) A report to securityholders must not contain standard performance data unless

(a) to the extent applicable, the standard performance data has been calculated for the 10, 5, 3 and one year periods;

(a.1) in the case of a mutual fund that has been offering securities by way of prospectus for more than one and less than 10 years, the standard performance data has been calculated for the period since the inception of the mutual fund;

(a.2) in the case of a non-redeemable investment fund that has been a reporting issuer for more than one and less than 10 years, the standard performance data has been calculated for the period since the inception of the non-redeemable investment fund; and

(b) the periods referred to in paragraphs (a), (a.1) and (a.2) end on the day as of which the balance sheet of the financial statements contained in the report to securityholders was prepared.";

(3) by replacing, in paragraph (4), the word "shall" with the word "must".

64. Section 15.9 of the Regulation is amended by replacing, wherever they occur, the words "mutual fund" with the words "investment fund", and making the necessary changes, and the word "shall" with the word "must".

65. Section 15.10 of the Regulation is amended:

(1) by replacing paragraph (1) with the following:

"(1) The standard performance data of an investment fund must be calculated in accordance with this Part.";

(2) in paragraph (2):

(a) by replacing the definition of the expression "standard performance data" with the following:

""standard performance data" means, as calculated in each case in accordance with this Part,

(a) for a money market fund

(i) the current yield; or

(ii) the current yield and effective yield, if the effective yield is reported in a type size that is at least equal to that of the current yield; and

(b) for any investment fund other than a money market fund, the total return; and";

(b) by replacing, in the definition of the expression "total return", the words "a mutual fund" with the words "an investment fund";

(3) by replacing paragraph (3) with the following:

"(3) If there are fees and charges of the type described in paragraph 15.11(1)1 relevant to the calculation of redeemable value and initial value of the securities of an investment fund, the redeemable value and initial value of securities of an investment fund must be the net asset value of one unit or share of the investment fund at the beginning or at the end of the performance measurement period, minus the amount of those fees and charges calculated by applying the assumptions referred to in that paragraph to a hypothetical securityholder account.";

(4) in paragraph (4):

(a) by replacing, in the part preceding subparagraph (a), the words "a mutual fund" with the words "an investment fund" and the words "the mutual fund" with the words "the investment fund";

(b) by replacing, in subparagraph (a), the words "a mutual fund" with the words "an investment fund";

(c) by replacing subparagraph (b) with the following:

"b) "redeemable value" =

R x (1 + D1/P1) x (1 + D2/P2) x (1 + D3/P3) . . . x (1 + Dn/Pn)

where R = the net asset value of one unit or security of the investment fund at the end of the performance measurement period,

D = the dividend or distribution amount per security of the investment fund at the time of each distribution,

P = the dividend or distribution reinvestment price per security of the investment fund at the time of each distribution, and

n = the number of dividends or distributions during the performance measurement period.";

(5) by replacing, in paragraph (5), the word "shall" with the word "must";

(6) in paragraph (6):

(a) by replacing, in subparagraph (a), the words "a mutual fund" with the words "an investment fund" and the word "shall" with the word "must";

(b) by replacing, in subparagraph (b), the word “shall” with the word “must”.

66. Section 15.11 of the Regulation is amended:

(1) in paragraph (1):

(a) by replacing, in the part preceding point 1, the word “shall” with the word “must” and the words “a mutual fund” with the words “an investment fund”;

(b) by replacing, in point 3, the words “mutual fund” with the words “investment fund”;

(c) by replacing point 4 with the following:

“4. Dividends or distributions by the investment fund are reinvested in the investment fund at the net asset value per security of the investment fund on the reinvestment dates during the performance measurement period.”;

(d) by replacing point 6 with the following:

“6. In the case of a mutual fund, a complete redemption occurs at the end of the performance measurement period so that the ending redeemable value includes elements of return that have been accrued but not yet paid to securityholders.

7. In the case of a non-redeemable investment fund, a complete redemption occurs at the net asset value of one security at the end of the performance measurement period so that the ending redeemable value includes elements of return that have been accrued but not yet paid to securityholders.”;

(2) by replacing, in paragraph (2), the word “shall” with the word “must”;

(3) by replacing, in paragraph (3), the word “shall” with the word “must” and the words “mutual fund” with the words “investment fund”.

67. Section 15.13 of the Regulation is replaced with the following:

“**15.13. Prohibited Representations**

(1) Securities issued by an unincorporated investment fund must be described by a term that is not and does not include the word “shares”.

(2) A communication by an investment fund or asset allocation service, its promoter, manager, portfolio adviser, principal distributor, participating dealer or a person providing services to the investment fund or asset allocation service must not describe the investment fund as a commodity pool or as a vehicle for investors to participate in the speculative trading of, or leveraged investment in, derivatives, unless the investment fund is a commodity pool as defined in Regulation 81-104 respecting Commodity Pools (chapter V-1.1, r. 40).”.

68. Section 18.1 of the Regulation is amended:

(1) by replacing, in the part preceding subparagraph (a), the words “A mutual fund that is not a corporation shall” with the words “An investment fund that is not a corporation must”;

(2) by replacing, in subparagraph (a), the words “mutual fund” with the words “investment fund”;

(3) by replacing, in subparagraph (b), the words “mutual fund” with the words “investment fund”;

(4) by replacing, in subparagraph (c), the words “mutual fund” with the words “investment fund”.

69. Section 18.2 of the Regulation is replaced with the following:

“**18.2. Availability of Records**

(1) An investment fund that is not a corporation must make, or cause to be made, the records referred to in section 18.1 available for inspection, free of charge, during normal business hours at its principal or head office by a securityholder or a representative of a securityholder, if the securityholder has agreed in writing that the information contained in the register will not be used by the securityholder for any purpose other than

(a) in the case of a mutual fund, attempting to influence the voting of securityholders of the mutual fund or a matter relating to the relationships among the mutual fund, the members of the organization of the mutual fund, and the securityholders, partners, directors and officers of those entities; or

(b) in the case of a non-redeemable investment fund, attempting to influence the voting of securityholders of the non-redeemable investment fund or a matter relating to the relationships among the non-redeemable investment fund, the manager and portfolio adviser of the non-redeemable investment fund and any of their affiliates, and the securityholders, partners, directors and officers of those entities.

(2) An investment fund must, upon written request by a securityholder of the investment fund, provide, or cause to be provided, to the securityholder a copy of the records referred to in paragraphs 18.1(a) and (b) if the securityholder

(a) has agreed in writing that the information contained in the register will not be used by the securityholder for any purpose other than attempting to influence the voting of securityholders of the investment fund or a matter relating to the administration of the investment fund; and

(b) has paid a reasonable fee to the investment fund that does not exceed the reasonable costs to the investment fund of providing the copy of the register.”.

70. Section 19.3 of the Regulation is replaced with the following:

“**19.3. Revocation of Exemptions**

(1) A mutual fund that has obtained an exemption or waiver from, or approval under, National Policy Statement No. 39 or this Regulation before December 31, 2003, that relates to a mutual fund investing in other mutual funds, may no longer rely on the exemption, waver or approval as of Decembre 31, 2004.

(2) In British Columbia, subsection (1) does not apply.”.

71. Section 20.4 of the Regulation is amended by deleting, in paragraph (b), the word “simplified”.

72. Sections 20.2, 20.3 and 20.5 of the Regulation are repealed.

73. The Regulation is amended by replacing Appendix C with the following:

“**APPENDIX C PROVISIONS CONTAINED IN SECURITIES LEGISLATION FOR THE PURPOSE OF SUBSECTION 4.1(5) - PROHIBITED INVESTMENTS**

JURISDICTION	SECURITIES LEGISLATION REFERENCE
All Jurisdictions	Section 13.6 of *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations*
Newfoundland and Labrador	Section 191 of Reg 805/96".

74. The Regulation is amended by replacing, wherever they occur in sections 2.6.1, 2.7 to 2.9, 2.14 to 2.16, 4.2, 5.9, 6.8.1, 11.5 and 15.14, the words "mutual fund" with the words "investment fund", and making the necessary changes.

73. The Regulation is amended by replacing, wherever it occur in sections 2.7, 2.8, 2.10, 2.15, 2.16, 3.2, 4.2, 9.1, 9.4, 10.2, 10.5, 11.2, 11.5, 12.1, 15.7, 15.12, 15.14 and 19.2, the word "shall with the word "must".

74. Transition and coming into force

(1) Subject to subsections (2) to (4), this Regulation comes into force on (*insert here the date of coming into force of this Regulation*).

(2) For a non-redeemable investment fund that has filed a prospectus on or before ●, sections 5 to 8, 38 and 39 of this Regulation come into force on the day that is 18 months after the day referred to in subsection (1).

(3) Despite any requirements to the contrary in this Regulation, sales communications, other than advertisements, that were printed before ● may be used until the day that is six months after the day referred to in subsection (1).

(4) Subsection 46(3) of this Regulation comes into force at the beginning of the first calendar year beginning after the day referred to in subsection (1).

POLICY STATEMENT TO REGULATION 81-102 RESPECTING MUTUAL FUNDS

PART 1 PURPOSE

1.1 Purpose

The purpose of this Policy is to state the views of the Canadian securities regulatory authorities on various matters relating to Regulation 81-102 Mutual Funds (the "Regulation"), including

(a) the interpretation of various terms used in the Regulation;

(b) recommendations concerning the operating procedures that the Canadian securities regulatory authorities suggest that ~~mutual~~investment funds subject to the Regulation, or persons performing services for ~~mutual~~the investment funds, adopt to ensure compliance with the Regulation;

(c) discussions of circumstances in which the Canadian securities regulatory authorities have granted relief from particular requirements of National Policy Statement No. 39 ("NP39"), the predecessor to the Regulation, and the conditions that those authorities imposed in granting that relief; and

(d) recommendations concerning applications for approvals required under, or relief from, provisions of the Regulation.

PART 2 COMMENTS ON DEFINITIONS CONTAINED IN THE REGULATION

2.1 "asset allocation service"

The definition of "asset allocation service" in the Regulation includes only specific administrative services in which an investment in mutual funds subject to the Regulation is an integral part. The Canadian securities regulatory authorities do not view this definition as including general investment services such as discretionary portfolio management that may, but are not required to, invest in mutual funds subject to this Regulation.

2.2 "cash equivalent"

The definition of "cash equivalent" in the Regulation includes certain evidences of indebtedness of Canadian financial institutions. This includes banker's acceptances.

2.3 "clearing corporation"

The definition of "clearing corporation" in the Regulation includes both incorporated and unincorporated organizations, which may, but need not, be part of an options or futures exchange.

2.4 "debt-like security"

Paragraph (b) of the definition of "debt-like security" in the Regulation provides that the value of the component of an instrument that is not linked to the underlying interest of the instrument must account for less than 80% of the aggregate value of the instrument in order that the instrument be considered a debt-like security. The Canadian securities regulatory authorities have structured this provision in this manner to emphasize what they consider the most appropriate manner to value these instruments. That is, one should first value the component of the instrument that is not linked to the underlying interest, as this is often much easier to value than the component that is linked to the underlying interest. The Canadian securities regulatory authorities recognize the

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valuation difficulties that can arise if one attempts to value, by itself, the component of an instrument that is linked to the underlying interest.

2.5 "fundamental investment objectives"

(1) The definition of "fundamental investment objectives" is relevant in connection with paragraph 5.1(c) of the Regulation, which requires that the approval of securityholders of ~~a mutual~~ an investment fund be obtained before any change is made to the fundamental investment objectives of the ~~mutual~~investment fund. The fundamental investment objectives of ~~a mutual~~an investment fund are required to be disclosed in a ~~simplified~~ prospectus under Part B of Form 81-101F1 *Contents of Simplified Prospectus*~~.~~ or under the requirements of Form 41-101F2 *Information Required in an Investment Fund Prospectus*. The definition of "fundamental investment objectives" contained in the Regulation uses the language contained in the disclosure requirements of ~~Part B of~~ Form 81-101F1 and Form 41-101F2, and the definition should be read to include the matters that would have to be disclosed under the Item of ~~Part B of~~ the applicable form concerning "Fundamental Investment Objectives". Accordingly, any change to the ~~mutual~~investment fund requiring a change to that disclosure would trigger the requirement for securityholder approval under paragraph 5.1(c) of the Regulation.

(2) Part B of Form 81-101F1 ~~sets~~and Form 41-101F2 set out, among other things, the obligation that ~~a mutual~~ an investment fund disclose in a ~~simplified~~ prospectus both its fundamental investment objectives and its investment strategies. ~~–~~The matters required to be disclosed under the Item of ~~Part B of~~ the applicable form relating to "Investment Strategies" are not "fundamental investment objectives" under the Regulation.

(3) Generally speaking, the "fundamental investment objectives" of ~~a mutual~~an investment fund are those attributes that define its fundamental nature. For example, ~~mutual~~investment funds that are guaranteed or insured, or that pursue a highly specific investment approach such as index funds or derivative funds, may be defined by those attributes. Often the manner in which ~~a mutual~~an investment fund is marketed will provide evidence as to its fundamental nature; ~~a mutual~~an investment fund whose advertisements emphasize, for instance, that investments are guaranteed likely will have the existence of a guarantee as a "fundamental investment objective".

(4) (paragraph repealed).

(5) One component of the definition of "fundamental investment objectives" is that those objectives distinguish ~~a mutual~~ an investment fund from other ~~mutual~~investment funds. This component does not imply that the fundamental investment objectives for each ~~mutual~~investment fund must be unique. ~~–~~Two or more ~~mutual~~investment funds can have identical fundamental investment objectives.

2.6 "guaranteed mortgage"

A mortgage insured under the National Housing Act (Canada) or similar provincial statutes is a "guaranteed mortgage" for the purposes of the Regulation.

2.7 "hedging"

(1) One component of the definition of "hedging" is the requirement that hedging transactions result in a "high degree of negative correlation between changes in the value of the investment or position, or group of investments or positions, being hedged and changes in the value of the instrument or instruments with which the investment or position is hedged". The Canadian securities regulatory authorities are of the view that there need not be complete congruence between the hedging instrument or instruments and the position or positions being hedged if it is reasonable to regard the one as a hedging instrument for the other, taking into account the closeness of the relationship between fluctuations in the price of the two and the availability and pricing of hedging instruments.

(2) The definition of "hedging" includes a reference to the "maintaining" of the position resulting from a hedging transaction or series of hedging transactions. The

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inclusion of this component in the definition requires ~~a mutual~~an investment fund to ensure that a transaction continues to offset specific risks of the ~~mutual~~investment fund in order that the transaction be considered a "hedging" transaction under the Regulation; if the "hedging" position ceases to provide an offset to an existing risk of ~~a mutual~~an investment fund, then that position is no longer a hedging position under the Regulation, and can be held by the ~~mutual~~investment fund only in compliance with the specified derivatives rules of the Regulation that apply to non-hedging positions. The component of the definition that requires the "maintaining" of a hedge position does not mean that ~~a mutual~~an investment fund is locked into a specified derivatives position; it simply means that the specified derivatives position must continue to satisfy the definition of "hedging" in order to receive hedging treatment under the Regulation.

(3) Paragraph (b) of the definition of "hedging" has been included to ensure that currency cross hedging continues to be permitted under the Regulation. Currency cross hedging is the substitution of currency risk associated with one currency for currency risk associated with another currency, if neither currency is a currency in which the ~~mutual~~investment fund determines its net asset value per security and the aggregate amount of currency risk to which the ~~mutual~~investment fund is exposed is not increased by the substitution. Currency cross hedging is to be distinguished from currency hedging, as that term is ordinarily used. Ordinary currency hedging, in the context of ~~mutual~~investment funds, would involve replacing the ~~mutual fund's~~investment fund's exposure to a "non-net asset value" currency with exposure to a currency in which the ~~mutual~~investment fund calculates its net asset value per security. That type of currency hedging is subject to paragraph (a) of the definition of "hedging".

2.8 "illiquid asset"

A portfolio asset of ~~a mutual~~an investment fund that meets the definition of "illiquid asset" will be an illiquid asset even if a person, including the manager or the portfolio adviser of ~~a mutual~~an investment fund or a partner, director or officer of the manager or portfolio adviser of ~~a mutual~~an investment fund or any of their respective associates or affiliates, has agreed to purchase the asset from the ~~mutual~~investment fund. That type of agreement does not affect the words of the definition, which defines "illiquid asset" in terms of whether that asset cannot be readily disposed of through market facilities on which public quotations in common use are widely available.

2.9 "manager"

The definition of "manager" under the Regulation only applies to the person that actually directs the business of the ~~mutual~~investment fund, and does not apply to others, such as trustees, that do not actually carry out this function. Also, a "manager" would not include a person whose duties are limited to acting as a service provider to the ~~mutual~~investment fund, such as a portfolio adviser.

2.10 "option"

The definition of "option" includes warrants, whether or not the warrants are listed on a stock exchange or quoted on an over-the-counter market.

2.11 "performance data"

The term "performance data" includes data on an aspect of the investment performance of ~~a mutual~~an investment fund, an asset allocation service, security, index or benchmark. This could include data concerning return, volatility or yield. The Canadian securities regulatory authorities note that the term "performance data" would not include a rating prepared by an independent organization reflecting the credit quality, rather than the performance, of, for instance, ~~a mutual fund's~~an investment fund's portfolio or the participating funds of an asset allocation service.

2.12 "public medium"

An "advertisement" is defined in the Regulation to mean a sales communication that is published or designed for use on or through a "public medium". The Canadian securities regulatory authorities interpret the term "public medium" to include print,

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television, radio, tape recordings, video tapes, computer disks, the Internet, displays, signs, billboards, motion pictures and telephones.

2.13 "purchase"

(1) The definition of a "purchase", in connection with the acquisition of a portfolio asset by ~~a mutual~~an investment fund, means an acquisition that is the result of a decision made and action taken by the ~~mutual~~investment fund.

(2) The Canadian securities regulatory authorities consider that the following types of transactions would generally be purchases of a security by ~~a mutual~~an investment fund under the definition:

1. The ~~mutual~~investment fund effects an ordinary purchase of the security, or, at its option, exercises, converts or exchanges a convertible security held by it.

2. The ~~mutual~~investment fund receives the security as consideration for ~~a~~ security tendered by the ~~mutual~~investment fund into a take-over bid.

3. The ~~mutual~~investment fund receives the security as the result of a merger, amalgamation, plan of arrangement or other reorganization for which the ~~mutual~~investment fund voted in favour.

4. The ~~mutual~~investment fund receives the security as a result of the automatic exercise of an exchange or conversion right attached to another security held by the ~~mutual~~investment fund in accordance with the terms of that other security or the exercise of that exchange or conversion right at the option of the ~~mutual~~investment fund.

5. (a) The ~~mutual~~investment fund has become legally entitled to dispose of the collateral held by it under a securities loan or repurchase agreement and to apply proceeds of realization to satisfy the obligations of the counterparty of the ~~mutual~~investment fund under the transaction, and

(b) sufficient time has passed after the event described in paragraph (a) to enable the ~~mutual~~investment fund to sell the collateral in a manner that maintains an orderly market and that permits the preservation of the best value for the ~~mutual~~investment fund.

(3) The Canadian securities regulatory authorities consider that the following types of transactions would generally not be purchases of a security by ~~a mutual~~an investment fund under the definition:

1. The ~~mutual~~investment fund receives the security as a result of a compulsory acquisition by an issuer following completion of a successful take-over bid.

2. The ~~mutual~~investment fund receives the security as a result of a merger, amalgamation, plan of arrangement or other reorganization that the ~~mutual~~investment fund voted against.

3. The ~~mutual~~investment fund receives the security as the result of the exercise of an exchange or conversion right attached to a security held by the ~~mutual~~investment fund made at the discretion of the issuer of the security held by the ~~mutual~~investment fund.

4. The ~~mutual~~investment fund declines to tender into an issuer bid, even though its decision is likely to result in an increase in its percentage holdings of a security beyond what the ~~mutual~~investment fund would be permitted under the Regulation to purchase.

2.14 "restricted security"

A special warrant is a form of restricted security and, accordingly, the provisions of the Regulation applying to restricted securities apply to special warrants.

2.15 "sales communication"

(1) The term "sales communication" refers to a communication to a securityholder of ~~a mutual~~an investment fund and to a person that is not a securityholder if the purpose of the communication is to induce the purchase of securities of the ~~mutual~~investment fund. A sales communication therefore does not include a communication solely between ~~a mutual~~an investment fund or its promoter, manager, principal distributor or portfolio adviser and a participating dealer, or between the principal distributor or a participating dealer and its registered salespersons, that is indicated to be internal or confidential and that is not designed to be passed on by any principal distributor, participating dealer or registered salesperson to any securityholder of, or potential investor in, the ~~mutual~~investment fund. In the view of the Canadian securities regulatory authorities, if a communication of that type were so passed on by the principal distributor, participating dealer or registered salesperson, the communication would be a sales communication made by the party passing on the communication if the recipient of the communication were a securityholder of the ~~mutual~~investment fund or if the intent of the principal distributor, participating dealer or registered salesperson in passing on the communication were to induce the purchase of securities of the ~~mutual~~investment fund.

(2) The term "sales communication" is defined in the Regulation such that the communication need not be in writing and includes any oral communication. The Canadian securities regulatory authorities are of the view that the requirements in the Regulation pertaining to sales communications would apply to statements made at an investor conference to securityholders or to others to induce the purchase of securities of the ~~mutual~~investment fund.

(3) The Canadian securities regulatory authorities are of the view that image advertisements that are intended to promote a corporate identity or the expertise of ~~a mutual~~an investment fund manager fall outside the definition of "sales communication". However, an advertisement or other communication that refers to a specific ~~mutual~~investment fund or funds or promotes any particular investment portfolio or strategy would be a sales communication and therefore be required to include warnings of the type now described in section 15.4 of the Regulation.

(4) Paragraph (b) of the definition of a "sales communication" in the Regulation excludes sales communications contained in certain documents that the ~~mutual~~investment fund is required to prepare, including audited or unaudited financial statements, statements of account and confirmations of trade. The Canadian securities regulatory authorities are of the view that if information is contained in these types of documents that is not required to be included by securities legislation, any such additional material is not excluded by paragraph (b) of the definition of sales communication and may, therefore, constitute a sales communication if the additional material otherwise falls within the definition of that term in the Regulation.

2.16 "specified derivative"

(1) The term "specified derivative" is defined to mean an instrument, agreement or security, the market price, value or payment obligations of which are derived from, referenced to or based on an underlying interest. Certain instruments, agreements or securities that would otherwise be specified derivatives within the meaning of the definition are then excluded from the definition for purposes of the Regulation.

(2) Because of the broad ambit of the lead-in language to the definition, it is impossible to list every instrument, agreement or security that might be caught by that lead-in language but that is not considered to be a derivative in any normal commercial sense of that term. The Canadian securities regulatory authorities consider conventional floating rate debt instruments, securities of ~~a mutual fund or commodity pool, non-redeemable securities of~~ an investment fund, American depositary receipts and instalment receipts generally to be within this category, and generally will not treat those instruments as specified derivatives in administering the Regulation.

(3) However, the Canadian securities regulatory authorities note that these general exclusions may not be applicable in cases in which ~~a mutual~~an investment fund invests in one of the vehicles described in subsection (2) with the result that the ~~mutual~~investment fund obtains or increases exposure to a particular underlying interest in excess of the limit set out in section 2.1 of the Regulation. In such circumstances, the Canadian securities regulatory authorities are likely to consider that instrument a specified derivative under the Regulation.

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2.17 "standardized future"

The definition of "standardized future" refers to an agreement traded on a futures exchange. This type of agreement is called a "futures contract" in the legislation of some jurisdictions, and an "exchange contract" in the legislation of some other jurisdictions (such as British Columbia and Alberta). The term "standardized future" is used in the Regulation to refer to these types of contracts, to avoid conflict with existing local definitions.

2.18 "swap"

The Canadian securities regulatory authorities are of the view that the definition of a swap in the Regulation would include conventional interest rate and currency swaps, as well as equity swaps.

PART 3 INVESTMENTS

3.1 Evidences of Indebtedness of Foreign Governments and Supranational Agencies

(1) Section 2.1 of the Regulation prohibits ~~mutual~~investment funds from purchasing a security of an issuer, other than a government security or a security issued by a clearing corporation if, immediately after the purchase, more than 10% of their net asset value would be invested in securities of that issuer. The term "government security" is defined in the Regulation as an evidence of indebtedness that is issued, or fully and unconditionally guaranteed as to principal and interest, by any of the government of Canada, the government of a jurisdiction or the government of the United States of America.

(2) Before the Regulation came into force, the Canadian securities regulatory authorities granted relief from the predecessor provision of NP39 to a number of international bond funds in order to permit those mutual funds to pursue their fundamental investment objectives with greater flexibility.

(3) The Canadian securities regulatory authorities will continue to consider applications for relief from section 2.1 of the Regulation if the ~~mutual~~investment fund making the application demonstrates that the relief will better enable the ~~mutual~~investment fund to meet its fundamental investment objectives. This relief will ordinarily be restricted to international bond funds.

(4) The relief from paragraph 2.04(1)(a) of NP39, which is replaced by section 2.1 of the Regulation, that has been provided to a mutual fund has generally been limited to the following circumstances:

1. The mutual fund has been permitted to invest up to 20% of its net asset value, in evidences of indebtedness of any one issuer if those evidences of indebtedness are issued, or guaranteed fully as to principal and interest, by supranational agencies or governments other than the government of Canada, the government of a jurisdiction or the government of the United States of America and are rated "AA" by Standard & Poor's, or have an equivalent rating by one or more other approved credit rating organizations.

2. The mutual fund has been permitted to invest up to 35% of its net ~~assets, taken at market~~asset value ~~at the time of purchase,~~ in evidences of indebtedness of any one issuer, if those securities are issued by issuers described in paragraph 1 and are rated "AAA" by Standard & Poor's, or have an equivalent rating by one or more other approved credit rating organizations.

(5) It is noted that the relief described in paragraphs 3.1(4)1 and 2 cannot be combined for one issuer.

(6) (paragraph repealed).

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(7) The relief from paragraph 2.04(1)(a) of NP39, which is replaced by section 2.1 of the Regulation, has generally been provided only if

(a) the securities that may be purchased under the relief referred to in subsection (4) are traded on a mature and liquid market;

(b) the acquisition of the evidences of indebtedness by the mutual fund is consistent with its fundamental investment objectives;

(c) the prospectus or simplified prospectus of the mutual fund disclosed the additional risks associated with the concentration of the net asset value of the mutual fund in securities of fewer issuers, such as the potential additional exposure to the risk of default of the issuer in which the fund has so invested and the risks, including foreign exchange risks, of investing in the country in which that issuer is located; and

(d) the prospectus or simplified prospectus of the mutual fund gave details of the relief provided by the Canadian securities regulatory authorities, including the conditions imposed and the type of securities covered by the exemption.

3.2 Index Mutual Funds

(1) An "index mutual fund" is defined in section 1.1 of the Regulation as a mutual fund that has adopted fundamental investment objectives that require it to

(a) hold the securities that are included in a permitted index or permitted indices of the mutual fund in substantially the same proportion as those securities are reflected in that permitted index or permitted indices; or

(b) invest in a manner that causes the mutual fund to replicate the performance of that permitted index or those permitted indices.

(2) This definition includes only mutual funds whose entire portfolio is invested in accordance with one or more permitted indices. ~~The CSA recognizes~~The Canadian securities regulatory authorities recognize that there may be mutual funds that invest part of their portfolio in accordance with a permitted index or indices, with a remaining part of the portfolio being actively managed. Those mutual funds cannot avail themselves of the relief provided by subsection 2.1(5) of the Regulation, which provides relief from the "10% rule" contained in subsection 2.1(1) of the Regulation, because they are not "index mutual funds". The ~~CSA~~Canadian securities regulatory authorities acknowledge that there may be circumstances in which the principles behind the relief contained in subsection 2.1(5) of the Regulation is also applicable to "partially-indexed" mutual funds. Therefore, the ~~CSA~~Canadian securities regulatory authorities will consider applications from those types of mutual funds for relief analogous to that provided by subsection 2.1(5) of the Regulation.

(3) It is noted that the manager of an index mutual fund may make a decision to base all or some of the investments of the mutual fund on a different permitted index than a permitted index previously used. ~~-~~This decision might be made for investment reasons or because that index no longer satisfies the definition of "permitted index" in the Regulation. It is noted that this decision by the manager will be considered by the Canadian securities regulatory authorities generally to constitute a change of fundamental investment objectives, thereby requiring securityholder approval under paragraph 5.1(c) of the Regulation. In addition, this decision would also constitute a material change for the mutual fund, thereby requiring an amendment to the prospectus of the mutual fund and the issuing of a press release under Part 11 of Regulation 81-106 respecting Investment Fund Continuous Disclosure.

3.2.1 Control Restrictions

An investment fund generally holds a passive stake in the businesses in which it invests; that is, an investment fund generally does not seek to obtain control of, or become involved in, the management of investee companies. This key restriction on the type of investment activities that may be undertaken by an investment fund is codified in section 2.2 of the Regulation.

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Exceptions to this are labour sponsored or venture capital funds, where some degree of involvement in the management of the investees is an integral part of the investment strategy.

In determining whether an investment fund exercises control over, or is involved in the management of, an investee company, the Canadian securities regulatory authorities will generally consider indicators, including the following:

(a) any right of the investment fund to appoint directors, or observers, of the board of the investee company;

(b) restrictions on the management, or approval or veto rights over decisions made by the management, of the investee company by the investment fund;

(c) any right of the investment fund to restrict the transfer of securities by other securityholders of the investee company.

The Canadian securities regulatory authorities will take the above factors into consideration when considering the nature of an investment fund's investment in an issuer to determine whether the investment fund is in compliance with section 2.2 of the Regulation. We will also refer to the applicable accounting standards in determining whether an investment fund is exercising control of an issuer.

3.3 Special Warrants

~~A mutual~~An investment fund is required by subsection 2.2(3) of the Regulation to assume the conversion of each special warrant it holds. This requirement is imposed because the nature of a special warrant is such that there is a high degree of likelihood that its conversion feature will be exercised shortly after its issuance, once a prospectus relating to the underlying security has been filed.

3.4 Investment in Other ~~Mutual~~Investment Funds

(1) (paragraph repealed).

(2) Subsection 2.5(7) of the Regulation provides that certain investment restrictions and reporting requirements do not apply to investments in other ~~mutual~~investment funds made in accordance with section 2.5. In some cases, ~~a mutual fund's~~an investment fund's investments in other ~~mutual~~investment funds will be exempt from the requirements of section 2.5 because of an exemption granted by the regulator or securities regulatory authority. In these cases, assuming the ~~mutual~~investment fund complies with the terms of the exemption, its investments in other ~~mutual~~investment funds would be considered to have been made in accordance with section 2.5. It is also noted that subsection 2.5(7) applies only with respect to ~~a mutual fund's~~an investment fund's investments in other ~~mutual~~investment funds, and not for any other investment or transaction.

3.5 Instalments of Purchase Price

Paragraph 2.6(d) of the Regulation prohibits ~~a mutual~~an investment fund from purchasing a security, other than a specified derivative, that by its terms may require the ~~mutual~~investment fund to make a contribution in addition to the payment of the purchase price. This prohibition does not extend to the purchase of securities that are paid for on an instalment basis in which the total purchase price and the amounts of all instalments are fixed at the time the first instalment is made.

3.6 Purchase of Evidences of Indebtedness

Paragraph 2.6(f) of the Regulation prohibits ~~a mutual~~an investment fund from lending either cash or a portfolio asset other than cash. The Canadian securities regulatory authorities are of the view that the purchase of an evidence of indebtedness, such as a bond or debenture, a loan participation or loan syndication as permitted by paragraph 2.3(1)(i) or (2)(f) of the Regulation, or the purchase of a preferred share that is treated as debt for accounting purposes, does not constitute the lending of cash or a portfolio asset.

3.7 Securities Lending, Repurchase and Reverse Repurchase Transactions

(1) Section 2.12, 2.13 and 2.14 of the Regulation each contains a number of conditions that must be satisfied in order that ~~a mutual~~an investment fund may enter into a securities lending, repurchase or reverse repurchase transaction in compliance with the Regulation. It is expected that, in addition to satisfying these conditions, the manager on behalf of the ~~mutual~~investment fund, in co-ordination with an agent, will ensure that the documentation evidencing these types of transactions contains customary provisions to protect the ~~mutual~~investment fund and to document the transaction properly. ~~–~~ Among other things, these provisions would normally include

(a) a definition of an "event of default" under the agreement, which would include failure to deliver cash or securities, or to promptly pay to the ~~mutual~~investment fund amounts equal to dividends and interest paid, and distributions made, on loaned or sold securities, as required by the agreement;

(b) provisions giving non-defaulting parties rights of termination, rights to sell the collateral, rights to purchase identical securities to replace the loaned securities and legal rights of set-off in connection with their obligations if an event of default occurs; and

(c) provisions that deal with, if an event of default occurs, how the value of collateral or securities held by the non-defaulting party that is in excess of the amount owed by the defaulting party will be treated.

(2) Section 2.12, 2.13 and 2.14 of the Regulation each imposes a requirement that ~~a mutual~~an investment fund that has entered into a securities lending, repurchase or reverse repurchase transaction hold cash or securities of at least 102% of the market value of the securities or cash held by the ~~mutual fund's~~investment fund's counterparty under the transaction. It is noted that the 102% requirement is a minimum requirement, and that it may be appropriate for the manager of ~~a mutual~~an investment fund, or the agent acting on behalf of the ~~mutual~~investment fund, to negotiate the holding of a greater amount of cash or securities if necessary to protect the interests of the ~~mutual~~investment fund in a particular transaction, having regard to the level of risk for the ~~mutual~~investment fund in the transaction. ~~–~~ In addition, if the recognized best practices for a particular type of transaction in a particular market calls for a higher level of collateralization than 102%, it is expected that, absent special circumstances, the manager or the agent would ensure that its arrangements reflect the relevant best practices for that transaction.

(3) Paragraph 3 of subsection 2.12(1) of the Regulation refers to securities lending transactions in terms of securities that are "loaned" by ~~a mutual~~an investment fund in exchange for collateral. Some securities lending transactions are documented so that title to the "loaned" securities is transferred from the "lender" to the "borrower". The Canadian securities regulatory authorities do not consider this fact as sufficient to disqualify those transactions as securities loan transactions within the meaning of the Regulation, so long as the transaction is in fact substantively a loan. References throughout the Regulation to "loaned" securities, and similar references, should be read to include securities "transferred" under a securities lending transaction.

(4) Paragraph 6 of subsection 2.12(1) permits the use of irrevocable letters of credit as collateral in securities lending transactions. The Canadian securities regulatory authorities believe that, at a minimum, the prudent use of letters of credit will involve the following arrangements:

(a) the ~~mutual~~investment fund should be allowed to draw down any amount of the letter of credit at any time by presenting its sight draft and certifying that the borrower is in default of its obligations under the securities lending agreement, and the amount capable of being drawn down would represent the current market value of the outstanding loaned securities or the amount required to cure any other borrower default; and

(b) the letter of credit should be structured so that the lender may draw down, on the date immediately preceding its expiration date, an amount equal to the current market value of all outstanding loaned securities on that date.

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(5) Paragraph 9 of subsection 2.12(1) and paragraph 8 of subsection 2.13(1) of the Regulation each provides that the agreement under which ~~a mutual~~an investment fund enters into a securities lending or repurchase transaction include a provision requiring the ~~mutual fund's~~investment fund's counterparty to promptly pay to the ~~mutual~~investment fund, among other things, distributions made on the securities loaned or sold in the transaction. In this context, the term "distributions" should be read broadly to include all payments or distributions of any type made on the underlying securities, including, without limitation, distributions of property, stock dividends, securities received as the result of splits, all rights to purchase additional securities and full or partial redemption proceeds. This extended meaning conforms to the meaning given the term "distributions" in several standard forms of securities loan agreements widely used in the securities lending and repurchase markets.

(6) Section 2.12, 2.13 and 2.14 of the Regulation make reference to the "delivery" and "holding" of securities or collateral by the ~~mutual~~investment fund. The Canadian securities regulatory authorities note that these terms will include the delivery or holding by an agent for ~~a mutual~~an investment fund. In addition, the Canadian securities regulatory authorities recognize that under ordinary market practice, agents pool collateral for securities lending/repurchase clients; this pooling of itself is not considered a violation of the Regulation.

(7) Section 2.12, 2.13 and 2.14 of the Regulation require that the securities involved in a securities lending, repurchase or reverse repurchase transaction be marked to market daily and adjusted as required daily. It is recognized that market practice often involves an agent marking to market a portfolio at the end of a business day, and effecting the necessary adjustments to a portfolio on the next business day. So long as each action occurs on each business day, as required by the Regulation, this market practice is not a breach of the Regulation.

(8) As noted in subsection (7), the Regulation requires the daily marking to market of the securities involved in a securities lending, repurchase or reverse repurchase transaction. The valuation principles used in this marking to market may be those generally used by the agent acting for the ~~mutual~~investment fund, even if those principles deviate from the principles that are used by the ~~mutual~~investment fund in valuing its portfolio assets for the purposes of calculating net asset value.

(9) Paragraph 6 of subsection 2.13(1) of the Regulation imposes a requirement concerning the delivery of sales proceeds to the ~~mutual~~investment fund equal to 102 per cent of the market value of the securities sold in the transaction. It is noted that accrued interest on the sold securities should be included in the calculation of the market value of those securities.

(10) Section 2.15 of the Regulation imposes the obligation on a manager of ~~a mutual~~an investment fund to appoint an agent or agents to administer its securities lending and repurchase transactions, and makes optional the ability of a manager to appoint an agent or agents to administer its reverse repurchase transactions. A manager that appoints more than one agent to carry out these functions may allocate responsibility as it considers best. For instance, it may be appropriate that one agent be responsible for domestic transactions, with one or more agents responsible for ~~off-shore~~offshore transactions. Managers should ensure that the various requirements of sections 2.15 and 2.16 of the Regulation are satisfied for all agents.

(11) It is noted that the responsibilities of an agent appointed under section 2.15 of the Regulation include all aspects of acting on behalf of ~~a mutual~~an investment fund in connection with securities lending, repurchase or reverse repurchase agreements. This includes acting in connection with the reinvestment of collateral or securities held during the life of a transaction.

(12) Subsection 2.15(3) of the Regulation requires that an agent appointed by ~~a mutual~~an investment fund to administer its securities lending, repurchase or reverse repurchase transactions shall be a custodian or sub-custodian of the ~~mutual~~investment fund. It is noted that the provisions of Part 6 of the Regulation generally apply to the agent in connection with its activities relating to securities lending, repurchase or reverse repurchase transactions. The agent must have been appointed as custodian or sub-custodian in accordance with section 6.1, and must satisfy the other requirements of Part 6 in carrying out its responsibilities.

(13) Subsection 2.15(5) of the Regulation provides that the manager of ~~a mutual~~an investment fund ~~shall~~must not authorize an agent to enter into securities lending, repurchase or, if applicable, reverse repurchase transactions on behalf of the ~~mutual~~investment fund unless there is a written agreement between the agent, the manager and the ~~mutual~~investment fund that deals with certain prescribed matters. Subsection (~~5~~4) requires that the manager and the ~~mutual~~investment fund, in the agreement, provide instructions to the agent on the parameters to be followed in entering into the type of transaction to which the agreement pertains. ~~–~~The parameters would normally include

(a) details on the types of transactions that may be entered into by the ~~mutual~~investment fund;

(b) types of portfolio assets of the ~~mutual~~investment fund to be used in the transaction;

(c) specification of maximum transaction size, or aggregate amount of assets that may be committed to transactions at any one time;

(d) specification of permitted counterparties;

(e) any specific requirements regarding collateralization, including minimum requirements as to amount and diversification of collateralization, and details on the nature of the collateral that may be accepted by the ~~mutual~~investment fund;

(f) directions and an outline of responsibilities for the reinvestment of cash collateral received by the ~~mutual~~investment fund under the program to ensure that proper levels of liquidity are maintained at all times; and

(g) duties and obligations on the agent to take action to obtain payment by a borrower of any amounts owed by the borrower.

(14) The definition of "cash cover" contained in section 1.1 of the Regulation requires that the portfolio assets used for cash cover not be "allocated for specific purposes". Securities loaned by ~~a mutual~~an investment fund in a securities lending transaction have been allocated for specific purposes and therefore cannot be used as cash cover by the ~~mutual~~investment fund for its specified derivatives obligations.

(15) ~~A mutual~~An investment fund sometimes needs to vote securities held by it in order to protect its interests in connection with corporate transactions or developments relating to the issuers of the securities. ~~–~~The manager and the portfolio adviser of ~~a mutual~~an investment fund, or the agent of the ~~mutual~~investment fund administering a securities lending program on behalf of the ~~mutual~~investment fund, should monitor corporate developments relating to securities that are loaned by the ~~mutual~~investment fund in securities lending transactions, and take all necessary steps to ensure that the ~~mutual~~investment fund can exercise a right to vote the securities when necessary. ~~–~~ This may be done by way of a termination of a securities lending transaction and recall of loaned securities, as described in paragraph 11 of subsection 2.12(1) of the Regulation.

(16) As part of the prudent management of a securities lending, repurchase or reverse repurchase program, managers of ~~mutual~~investment funds, together with their agents, should ensure that transfers of securities in connection with those programs are effected in a secure manner over an organized market or settlement system. ~~–~~For foreign securities, this may entail ensuring that securities are cleared through central depositories. ~~–Mutual~~Investment funds and their agents should pay close attention to settlement arrangements when entering into securities lending, repurchase and reverse repurchase transactions.

3.7.1. Money Market Funds

Section 2.18 of the Regulation imposes daily and weekly liquidity requirements on money market funds. Specifically, money market funds must keep 5% of their assets invested in cash or readily convertible into cash within one day, and 15% of their assets invested in cash or readily convertible into cash within one week. Assets that are "readily convertible to cash" would generally be short-term, highly liquid investments that are

readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Such assets can be sold in the ordinary course of business within one business day (in the case of the daily liquidity requirement) or within 5 business days (in the case of the weekly liquidity requirement) at approximately the value ascribed to them by the money market fund. The ~~CSA~~Canadian securities regulatory authorities note that the securities do not have to mature within the one and 5 business day periods. For example, direct obligations of the Canadian or U.S. government, or of a provincial government, that mature after one or five business days but that can be readily converted to cash within one or 5 business days, would likely be eligible for the 5% and 15% liquidity requirements.

3.8 Prohibited Investments

(1) Subsection 4.1(4) of the Regulation permits a dealer managed mutual fund to make an investment otherwise prohibited by subsection 4.1(1) of the Regulation and the corresponding provisions in securities legislation referred to in Appendix C to the Regulation if the independent review committee of the dealer managed ~~mutual~~investment fund has approved the transaction under subsection 5.2(2) of Regulation 81-107 respecting *Independent Review Committee for Investment Funds* ("Regulation 81-107"). The ~~CSA~~Canadian securities regulatory authorities expect the independent review committee may contemplate giving its approval as a standing instruction, as contemplated in section 5.4 of Regulation 81-107.

(2) Subsection 4.3(2) of the Regulation permits ~~a mutual~~an investment fund to purchase a class of debt securities from, or sell a class of debt securities to, another ~~mutual~~investment fund managed by the same manager or an affiliate of the manager where the price payable for the security is not publicly available, if the independent review committee of the ~~mutual~~investment fund has approved the transaction under subsection 5.2(2) of Regulation 81-107 and the requirements in section 6.1 of Regulation 81-107 have been met. The ~~CSA~~Canadian securities regulatory authorities expect the independent review committee may contemplate giving its approval as a standing instruction, as contemplated in section 5.4 of Regulation 81-107.

(3) In providing its approval under paragraph 4.3(2) of the Regulation, the ~~CSA~~Canadian securities regulatory authorities expect the independent review committee to have satisfied itself that the price of the security is fair. It may do this by considering the price quoted on a marketplace (e.g., CanPx or TRACE), or by obtaining a quote from an independent, arm's-length purchaser or seller, immediately before the purchase or sale.

PART 4 USE OF SPECIFIED DERIVATIVES

4.1 Exercising Options on Futures

Paragraphs 2.8(1)(d) and (e) of the Regulation prohibit ~~a mutual~~an investment fund from, among other things, opening and maintaining a position in a standardized future except under the conditions referred to in those paragraphs. Opening and maintaining a position in a standardized future could be effected through the exercise by ~~a mutual~~an investment fund of an option on futures. ~~-~~Therefore, it should be noted that ~~a mutual~~an investment fund cannot exercise an option on futures and assume a position in a standardized future unless the applicable provisions of paragraphs 2.8(1)(d) or (e) are satisfied.

4.2 Registration Matters

The Canadian securities regulatory authorities remind industry participants of the following requirements contained in securities legislation:

1. ~~A mutual~~ An investment fund may only invest in or use clearing corporation options and over-the-counter options if the portfolio adviser advising with respect to these investments

(a) is permitted, either by virtue of registration as an adviser under the securities legislation or commodity futures legislation of the jurisdiction in which the portfolio adviser is providing the advice or an exemption from the requirement to be registered, to provide that advice to the ~~mutual~~investment fund under the laws of that jurisdiction; and

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(b) has satisfied all applicable option proficiency requirements of that jurisdiction which, ordinarily, will involve completion of the Canadian Options Course.

2. ~~A mutual~~ An investment fund may invest in or use futures and options on futures only if the portfolio adviser advising with respect to these investments or uses is registered as an adviser under the securities or commodity futures legislation of the jurisdiction in which the portfolio adviser is providing the advice, if this registration is required in that jurisdiction, and meets the proficiency requirements for advising with respect to futures and options on futures in the jurisdiction.

3. A portfolio adviser of ~~a mutual~~an investment fund that receives advice from a non-resident sub-adviser as contemplated by section 2.10 of the Regulation is not relieved from the registration requirements described in paragraphs 1 and 2.

4. In Ontario, a non-resident sub-adviser is required, under the commodity futures legislation of Ontario, to be registered in Ontario if it provides advice to another portfolio adviser of ~~a mutual~~an investment fund in Ontario concerning the use of standardized futures by the ~~mutual~~investment fund. ~~-~~Section 2.10 of the Regulation does not exempt the non-resident sub-adviser from this requirement. A non-resident sub-adviser should apply for an exemption in Ontario if it wishes to carry out the arrangements contemplated by section 2.10 without being registered in Ontario under that legislation.

4.3 Leveraging

The Regulation is designed to prevent the use of specified derivatives for the purpose of leveraging the assets of the ~~mutual~~investment fund. The definition of "hedging" prohibits leveraging with specified derivatives used for hedging purposes. The provisions of subsection 2.8(1) of the Regulation restrict leveraging with specified derivatives used for non-hedging purposes.

4.4 Cash Cover

The definition of "cash cover" in the Regulation prescribes the securities or other portfolio assets that may be used to satisfy the cash cover requirements relating to specified derivatives positions of ~~mutual~~investment funds required by Part 2 of the Regulation. The definition of "cash cover" includes various interest-bearing securities; the definition includes interest accrued on those securities, and so ~~mutual~~investment funds are able to include accrued interest for purposes of cash cover calculations.

PART 4.1 REIMBURSEMENT OF ORGANIZATION COSTS

4.1.1 Prohibition Against Reimbursement of Organization Costs

Section 3.3 of the Regulation prohibits an investment fund from paying the costs of the preparation and filing of the initial preliminary and final prospectus (and related documents) or the costs of incorporation, formation or initial organization. The Canadian securities regulatory authorities consider that the costs of incorporation, formation or initial organization of an investment fund referred to in section 3.3 of the Regulation include all costs incurred to establish an investment fund. These costs include, without limitation, the following:

(a) fees for listing the securities of the investment fund on an exchange;

(b) fees related to regulatory filings other than the preliminary or final prospectus and related documents, such as fees for filing any exemptive relief application;

(c) legal and accounting fees incurred for the incorporation or formation of the fund, as well as the legal fees incurred to draft the constating documents of the fund and material contracts for the operation of the fund;

(d) for an investment fund that is not in continuous distribution, transfer agent's fees related to the initial public offering of the investment fund;

(e) roadshow expenses and marketing costs related to the initial public offering of the investment fund; and

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(f) printing and translation costs for the offering documents of the investment fund.

However, the Canadian securities regulatory authorities do not consider the agents' or underwriters' commission in connection with the initial public offering of an investment fund to be a cost of initial organization.

PART 5 LIABILITY AND INDEMNIFICATION

5.1 Liability and Indemnification

(1) Subsection 4.4(1) of the Regulation contains provisions that require that any agreement or declaration of trust under which a person acts as manager of ~~a mutual~~an investment fund provide that the manager is responsible for any loss that arises out of the failure of it, and of any person retained by it or the ~~mutual~~investment fund to discharge any of the ~~manager's~~manager's responsibilities to the ~~mutual~~investment fund, to satisfy the standard of care referred to in that section. Subsection 4.4(2) of the Regulation provides that ~~a mutual~~an investment fund ~~shall~~must not relieve the manager from that liability.

(2) The purpose of these provisions is to ensure that the manager remains responsible to the ~~mutual~~investment fund and therefore indirectly to its securityholders for the duty of care that is imposed by the securities legislation of most jurisdictions, and to clarify that the manager is responsible ~~to ensure~~for ensuring that service providers perform to the level of that standard of care. The Regulation does not regulate the contractual relationships between the manager and service providers; whether a manager can seek indemnification from a service provider that fails to satisfy that standard of care is a contractual issue between those parties.

(3) Subsection 4.4(5) of the Regulation provides that section 4.4 does not apply to any losses to ~~a mutual~~an investment fund or securityholder arising out of an action or inaction by a custodian or ~~sub-custodian~~subcustodian or by a director of ~~a mutual~~an investment fund. A separate liability regime is imposed, on custodians or sub-custodians by section 6.6 of the Regulation. Directors are subject to the liability regime imposed by the relevant corporate legislation.

5.2 Securities Lending, Repurchase and Reverse Repurchase Transactions

(1) As described in section 5.1, section 4.4 of the Regulation is designed to ensure that the manager of ~~a mutual~~an investment fund is responsible for any loss that arises out of the failure of it, and of any person retained by it or the ~~mutual~~investment fund to discharge any of the manager's responsibilities to the ~~mutual~~investment fund, to satisfy the standard of care referred to in that section.

(2) The retention by a manager of an agent under section 2.15 of the Regulation to administer the ~~mutual~~investment fund's securities lending, repurchase or reverse repurchase transactions does not relieve the manager from ultimate responsibility for the administration of those transactions in accordance with the Regulation and in conformity with the standard of care imposed on the manager by statute and required to be imposed on the agent in the relevant agreement by subsection 2.15(~~6~~4) of the Regulation.

(3) Because the agent is required to be a custodian or sub-custodian of the ~~mutual~~investment fund, its activities, as custodian or sub-custodian, are not within the responsibility of the manager of the ~~mutual~~investment fund, as provided for in subsection 4.4(5) of the Regulation. However, the activities of the agent, in its role as administering the ~~mutual~~investment funds' securities lending, repurchase or reverse repurchase transactions, are within the ultimate responsibility of the manager, as provided for in subsection 4.4(6) of the Regulation.

PART 6 SECURITYHOLDER MATTERS

6.1 Meetings of Securityholders

Subsection 5.4(1) of the Regulation imposes a requirement that a meeting of securityholders of ~~a mutual~~an investment fund called for the purpose of considering any of the matters referred to in ~~section~~subsection 5.1(1) of the Regulation must be called on notice sent at least 21 days before the date of the meeting. Industry participants are reminded that the provisions of National Policy Statement No. 41, or a successor instrument, may apply to

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any meetings of securityholders of ~~mutual~~investment funds and that those provisions may require that a longer period of notice be given.

6.2 Limited Liability

(1) ~~Mutual~~Investment funds generally are structured in a manner that ensures that investors are not exposed to the risk of loss of an amount more than their original investment. This is a very important and essential attribute of ~~mutual~~investment funds.

(2) ~~Mutual~~Investment funds that are structured as corporations do not raise pressing liability problems because of the limited liability regime of corporate statutes.

(3) ~~Mutual~~Investment funds that are structured as limited partnerships may raise some concerns about the loss of limited liability if limited partners participate in the management or control of the partnership. The Canadian securities regulatory authorities encourage managers of ~~mutual~~investment funds that are structured as limited partnerships to consider this issue in connection with the holding of meetings of securityholders, even if required under ~~section~~subsection 5.1(1) of the Regulation. In addition, all managers of ~~mutual~~investment funds that are structured as limited partnerships should consider whether disclosure and discussion of this issue should be included as a risk factor in prospectuses.

6.3 Calculation of Fees

(1) Paragraph 5.1(1)(a) of the Regulation requires securityholder approval before the basis of the calculation of a fee or expense that is charged to ~~a mutual~~an investment fund is changed in a way that could result in an increase in charges to the ~~mutual~~investment fund. The Canadian securities regulatory authorities note that the phrase "basis of the calculation" includes any increase in the rate at which a particular fee is charged to the ~~mutual~~investment fund.

(2) The Canadian securities regulatory authorities are ~~also~~ of the view that the requirement of ~~subsection~~paragraph 5.1(1)(a) would not apply in instances where the change to the basis of the calculation is the result of separate individual agreements between the manager of the ~~mutual~~investment fund and individual securityholders of the ~~mutual~~investment fund, and the resulting increase in charges is payable directly or indirectly by those individual securityholders only.

6.4. Fund Conversions

(1) For the purposes of subparagraphs 5.1(1)(h)(i), (ii) and (iii) of the Regulation, the Canadian securities regulatory authorities consider that any change that will restructure an investment fund from its original structure requires the prior approval of the securityholders of the investment fund. For example, a non-redeemable investment fund may be designed to convert into a mutual fund on a specified date, or it may be designed to convert into a mutual fund after a specified date if the securities of the investment fund have traded at a specified discount to their net asset value per security for more than a set period of time. In each case, when the event that triggers the conversion occurs, the redemption feature of the securities of the non-redeemable investment fund changes and the securities of the non-redeemable investment fund will typically become redeemable at their net asset value per security daily. This change in the redemption feature of the securities of the investment fund may not be implemented unless securityholder approval has been obtained under subparagraph 5.1(1)(h)(i) or the exemption in subsection 5.3(3) is being relied on. Another example of a change requiring securityholder approval is where an investment fund wishes to seek to obtain control, or become involved in the management, of companies in which it invests. This involvement in the management or control of investees is inconsistent with the activities of an investment fund and would therefore cause the investment fund to cease to be an investment fund. In such a situation, the investment fund would be required to obtain securityholder approval under subparagraph 5.1(1)(h)(iii) of the Regulation before it could become involved in the management of, or exercise control over, investee companies.

(2) For the purposes of subsection 5.1(2) of the Regulation, the Canadian securities regulatory authorities consider the costs and expenses associated with a change referred to in subparagraphs 5.1(1)(h)(i), (ii) and (iii) of the Regulation to include costs associated with the securityholder meeting to obtain approval of the change, the costs of preparing and filing a prospectus to commence continuous distribution of securities if the investment fund is converting from a non-redeemable investment fund to a mutual fund in continuous distribution and

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brokerage commissions payable as a result of any portfolio realignment necessary to carry out the transaction.

PART 7 CHANGES

7.1 Integrity and Competence of ~~Mutual~~Investment Fund Management Groups

(1) Paragraph 5.5(1)(a) of the Regulation requires that the approval of the securities regulatory authority be obtained before the manager of ~~a mutual~~an investment fund is changed. ~~Subsection~~Paragraph 5.5(~~2~~1)(a.1) of the Regulation contemplates similar approval to a change in control of a manager.

(2) In connection with each of these approvals, applicants are required by section 5.7 of the Regulation to provide information to the securities regulatory authority concerning the integrity and experience of the persons that are proposed to be involved in, or control, the management of the ~~mutual~~investment fund after the proposed transaction.

(3) The Canadian securities regulatory authorities would generally consider it helpful in their assessment of the integrity and experience of the proposed new management group that will manage ~~a mutual~~an investment fund after a change in manager if the application set out, among any other information the applicant wishes to provide

(a) the name, registered address and principal business activity or the name, residential address and occupation or employment of

(i) if the proposed manager is not a public company, each beneficial owner of securities of each shareholder, partner or limited partner of the proposed manager, and

(ii) if the proposed manager is a public company, each beneficial owner of securities of each shareholder of the proposed manager that is the beneficial holder, directly or indirectly, of more than 10% of the outstanding securities of the proposed manager; and

(b) information concerning

(i) if the proposed manager is not a public company, each shareholder, partner or limited partner of the proposed manager,

(ii) if the proposed manager is a public company, each shareholder that is the beneficial holder, directly or indirectly, of more than 10% of the outstanding securities of the proposed manager,

(iii) each director and officer of the proposed manager, and

(iv) each proposed director, officer or individual trustee of the ~~mutual~~investment fund.

(4) The Canadian securities regulatory authorities would generally consider it helpful if the information relating to the persons and companies referred to in paragraph (3)(b) included

(a) for a company

(i) its name, registered address and principal business activity,

(ii) the number of securities or partnership units of the proposed manager beneficially owned, directly or indirectly, and

(iii) particulars of any existing or potential conflicts of interest that may arise as a result of the activities of the company and its relationship with the management group of the ~~mutual~~investment fund; and

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(b) for an individual

(i) his or her name, birthdate and residential address,

(ii) his or her principal occupation or employment,

(iii) his or her principal occupations or employment during the five years before the date of the application, with a particular emphasis on the individual's experience in the financial services industry,

(iv) the individual's educational background, including information regarding courses successfully taken that relate to the financial services industry,

(v) his or her position and responsibilities with the proposed manager or the controlling shareholders of the proposed manager or the ~~mutual~~investment fund,

(vi) whether he or she is, or within five years before the date of the application has been, a director, officer or promoter of any reporting issuer other than the ~~mutual~~investment fund, and if so, disclosing the names of the reporting issuers and their business purpose, with a particular emphasis on relationships between the individual and other ~~mutual~~investment funds,

(vii) the number of securities or partnership units of the proposed manager beneficially owned, directly or indirectly,

(viii) particulars of any existing or potential conflicts of interest that may arise as a result of the individual's outside business interests and his or her relationship with the management group of the ~~mutual~~investment fund, and

(ix) a description of the individual's relationships to the proposed manager and other service providers to the ~~mutual~~investment fund.

(5) The Canadian securities regulatory authorities would generally consider it helpful in their assessment of the integrity and experience of the persons that are proposed to manage ~~a mutual~~an investment fund after a change of control of the manager, if the application set out, among any other information that applicant wishes to provide, a description of

(a) the proposed corporate ownership of the manager of the ~~mutual~~investment fund after the proposed transaction, indicating for each proposed direct or indirect shareholder of the manager of the ~~mutual~~investment fund the information about that shareholder referred to in subsection (4);

(b) the proposed officers and directors of the manager of the ~~mutual~~investment fund, of the ~~mutual~~investment fund and of each of the proposed controlling shareholders of the ~~mutual~~investment fund, indicating for each individual, the information about that individual referred to in subsection (4);

(c) any anticipated changes to be made to the officers and directors of the manager of the ~~mutual~~investment fund, of the ~~mutual~~investment fund and of each of the proposed controlling shareholders of the ~~mutual~~investment fund that are not set out in paragraph (b); and

(d) the relationship of the members of the proposed controlling shareholders and the other members of the management group to the manager and any other service provider to the ~~mutual~~investment fund.

7.2 Mergers ~~and Conversions~~ of ~~Mutual~~Investment Funds

Subsection 5.6(1) of the Regulation provides that mergers ~~or conversions~~ of ~~mutual~~investment funds may be carried out on the conditions described in that subsection without prior approval of the securities regulatory authority. The Canadian securities regulatory authorities consider that the types of transactions contemplated by subsection 5.6(1) of the Regulation when carried out in accordance with the conditions of that subsection address the fundamental regulatory concerns raised by mergers ~~and conversions~~ of ~~mutual~~investment

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funds. Subsection 5.6(1) is designed to facilitate consolidations of ~~mutual~~investment funds within fund families that have similar fundamental investment objectives and strategies and that are operated in a consistent and similar fashion. Since subsection 5.6(1) will be unavailable unless the ~~mutual~~investment funds involved in the transaction have substantially similar fundamental investment objectives and strategies and are operated in a substantially similar fashion, the Canadian securities regulatory authorities do not expect that the portfolios of the consolidating funds will be required to be realigned to any great extent before a merger. ~~–~~If realignment is necessary, the Canadian securities regulatory authorities note that paragraph 5.6(1)(h) of the Regulation provides that none of the costs and expenses associated with the transaction may be borne by the ~~mutual~~investment fund.~~–~~ Brokerage commissions payable as a result of any portfolio realignment necessary to carry out the transaction would, in the view of the Canadian securities regulatory authorities, be costs and expenses associated with the transaction.

7.3 Regulatory Approval for Reorganizations

(1) Paragraph 5.7(1)(b) of the Regulation requires certain details to be provided in respect of an application for regulatory approval required by paragraph 5.5(1)(b) that is not automatically approved under subsection 5.6(1). ~~–~~The Canadian securities regulatory authorities will be reviewing this type of proposed transaction, among other things, to ensure that adequate disclosure of the differences between the ~~funds~~issuers participating in the proposed transaction is given to securityholders of the ~~mutual~~investment fund that will be merged, reorganized or amalgamated with another ~~mutual fund~~issuer.

(2) If ~~a mutual~~an investment fund is proposed to be merged, amalgamated or reorganized with ~~a mutual~~an investment fund that has a net asset value that is smaller than the net asset value of the terminating ~~mutual~~investment fund, the Canadian securities regulatory authorities will consider the implications of the proposed transaction on the smaller continuing ~~mutual~~investment fund. The Canadian securities regulatory authorities believe that this type of transaction generally would constitute a material change for the smaller continuing ~~mutual~~investment fund, thereby triggering the requirements of paragraph 5.1(1)(g) of the Regulation and Part 11 of Regulation 81-106 respecting Investment Fund Continuous Disclosure.

7.4 [Deleted]

7.5 Circumstances in Which Approval of Securityholders Not Required

(1) Subsection 5.3(2) of the Regulation provides that ~~a mutual fund's~~an investment fund's reorganization with, or transfer of assets to, another ~~mutual fund~~issuer may be carried out on the conditions described in ~~the subsection~~paragraph 5.3(2)(a) or 5.3(2)(b) without the prior approval of the securityholders of the ~~mutual~~investment fund.

(2) If the manager refers the change contemplated in subsection 5.3(2) of the Regulation to the ~~mutual fund's~~investment fund's independent review committee, and subsequently seeks the approval of the securityholders of the ~~mutual~~investment fund, the ~~CSA~~Canadian securities regulatory authorities expect the manager to include a description of the independent review ~~committee's~~committee's determination in the written notice to securityholders referred to in section 5.4 of the Regulation.

(3) The Canadian securities regulatory authorities expect the written notice referred to in subparagraphs 5.3(2)(a)(iv) and (v) of the Regulation to include, at a minimum, the expected date of the reorganization, the name of the other investment fund with which the investment fund will be reorganized, how a securityholder of the investment fund may obtain a copy of the other investment fund's fund facts, simplified prospectus or annual information form, as applicable, and a description of the determination of the investment fund's independent review committee with respect to the reorganization.

7.6 Change of Auditor

Section 5.3.1 of the Regulation requires that the independent review committee of the ~~mutual~~investment fund give its prior approval to the manager before the auditor of the ~~mutual~~investment fund may be changed.

7.7 Connection to Regulation 81-107

There may be matters under ~~section~~subsection 5.1(1) of the Regulation that may also be a conflict of interest matter as defined in Regulation 81-107. ~~The CSA~~The Canadian securities regulatory authorities expect any matter under ~~section~~subsection 5.1(1) subject to review by the independent review committee to be referred by the manager to the independent review committee before seeking the approval of securityholders of the ~~mutual~~investment fund. The ~~CSA~~Canadian securities regulatory authorities further expect the manager to include a description of the independent review committee's determination in the written notice to securityholders referred to in subsection 5.4(2) of the Regulation.

7.8 Termination of a Non-Redeemable Investment Fund

Section 5.8.1 of the Regulation requires a non-redeemable investment fund that is terminating to issue a press release announcing the termination. Investment funds for which the termination is a material change must also comply with the requirements of Part 11 of *Regulation 81-106 respecting Investment Fund Continuous Disclosure.*

PART 8 CUSTODIANSHIP OF PORTFOLIO ASSETS

8.1 Standard of Care

The standard of care prescribed by section 6.6 of the Regulation is a minimum standard only. Similarly, the provisions of section 6.5 of the Regulation, designed to protect ~~a mutual~~an investment fund from loss in the event of the insolvency of those holding its portfolio assets, are minimum requirements. The Canadian securities regulatory authorities are of the view that the requirements set out in section 6.5 may require custodians and sub-custodians to take such additional steps as may be necessary or desirable properly to protect the portfolio assets of the ~~mutual~~investment fund in a foreign jurisdiction and to ensure that those portfolio assets are unavailable to satisfy the claims of creditors of the custodian or sub-custodian, having regard to creditor protection and bankruptcy legislation of any foreign jurisdiction in which portfolio assets of ~~a mutual~~an investment fund may be located.

8.2 Book-Based System

(1) Subsection 6.5(3) of the Regulation provides that a custodian or sub-custodian of ~~a mutual~~an investment fund may arrange for the deposit of portfolio assets of the ~~mutual~~investment fund with a depository, or clearing agency, that operates a book-based system. Such depositories or clearing agencies include The Canadian Depository For Securities Limited, the Depository Trust Company or any other domestic or foreign depository or clearing agency that is incorporated or organized under the laws of a country or a political subdivision of a country and operates a book-based system in that country or political subdivision or operates a transnational book-based system.

(2) A depository or clearing agency that operates a book-based system used by ~~a mutual~~an investment fund is not considered to be a custodian or sub-custodian of the ~~mutual~~investment fund.

8.3 Compliance

Paragraph 6.7(1)(c) of the Regulation requires the custodian of ~~a mutual~~an investment fund to make any changes periodically that may be necessary to ensure that the custodian and sub-custodian agreements comply with Part 6, and that there is no sub-custodian of the ~~mutual~~investment fund that does not satisfy the applicable requirements of sections 6.2 or 6.3. The Canadian securities regulatory authorities note that necessary changes to ensure this compliance could include a change of sub-custodian.

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PART 9 CONTRACTUAL PLANS

9.1 Contractual Plans

Industry participants are reminded that the term "contractual plan" used in Part 8 of the Regulation is a defined term in the securities legislation of most jurisdictions, and that contractual plans as so defined are not the same as automatic or periodic investment plans. The distinguishing feature of a contractual plan is that sales charges are not deducted at a constant rate as investments in mutual fund securities are made under the plan; rather, proportionately higher sales charges are deducted from the investments made during the first year, or in some plans the first two years.

PART 10 SALES AND REDEMPTIONS OF SECURITIES

10.1 General

One of the purposes of Parts 9, 10 and 11 of the Regulation ~~are intended~~ is to ensure that

(a) investors' cash is received by ~~a mutual~~an investment fund promptly;

(b) the opportunity for loss of an ~~investors'~~investors' cash before investment in the ~~mutual~~investment fund is minimized; and

(c) the ~~mutual~~investment fund or the appropriate investor receives all interest that accrues on cash during the periods between delivery of the cash by an investor until investment in the ~~mutual~~investment fund, in the case of the purchase of ~~mutual~~investment fund securities, or between payment of the cash by the ~~mutual~~investment fund until receipt by the investor, in the case of redemptions.

10.2 Interpretation

(1) The Regulation refers to "securityholders" of ~~a mutual~~an investment fund in several provisions~~, most notably in Parts 9 and 10 when referring to purchase and redemption orders received by a mutual fund or a participating dealer or principal distributor from "securityholders"~~.

(2) ~~Mutual~~. Investment funds must keep a record of the holders of their securities. ~~A mutual~~An investment fund registers a holder of its securities on this record as requested by the person placing a purchase order or as subsequently requested by that registered securityholder. The Canadian securities regulatory authorities are of the view that ~~a mutual~~an investment fund is entitled to rely on its register of holders of securities to determine the names of such holders and in its determination as to whom it is to take instructions from.

(3) Accordingly, when the Regulation refers to "securityholder" of ~~a mutual~~an investment fund, it is referring to the securityholder registered as a holder of securities on the records of the ~~mutual~~investment fund. If that registered securityholder is a participating dealer acting for its client, the ~~mutual~~investment fund deals with and takes instructions from that participating dealer. The Regulation does not regulate the relationship between the participating dealer and its client for whom the participating dealer is acting as agent. The Canadian securities regulatory authorities note however, that the participating dealer should, as a matter of prudent business practice, obtain appropriate instructions, in writing, from its client when dealing with the client's beneficial holdings in ~~a mutual~~an investment fund.

10.3 Receipt of Orders

(1) A principal distributor or participating dealer of a mutual fund should endeavour, to the extent possible, to receive cash to be invested in the mutual fund at the time the order to which they pertain is placed.

(2) A dealer receiving an order for redemption should, at the time of receipt of the investor's order, obtain from the investor all relevant documentation required by the mutual fund in respect of the redemption including, without limitation, any written request for redemption that may be required by the mutual fund, duly completed and executed, and any

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certificates representing the mutual fund securities to be redeemed, so that all required documentation is available at the time the redemption order is transmitted to the mutual fund or to its principal distributor for transmittal to the mutual fund.

10.4 Backward Pricing

~~Sections~~Subsections 9.3(1) and 10.3(1) of the Regulation provide that the issue price or the redemption price of a security of a mutual fund to which a purchase order or redemption order pertains shall be the net asset value per security, next determined after the receipt by the mutual fund of the relevant order. ~~–~~For clarification, the Canadian securities regulatory authorities emphasize that the issue price and redemption price cannot be based upon any net asset value per security calculated before receipt by the mutual fund of the relevant order.

10.5 Coverage of Losses

(1) Subsection 9.4(6) of the Regulation provides that certain participating dealers may be required to compensate a mutual fund for a loss suffered as the result of a failed settlement of a purchase of securities of the mutual fund. Similarly, subsection 10.5(3) of the Regulation provides that certain participating dealers may be required to compensate a mutual fund for a loss suffered as the result of a redemption that could not be completed due to the failure to satisfy the requirements of the mutual fund concerning redemptions.

(2) The Canadian securities regulatory authorities have not carried forward into the Regulation the provisions contained in NP39 relating to a participating dealer's ability to recover from their clients or other participating dealers any amounts that they were required to pay to a mutual fund. If participating dealers wish to provide for such rights they should make the appropriate provisions in the contractual arrangements that they enter into with their clients or other participating dealers.

PART 11 COMMINGLING OF CASH

10.6 Issue Price of Securities for Non-Redeemable Investment Funds

Subsection 9.3(3) of the Regulation provides that the issue price of a security of a non-redeemable investment fund distributed under a prospectus must not, as far as reasonably practicable, be a price that causes dilution of the net asset value of other outstanding securities of the investment fund. The Canadian securities regulatory authorities have observed when an existing non-redeemable investment fund issues new securities under a prospectus, the issue price typically exceeds the net asset value per security on the day before the date of the prospectus, such that the net proceeds of the offering on a per unit basis is no less than the net asset value per security on the day before the date of the prospectus. The Canadian securities regulatory authorities do not consider this issue price to cause dilution to the net asset value of other outstanding securities of the investment fund.

11.1 Commingling of Cash

(1) Part 11 of the Regulation requires principal distributors and participating dealers to account separately for cash they may receive for the purchase of, or upon the redemption of, ~~mutual~~investment fund securities. Those principal distributors and participating dealers are prohibited from commingling any cash so received with their other assets or with cash held for the purchase or upon the sale of securities of other types of securities. The Canadian securities regulatory authorities are of the view that this means that dealers may not deposit into the trust accounts established under Part 11 cash obtained from the purchase or sale of other types of securities such as guaranteed investment certificates, government treasury bills, segregated funds or bonds.

(2) Subsections 11.1(2) and 11.2(2) of the Regulation state that principal distributors and participating dealers, respectively, may not use any cash received for the investment in ~~mutual~~investment fund securities to finance their own operations. ~~–~~ The Canadian securities regulatory authorities are of the view that any costs associated with returned client cheques that did not have sufficient funds to cover a trade ("NSF cheques") are a cost of doing business and should be borne by the applicable principal distributor or participating dealer and should not be offset by interest income earned on the trust accounts established under Part 11 of the Regulation.

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(3) No overdraft positions should arise in these trust accounts.

(4) Subsections 11.1(3) and 11.2(3) of the Regulation prescribe the circumstances under which a principal distributor or participating dealer, respectively, may withdraw funds from the trust accounts established under Part 11 of the Regulation. This would prevent the practice of "lapping". Lapping occurs as a result of the timing differences between trade date and settlement date, when cash of ~~a mutual~~an investment fund client held for a trade which has not yet settled is used to settle a trade for another ~~mutual~~investment fund client who has not provided adequate cash to cover the settlement of that other trade on the settlement date. The Canadian securities regulatory authorities view this practice as a violation of subsections 11.1(3) and 11.2(3) of the Regulation.

(5) Subsections 11.1(4) and 11.2(4) of the Regulation require that interest earned on cash held in the trust accounts established under Part 11 of the Regulation be paid to the applicable ~~mutual~~investment fund or its securityholders "pro rata based on cash flow". The Canadian securities regulatory authorities are of the view that this requirement means, in effect, that the applicable ~~mutual~~investment fund or securityholder should be paid the amount of interest that the ~~mutual~~investment fund or securityholder would have received had the cash held in trust for that ~~mutual~~investment fund or securityholder been the only cash held in that trust account.

(6) Paragraph 11.3(b) of the Regulation requires that trust accounts maintained in accordance with sections 11.1 or 11.2 of the Regulation bear interest "at rates equivalent to comparable accounts of the financial institution". A type of account that ordinarily pays zero interest may be used for trust accounts under sections 11.1 or 11.2 of the Regulation so long as zero interest is the rate of interest paid on that type of account for all depositors other than trust accounts.

PART 12 (DELETED)

PART 13 PROHIBITED REPRESENTATIONS AND SALES COMMUNICATIONS

13.1 Misleading Sales Communications

(1) Part 15 of the Regulation prohibits misleading sales communications relating to ~~mutual~~investment funds and asset allocation services. Whether a particular description, representation, illustration or other statement in a sales communication is misleading depends upon an evaluation of the context in which it is made. The following list sets out some of the circumstances, in the view of the Canadian securities regulatory authorities, in which a sales communication would be misleading. No attempt has been made to enumerate all such circumstances since each sales communication must be assessed individually.

1. A statement would be misleading if it lacks explanations, qualifications, limitations or other statements necessary or appropriate to make the statement not misleading.

2. A representation about past or future investment performance would be misleading if it is

(a) a portrayal of past income, gain or growth of assets that conveys an impression of the net investment results achieved by an actual or hypothetical investment that is not justified under the circumstances;

(b) a representation about security of capital or expenses associated with an investment that is not justified under the circumstances or a representation about possible future gains or income; or

(c) a representation or presentation of past investment performance that implies that future gains or income may be inferred from or predicted based on past investment performance or portrayals of past performance.

3. A statement about the characteristics or attributes of ~~a mutual~~ an investment fund or an asset allocation service would be misleading if

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(a) it concerns possible benefits connected with or resulting from services to be provided or methods of operation and does not give equal prominence to discussion of any risks or associated limitations;

(b) it makes exaggerated or unsubstantiated claims about management skill or techniques; characteristics of the ~~mutual~~investment fund or asset allocation service; an investment in securities issued by the fund or recommended by the service; services offered by the fund, the service or their respective manager; or effects of government supervision; or

(c) it makes unwarranted or incompletely explained comparisons to other investment vehicles or indices.

4. A sales communication that quoted a third party source would be misleading if the quote were out of context and proper attribution of the source were not given.

(2) Performance data information may be misleading even if it complies technically with the requirements of the Regulation. For instance, subsections 15.8(1) and (2) of the Regulation contain requirements that the standard performance data for ~~mutual~~investment funds given in sales communications be for prescribed periods falling within prescribed amounts of time before the date of the appearance or use of the advertisement or first date of publication of any other sales communication. That standard performance data may be misleading if it does not adequately reflect intervening events occurring after the prescribed period. An example of such an intervening event would be, in the case of money market funds, a substantial decline in interest rates after the prescribed period.

(3) An advertisement that presents information in a manner that distorts information contained in the preliminary prospectus or prospectus, or preliminary prospectus, preliminary fund facts document and preliminary annual information form or prospectus, fund facts document and annual information form, as applicable, of ~~a mutual~~an investment fund or that includes a visual image that provides a misleading impression will be considered to be misleading.

(4) Any discussion of the income tax implications of an investment in ~~a mutual~~an investment fund security should be balanced with a discussion of any other material aspects of the offering.

(5) Paragraph 15.2(1)(b) of the Regulation provides that sales communications must not include any statement that conflicts with information that is contained in, among other things and as applicable, a prospectus or fund facts document. The Canadian securities regulatory authorities are of the view that a sales communication that provides performance data in compliance with the requirements of Part 15 of the Regulation for time periods that differ from those shown in a prospectus, fund facts document or management report of fund performance does not violate the requirements of paragraph 15.2(1)(b) of the Regulation.

(6) Subsection 15.3(1) of the Regulation permits ~~a mutual~~an investment fund or asset allocation service to compare its performance to, among other things, other types of investments or benchmarks on certain conditions. Examples of such other types of investments or benchmarks to which the performance of ~~a mutual~~an investment fund or asset allocation service may be compared include consumer price indices; stock, bond or other types of indices; averages; returns payable on guaranteed investment certificates or other certificates of deposit; and returns from an investment in real estate.

(7) Paragraph 15.3(1)(c) of the Regulation requires that if the performance of ~~a mutual~~an investment fund or asset allocation service is compared to that of another investment or benchmark, the comparison sets out clearly any factors necessary to ensure that the comparison is fair and not misleading. Such factors would include an explanation of any relevant differences between the ~~mutual~~investment fund or asset allocation service and the investment or benchmark to which it is compared. Examples of such differences include any relevant differences in the guarantees of, or insurance on, the principal of or return from the investment or benchmark; fluctuations in principal, income or total return; any differing tax treatment; and, for a comparison to an index or average, any differences between the composition or calculation of the index or average and the investment portfolio of the ~~mutual~~investment fund or asset allocation service.

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13.2 Other Provisions

(1) Subsection 15.9(1) of the Regulation imposes certain disclosure requirements for sales communications in circumstances in which there was a change in the business, operations or affairs of ~~a mutual~~an investment fund or asset allocation service during or after a performance measurement period of performance data contained in the sales communication that could have materially affected the performance of the ~~mutual~~investment fund or asset allocation service. Examples of these changes are changes in the management, investment objectives, portfolio adviser, ownership of the manager, fees and charges, or of policies concerning the waiving or absorbing of fees and charges, of the ~~mutual~~investment fund or asset allocation service; or of a change in the characterization of ~~the~~a mutual fund as a money market fund. A reorganization or restructuring of an investment fund that results in a conversion of a non-redeemable investment fund into a mutual fund, or the conversion of a mutual fund into a non-redeemable investment fund, would also be an example of such a change.

(1.1) Subparagraph 15.6(1)(d)(i) of the Regulation prohibits a sales communication pertaining to a mutual fund from including performance data for a period that is before the time when the mutual fund offered its securities under a prospectus. Where the mutual fund has previously existed as a non-redeemable investment fund and has been a reporting issuer in a jurisdiction for a period of at least 12 consecutive months, either as a mutual fund or a non-redeemable investment fund, subsection 15.6(2) requires any sales communication that contains performance data of the mutual fund to include performance data for the period that the fund existed as a non-redeemable investment fund. The Canadian securities regulatory authorities are of the view that performance data pertaining to a mutual fund that has converted from a non-redeemable investment fund should include both the periods before and after the converting transaction, similar to the past performance information presented in the mutual fund's management report of fund performance. Performance data must not be included for any period before the time the non-redeemable investment fund was a reporting issuer.

(2) Paragraph 15.11(1)5 of the Regulation requires that no non-recurring fees and charges that are payable by some or all securityholders and no recurring fees and charges that are payable by some but not all securityholders be assumed in calculating standard performance data. Examples of non-recurring types of fees and charges are front-end sales commissions and contingent deferred sales charges, and examples of recurring types of fees and charges are the annual fees paid by purchasers who purchased on a contingent deferred charge basis.

(3) Paragraphs 15.11(1)2 and 15.11(2)2 of the Regulation require that no fees and charges related to optional services be assumed in calculating standard performance data. Examples of these fees and charges include transfer fees, except in the case of an asset allocation service, and fees and charges for registered retirement savings plans, registered retirement income funds, registered education savings plans, pre-authorized investment plans and systematic withdrawal plans.

(4) The Canadian securities regulatory authorities are of the view that it is inappropriate and misleading for ~~a mutual~~an investment fund that is continuing following a merger to prepare and use *pro forma* performance information or financial statements that purport to show the combined performance of the two funds during a period before their actual merger. The Canadian securities regulatory authorities are of the view that such *pro forma* information is hypothetical, involving the making of many assumptions that could affect the results.

(5) Subsections 15.8(2) and (3) of the Regulation require disclosure of standard performance data of a mutual fund, in some circumstances, from "the inception of the mutual fund". It is noted that paragraph 15.6(1)(d) generally prohibits disclosure of performance data for a period that is before the time when the mutual fund offered its securities under a prospectus or before an asset allocation service commenced operation. Also, Instruction (1) to Item 5 of Part B of Form 81-101F1 Contents of Simplified Prospectus requires disclosure of the date on which a mutual fund's securities first became available to the public as the date on which the mutual fund "started". Therefore, consistent with these provisions, the words "inception of the mutual fund" in subsections 15.8(2) and (3) should be read as referring to the beginning of the distribution of the securities of the mutual fund under a prospectus of the mutual fund, and not from any previous time in which the mutual fund may have existed but did not offer its securities under a prospectus. If a mutual fund previously existed as a non-redeemable investment fund, the words "inception of the mutual fund" in subsections 15.8(2) and (3) should be read as referring to the date that the non-redeemable investment fund became a reporting issuer.

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(6) Paragraph 15.6(1)(a) of the Regulation contains a prohibition against the inclusion of performance data for a mutual fund that has been distributing securities for less than 12 consecutive months. The creation of a new class or series of security of an existing mutual fund does not constitute the creation of a new mutual fund and therefore does not subject the mutual fund to the restrictions of paragraph 15.6(1)(a) unless the new class or series is referable to a new portfolio of assets.

(7) Section 15.14 of the Regulation contains the rules relating to sales communications for ~~multi-class mutual~~multiclass investment funds. ~~-~~Those rules are applicable to ~~a mutual~~an investment fund that has more than one class of securities that are referable to the same portfolio of assets. ~~-~~Section 15.14 does not deal directly with asset allocation services. It is possible that asset allocation services could offer multiple "classes"; the Canadian securities regulatory authorities recommend that any sales communications for those services generally respect the principles of section 15.14 in order to ensure that those sales communications not be misleading.

(8) The Canadian securities regulatory authorities believe that the use of hypothetical or *pro forma* performance data for new classes of securities of a multi-class ~~mutual~~investment fund would generally be misleading.

13.3 Sales Communications of Non-Redeemable Investment Funds During the Waiting Period and the Distribution Period

The Canadian securities regulatory authorities remind non-redeemable investment funds of the restrictions contained in securities legislation relating to the distribution of material and advertising and marketing in connection with a prospectus offering during the waiting period and during the distribution period following the issuance of a receipt for the final prospectus. Part 15 of the Regulation does not vary any of the restrictions imposed during these periods.

PART 14 (DELETED)

PART 15 SECURITYHOLDER RECORDS

15.1 Securityholder Records

(1) Section 18.1 of the Regulation requires the maintenance of securityholder records, including past records, relating to the issue and redemption of securities and distributions of the ~~mutual~~investment fund. Section 18.1 does not require that these records need be held indefinitely. It is up to the particular ~~mutual~~investment fund, having regard to prudent business practice and any applicable statutory limitation periods, to decide how long it wishes to retain old records.

(2) The Canadian securities regulatory authorities are of the view that the requirements in section 18.1 to maintain securityholder records may be satisfied if the investment fund maintains up to date records of registered securityholders. Each investment fund may decide whether it wishes to maintain records of beneficial securityholders.

PART 16 EXEMPTIONS AND APPROVALS

16.1 Need for Multiple or Separate Applications

The Canadian securities regulatory authorities note that a person that obtains an exemption from a provision of the Regulation need not apply again for the same exemption at the time of each prospectus or simplified prospectus refiling unless there has been some change in an important fact relating to the granting of the exemption. This also applies to exemptions from NP39 granted before the Regulation; as provided in section 19.2 of the Regulation, it is not necessary to obtain an exemption from the corresponding provision of the Regulation.

16.2 Exemptions under Prior Policies

(1) Subsection 19.2(1) of the Regulation provides that a mutual fund that has obtained, from the regulatory or securities regulatory authority, an exemption from a provision of NP 39 before the Regulation came into force is granted an exemption from any substantially similar provision of the Regulation, if any, on the same conditions, if any, contained in the earlier exemption.

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(2) The Canadian securities regulatory authorities are of the view that the fact that a number of small amendments have been made to many of the provisions of the Regulation from the corresponding provision of NP39 should not lead to the conclusion that the provisions are not "substantially similar", if the general purpose of the provisions remain the same. For instance, even though some changes have been made in the Regulation, the Canadian securities regulatory authorities consider paragraph 2.2(1)(a) of the Regulation to be substantially similar to paragraph 2.04(1)(b) of NP39, in that the primary purpose of both provisions is to prohibit mutual funds from acquiring securities of an issuer sufficient to permit the mutual fund to control or significantly influence the control of that issuer.

(3) The ~~CSA~~Canadian securities regulatory authorities are of the view that the new provisions of the Regulation relating to mutual funds investing in other mutual funds introduced on December 31, 2003 are not "substantially similar" to those of the Regulation which they replace.

16.3 Waivers and Orders concerning "Fund of Funds"

(1) The ~~CSA~~Canadian securities regulatory authorities in a number of jurisdictions have provided waivers and orders from NP39 and securities legislation to permit "fund of funds" to exist and carry on investment activities not otherwise permitted by NP39 or securities legislation. Some of those waivers and orders contained "sunset" provisions that provided that they expired when legislation or a ~~CSA~~ policy or regulation of the Canadian securities regulatory authorities came into force that effectively provided for a new "fund of funds" regime. For greater certainty, the Canadian securities regulatory authorities note that the coming into force of the Regulation will not trigger the "sunset" of those waivers and orders.

(2) For greater certainty, note that the coming into force of Regulation 81-102 did not trigger the "sunset" of those waivers and orders. However, the coming into force of section 19.3 of the Regulation will effectively cause those waivers and orders to expire one year after its coming into force.

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REGULATION TO AMEND REGULATION 41-101 RESPECTING GENERAL PROSPECTUS REQUIREMENTS

Securities Act
(chapter V-1.1, s. 331.1, par. (1), (6), (8) and (34))

1. Section 14.8.1 of Regulation 41-101 respecting General Prospectus Requirements is amended by replacing paragraph (1) with the following:

"(1) For the purposes of subsection (2), "borrowing agent" has the same meaning as in Regulation 81-102 respecting Investment Funds (chapter V-1.1, r. 39).".

2. Form 41-101F2 of the Regulation is amended :

(1) by deleting paragraph (8) of the General Instructions;

(2) in paragraph (1) of Item 1.3:

(a) by deleting ", including any options or warrants,";

(b) by replacing, in the French text, the words "OPC coté" with the words "OPC négocié en bourse";

(3) in Item 1.4:

(a) by deleting paragraph (5);

(b) by deleting paragraph (2) of the Instructions;

(4) by inserting, after Item 1.8, the following:

"**1.8.1. Conversion of the Investment Fund**

If the investment fund is a non-redeemable investment fund that intends to convert into a mutual fund, by undertaking a transaction that results in the securityholders of the investment fund becoming securityholders in a mutual fund or implementing a change that restructures the investment fund into a mutual fund, state this fact and, if applicable, the date on which the conversion is expected to occur. If applicable, state that the investment strategies of the investment fund will change after it becomes a mutual fund. Include a cross-reference to the section in the prospectus where disclosure regarding the conversion is provided.";

(5) by inserting, after Item 4.1, the following:

"**4.2. Conversion of the Investment Fund**

If the investment fund is a non-redeemable investment fund that intends to convert into a mutual fund, by undertaking a transaction that results in the securityholders of the investment fund becoming securityholders in a mutual fund or implementing a change that restructures the investment fund into a mutual fund,

(a) describe under the sub-heading "Conversion of the Fund":

(i) how the investment fund will implement the conversion,

(ii) the event or events that will trigger the conversion and, if applicable, the date on which the conversion is expected to occur,

(iii) the class or series of securities that securityholders of the investment fund will hold after the conversion,

(iv) how the investment strategies of the investment fund will differ after it becomes a mutual fund,

(v) any approvals that will be required in order to implement the conversion, and

(vi) any other change that is expected to occur as a result of the conversion, and

(b) if applicable, state under the sub-heading "Conversion of the Fund" that the securities of the investment fund will not be listed on the stock exchange on which they trade as a result of the conversion and describe how securityholders may dispose of the securities of the investment fund after the conversion.";

(6) by inserting, after paragraph (6) of Item 6.1, the following:

"(7) If the investment fund intends to invest in physical commodities

(a) state whether the investment fund may purchase physical commodities or use specified derivatives the underlying interest of which is a physical commodity, and

(b) briefly describe

(i) how physical commodities are or will be used in conjunction with other securities to achieve the investment fund's investment objectives,

(ii) the types of physical commodities the investment fund expects to invest in, and

(iii) the limits of the investment fund's use of physical commodities.";

(7) by replacing paragraph (2) of Item 14.1 with the following:

"(2) Describe how the issue price of the securities of the investment fund is determined.";

(8) by replacing Item 15.1 with the following:

"**15.1. Redemption of Securities**

(1) Under the heading "Redemption of Securities", describe how investors may redeem securities of the investment fund, including

(a) the procedures followed, or to be followed, by an investor who desires to redeem securities of the investment fund and specifying the procedures to be followed and the documents to be delivered before a redemption order pertaining to securities of the investment fund will be accepted by the investment fund for processing and before payment of the proceeds of redemption will be made by the investment fund,

(a.1) the dates on which securities of the investment fund will be redeemed,

(a.2) the dates on which payment of the proceeds of redemption will be made by the investment fund,

(b) how the redemption price of the securities is determined and, if applicable, state that the redemption price of the securities is based on the net asset value of a security of that class, or series of a class, next determined after the receipt by the investment fund of the redemption order, and

(c) the circumstances under which the investment fund may suspend redemptions of the securities of the investment fund.

(2) If the redemption proceeds are computed by reference to the net asset value per security and amounts may be deducted from the net asset value per security, describe each amount that may be deducted and the entity each amount is paid to. If there is a maximum amount or percentage that may be deducted from the net asset value per security, disclose that amount or percentage.";

(9) by deleting, in subparagraph (c) of paragraph (1) of Item 19.1, the words "or any of its subsidiaries";

(10) in paragraph (1) of Item 19.9:

(a) by deleting, in the part preceding subparagraph (a), the words "or of a subsidiary of the investment fund";

(b) by deleting, in subparagraph (b), the words "or any of its subsidiaries";

(c) by deleting, in subparagraph (c), the words "or from a subsidiary of the investment fund" and the words "or a subsidiary of the investment fund";

(d) by deleting, in subparagraph (d), the words "or by a subsidiary of the investment fund";

(11) by deleting Items 21.2 and 21.3;

(12) by inserting, in Item 25.8 and after the words "by the Regulation", the words "and Regulation 81-102 respecting Investment Funds";

(13) by deleting Item 27;

(14) by deleting, in subparagraph (d) of paragraph (5) of Item 29.2, the words "or its subsidiaries";

(15) by deleting, in Item 39.4, the words "or a subsidiary of the investment fund".

3. The Regulation is amended by replacing, wherever they occur, the words "Regulation 81-102 respecting Mutual Funds" with the words "Regulation 81-102 respecting Investment Funds".

4. This Regulation comes into force on *(indicate here the date of coming into force of this Regulation)*.

REGULATION TO AMEND REGULATION 81-106 RESPECTING INVESTMENT FUND CONTINUOUS DISCLOSURE

Securities Act
(chapter V-1.1, s. 331.1, par. (1), (11), (16) and (34))

1. Section 1.3 of Regulation 81-106 respecting Investment Fund Continuous Disclosure is amended by replacing paragraph (2) with the following:

"(2) Terms defined in Regulation 81-102 respecting Investment Funds (chapter V-1.1, r. 39) and Regulation 81-104 respecting Commodity Pools (chapter V-1.1, r. 40) and used in this Regulation have the respective meanings ascribed to them in those regulations.

"(3) Terms defined in Regulation 81-105 respecting Mutual Fund Sales Practices (chapter V-1.1, r. 41) and used in this Regulation have the respective meanings ascribed to them in that regulation except that the references in those definitions to "mutual fund" must be read as references to "investment fund".".

2. The Regulation is amended by replacing, wherever they occur, the words "Regulation 81-102 respecting Mutual Funds" with the words "Regulation 81-102 respecting Investment Funds".

3. This Regulation comes into force on *(indicate here the date of coming into force of this Regulation).*

REGULATION TO AMEND REGULATION 81-107 RESPECTING INDEPENDENT REVIEW COMMITTEE FOR INVESTMENT FUNDS

Securities Act
(chapter V-1.1, s. 331.1, par. (1), (11), (16) and (34))

1. Section 6.2 of Regulation 81-107 respecting Independent Review Committee for Investment Funds is amended by replacing paragraphs (2) and (3) with the following:

"(2) The investment fund conflict of interest investment restrictions do not apply to an investment fund with respect to an investment referred to in subsection (1) if the investment is made in accordance with that subsection.

"(3) In subsection (2), "investment fund conflict of interest investment restrictions" has the meaning ascribed to that term in Regulation 81-102 respecting Investment Funds (chapter V-1.1, r. 39).".

2. The Regulation is amended by replacing, wherever they occur, the words "Regulation 81-102 respecting Mutual Funds" with the words "Regulation 81-102 respecting Investment Funds".

3. This Regulation comes into force on *(indicate here the date of coming into force of this Regulation).*