NOTICE OF REGULATION 81-107 RESPECTING INDEPENDENT REVIEW COMMITTEE FOR INVESTMENT FUNDS

CSA Notice of Regulation, Commentary and Related Amendments

Introduction

We, the members of the Canadian Securities Administrators (the CSA or we), have developed an independent oversight regime for all publicly offered investment funds[1] that is intended to improve investment fund governance. This regime is set out in *Regulation 81-107 respecting Independent Review Committee for Investment Funds* (the Regulation). In Québec, the Regulation will be published subject to approval by the Minister of Finance.

Investment Fund Governance in Canada

The Canadian investment fund industry is a key segment of the financial services marketplace. With over $630 billion in assets under management, a sizable amount of public money and, by extension, public trust, is invested in the fund industry. Investors expect high standards of conduct from the stewards of their money. Yet, the conflicts of interest faced by fund managers may present a real challenge to their ability to meet their fiduciary duty to their funds and investors. There is currently no one whose sole responsibility it is to look out for the interests of investors. This has led us to consider the need to improve the governance of investment funds.

The International Organization of Securities Commissions (IOSCO)[2] recently defined investment fund governance to be a framework for the organization and operation of investment funds that seeks to ensure that investment funds are organized and operated in the interests of fund investors, and not in the interests of fund insiders.

For over 30 years, much of the literature written on investment funds and fund governance[3] has concluded that the structure of the fund industry – where the investor's "ownership" of the fund is separate from the fund manager's management and control of the fund – creates the potential for the interests of fund investors to diverge from the pecuniary interests of the fund manager. This could cause a fund manager to act contrary to its fiduciary duty to the investment fund (and ultimately, investors).

In Canada the potential for the interests of investors to diverge from the interests of the fund manager is exacerbated by the fact that often related parties carry out all of the requisite services provided to the investment fund, without any review of the terms or the manner in which these obligations are being carried out by unrelated persons. Coupled with this is the fact that investors are far removed from the fund manager and the decisions made by the manager or its agents. Investors rarely have the resources, the tools, or the inclination to effectively oversee the fund manager of their investment fund.

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1 This includes mutual funds, commodity pools, scholarship plans, labour-sponsored or venture capital funds, and closed-end funds and mutual funds that are listed and posted for trading on a stock exchange or quoted on an over-the-counter market.

2 *Examination of Governance for Collective Investment Schemes – Consultation Report* prepared by the Technical Committee of IOSCO, February 2005.

3 See, for example, the *Report of the Canadian Committee on Mutual Funds and Investment Contracts – Provincial and Federal Study*, 1969, Queen's Printer, 1969 prepared by Jim Baillie*; Regulatory Strategies for the Mid-90s: Recommendations for Regulating Investment Funds in Canada,* prepared by Glorianne Stromberg for the CSA, January 1995; *Making it Mutual: Aligning the Interests of Investors and Managers: Recommendations for a Mutual Fund Governance Regime in Canada,* prepared by Stephen Erlichman for the CSA, June, 2000; *Conflicts of Interest of CIS Operators* prepared by the Technical Committee of IOSCO, May 2000; *Examination of Governance for Collective Investment Schemes – Consultation Report* prepared by the Technical Committee of IOSCO, February 2005.

The Canadian regulatory regime for conflicts of interest currently relies on the fiduciary obligations of the fund manager set out in certain provincial securities legislation, and the prohibition of certain relationships or transactions. Although regulators have broad discretion to grant relief from those prohibitions, this discretion is generally exercised in narrow circumstances, and it has proven difficult for regulators to always provide timely relief. We recognize that our prohibition-based approach is too restrictive on the one hand, because it prohibits transactions that we acknowledge may be innocuous or even beneficial to investors, and not inclusive enough on the other, because it only deals with certain specific related-party transactions.

The Regulation imposes a minimum, consistent standard of independent oversight for all publicly offered investment funds in each of the jurisdictions represented by the CSA.

We believe the Regulation strikes the right balance between protecting investors and fostering fair and efficient capital markets. We also believe the Regulation keeps pace with global standards, which we consider essential to the continued success of the Canadian investment fund industry. The CSA expect that fund governance will evolve with time, and we anticipate that the governance framework set out in the Regulation will provide a flexible platform for future regulatory reform. We are committed to reviewing the impact of the Regulation following its implementation.

Consequential Amendments and Adoption of the Regulation

We are also publishing a policy statement to the Regulation, which we call Commentary. We refer to the Regulation and Commentary, together, as the Instrument.

Concurrently with the Instrument, we are publishing related consequential amendments to the following Regulations:

- *Regulation 81-101 respecting Mutual Fund Prospectus Disclosure,* Form 81-101F1 *Contents of Simplified Prospectus,* and Form 81-101F2 *Contents of Annual Information Form*;

- *Regulation 81-102 respecting Mutual Funds* (Regulation 81-102) and Policy Statement to *Regulation 81-102 respecting Mutual Funds*;

- *Regulation 81-106 respecting Investment Fund Continuous Disclosure* and Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance*;

- *Regulation 13-101 respecting System for Electronic Document Analysis and Retrieval (SEDAR)*;

- *Regulation 81-104 respecting Commodity Pools*; and

- in some jurisdictions, certain local amendments.

The Regulation has been adopted or is expected to be adopted as a rule in each of British Columbia, Alberta, Manitoba, Newfoundland and Labrador, Nova Scotia, Ontario and New Brunswick, as a commission regulation in Saskatchewan, as a regulation in Québec, and as a policy in the remaining jurisdictions represented by the CSA. The Commentary contained in the Regulation will be adopted as a policy in each of the jurisdictions represented by the CSA.

In Québec, the Regulation and the consequential amendments will be made by the *Autorité des marchés financiers* (the Authority") under section 331.1 of the *Securities Act* and must be approved by the Minister of Finance, with or without amendment. They will come into force on the date of their publication in the *Gazette officielle du Québec* or on a later date specified in the Regulation and consequential amendments. The Policy Statements to Regulation 81-107 and to Regulation 81-102 will be adopted as policies by the Authority

and will come into force concomitantly with the coming into force of Regulation 81-107 and Regulation 81-102. They will also be published in the Bulletin of the Authority.

In Ontario, the Instrument, consequential amendments and other required materials were delivered to the Minister of Government Services on July 28, 2006. The Minister may approve or reject the Instrument or return it for further consideration. If the Minister approves the Instrument or does not take any further action, the Instrument and consequential amendments will come into force on November 1, 2006.

In British Columbia, the implementation of the Instrument and consequential amendments are subject to ministerial approval. British Columbia also plans to adopt a local regulation that exempts from the Instrument and consequential amendments an investment fund that is a reporting issuer only in British Columbia. You can read more about this exemption in the notice that British Columbia has published about the Instrument.

Provided all necessary approvals are obtained, we expect the Regulation and consequential amendments to come into force on November 1, 2006.

Compliance with the Regulation may take place over a one year transition period. The Regulation also specifies that existing conflict of interest waivers and exemptions that deal with any matter that the Instrument regulates may not be relied on after one year following the coming into force of the Instrument.

Summary and Purpose

Purpose of the Regulation

Currently, there is no requirement for investment fund managers or investment funds to have any type of independent oversight of how they manage or monitor conflicts of interest. In compliance with the governance principles recently articulated by IOSCO[4], the Regulation provides for the independent review and oversight of the conflicts faced by the fund manager in the operation of the investment fund.

We expect the Regulation to enhance investor protection by ensuring that the interests of the investment fund (and ultimately, investors) are at the forefront when a fund manager is faced with a conflict of interest. The Regulation will also improve the transparency surrounding a fund manager's fiduciary obligation and decision-making process in such situations, by requiring an upfront check on how the conflict of interest is resolved. This process does not mean, nor do we intend it to result in, the second-guessing of the investment or business decisions of the fund manager. However, it does mean that, for the first time, the fund manager must formally account for each decision involving a conflict of interest to an independent body considering the decision solely from the perspective of the best interests of the investment fund and its investors.

We also expect the Regulation to contribute to more efficient Canadian capital markets by permitting fund managers to engage in certain related-party and self-dealing transactions without prior regulatory approval[5]. This will give fund managers greater flexibility to make timely investment decisions to take advantage of market opportunities they believe are in the best interests of the investment fund and investors.

The CSA believe managers of all investment funds, large and small, face conflicts of interest and will benefit from the independent perspective brought to bear by an independent body on such matters. We believe the costs associated with the Regulation, published with the 2004 Proposal and the 2005 Proposal, will be proportionate to the

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4 *Examination of Governance for Collective Investment Schemes – Consultation Report* prepared by the Technical Committee of IOSCO, February 2005.

5 These transaction are inter-fund trades, purchases by a mutual fund of the securities of related issuers and purchases of securities by mutual funds during the distribution period and the 60 day period thereafter where the offering is being underwritten by a related party.

benefit. We are further satisfied that the limited scope of the independent body's mandate will in turn limit its corresponding fiduciary duty and duty of care.

Summary of the Regulation

The Regulation requires every investment fund that is a reporting issuer to have a fully independent body, the Independent Review Committee (IRC), whose role is to oversee all decisions involving an actual or perceived conflict of interest faced by the fund manager in the operation of the fund.

The Regulation captures two types of conflicts: (i) 'business' or 'operational' conflicts - those relating to the operation by the manager of its funds that are not specifically regulated under securities legislation, except through the general duties of loyalty and care imposed on the fund manager; and (ii) 'structural' conflicts – those conflicts resulting from proposed transactions by the manager with related entities of the manager, fund or portfolio manager currently prohibited or restricted by securities legislation.

The Regulation requires that prior to making a decision involving a conflict of interest matter, the fund manager must establish written policies and procedures that it must follow and refer the matter to the IRC for its review.

A decision by the fund manager to engage in certain transactions giving rise to 'structural' conflicts currently prohibited or restricted by securities legislation, must be approved by the IRC before the transaction may proceed. The approval may be on a case-by-case basis, or in the form of a standing instruction. For any other proposed course of action that involves a conflict of interest for the fund manager, the IRC must provide the fund manager with a recommendation, which the fund manager must consider before proceeding.

The Regulation also requires the IRC to approve certain changes to a mutual fund before the manager may proceed with the change. In the consequential amendments to Regulation 81-102 which accompany the Instrument, we specify that the IRC must approve a change in the auditor of the mutual fund, and a reorganization or transfer of assets of the mutual fund to a mutual fund managed by the same fund manager or an affiliate. We have eliminated the requirement for securityholder approval in these instances but continue to require a securityholder vote in other circumstances.

Background

In 1999, the CSA retained Stephen Erlichman to provide a summary of the discussion on governance in Canada and abroad and to make specific recommendations to improve fund governance. We released his report entitled *Making it Mutual: Aligning the Interests of Investors and Managers: Recommendations for a Mutual Fund Governance Regime in Canada* in June, 2000[6].

On March 1, 2002, the CSA released Concept Proposal 81-402 *Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers* (the Concept Proposal) setting out our vision for a renewed framework for regulating mutual funds and their managers that rested on five pillars: registration of mutual fund managers, mutual fund governance, product regulation, disclosure and investor rights and regulatory presence. The Concept Proposal proposed a very robust system of fund governance, with a 'board'-like body that would oversee all of the fund manager's activities.

On January 9, 2004, we published for comment the first version of the Regulation and Commentary (the 2004 Proposal). In response to strong industry feedback to limit the role of the governance body, the 2004 Proposal narrowed the focus of the governance body (now called the IRC) to oversight of the potential conflicts of interest that exist for fund managers in the operation of their funds. The focus on conflicts of interest was deliberate. In our view, this was an area where independent review mattered most, and would not

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[6] *Making it Mutual: Aligning the Interests of Investors and Managers: Recommendations for a Mutual Fund Governance Regime in Canada,* prepared by Stephen Erlichman for the CSA, June, 2000.

impose an undue burden on mutual fund managers who have no experience working with an independent advisory body.

For additional background information on the Concept Proposal and the 2004 Proposal, please refer to the notices published with those documents on the websites of members of the Canadian Securities Administrators.

As a result of the comments we received from stakeholders (in particular investors and investor advocates who urged us to give the IRC more "teeth"), as well as our own experience to date with the exemptive relief that we have granted from the conflict prohibitions and restrictions in securities legislation, the CSA made a number of significant changes to the 2004 Proposal to provide for a greater level of investor protection. On May 27, 2005, we published the Regulation and Commentary for comment a second time (the 2005 Proposal). The comment period expired on August 25, 2005.

The 2005 Proposal introduced a number of key changes. Among them: the scope of the Regulation was expanded to include all publicly offered investment funds; instead of repealing the existing conflict prohibitions and restrictions in securities legislation, the Regulation codified exemptions for certain transactions giving rise to 'structural' conflicts currently prohibited or restricted by securities legislation; the Regulation introduced a number of tools for the IRC to use if it determines the fund manager has placed its interests ahead of the interests of the fund in conflict of interest matters; and the Regulation specified the key governance practices we expected of the IRC and the fund manager.

In response to concerns previously raised about the potential unlimited liability of IRC members, we sought advice from external legal counsel. Based on this advice, we revised the Regulation to clarify the very specific functions, duties and obligations of the IRC which, we were advised, should correspondingly limit the IRC's fiduciary duty and duty of care. We published this analysis with the 2005 Proposal on the website of the Ontario Securities Commission and the website of the Autorité des marchés financiers.

The Regulation continues to reflect the key changes made in the 2005 Proposal.

Throughout this initiative, we heard divergent views from stakeholders on almost every aspect of our proposals. We believe the Regulation strikes the right balance between these competing points of view.

While we remain confident that the five-pillared framework for mutual fund regulation we outlined in the Concept Proposal is a sound blueprint for change, we also understand that we cannot bring all five pillars into place overnight. The CSA remain committed to the pillars of fund regulation, some of which are already in place while others are being addressed in separate policy initiatives currently underway.

Summary of Changes to the Instrument

After considering all of the comments received, we have revised the Instrument. However, as these changes are not material, we are not republishing the Instrument for a further comment period. Many of the changes we have made respond to stakeholder comments on practical matters related to the implementation and ongoing operation of the IRC.

See Appendix A for a description of the noteworthy changes we have made to the 2005 Proposal.

The independent legal analysis we published with the 2005 Proposal concerning the liability of IRC members has also been updated to reflect the drafting changes made to the Instrument. It is available on the website of the Ontario Securities Commission and the website of the Autorité des marchés financiers.

Summary of Written Comments Received on the 2005 Proposal

We received 36 submissions on the 2005 Proposal. We have considered all comments received and wish to thank all those who took the time to comment. Copies of the comment letters have been posted on the Ontario Securities Commission website at www.osc.gov.on.ca. Copies are also available from any CSA member. The names of the commenters can be found in Appendix B to this Notice.

A summary of the comments we received on the 2005 Proposal, together with our responses, is also in Appendix B to this Notice.

Related Amendments

National Amendments

The following Regulations are attached to this Notice:

- Regulation to amend *Regulation 81-101 respecting Mutual Fund Prospectus Disclosure* (Regulation 81-101), Form 81-101F1 *Contents of Simplified Prospectus,* and Form 81-101F2 *Contents of Annual Information Form*;

- Regulation to amend *Regulation 81-102 respecting Mutual Funds* (Regulation 81-102) and Policy Statement to *Regulation 81-102 respecting Mutual Funds*;

- Regulation to amend *Regulation 81-106 respecting Investment Fund Continuous Disclosure* (Regulation 81-106) and Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance*;

- Regulation to amend *Regulation 13-101 respecting System for Electronic Document Analysis and Retrieval (SEDAR)* (Regulation 13-101); and

- Regulation to amend *Regulation 81-104 respecting Commodity Pools* (Regulation 81-104).

Local Amendments

We have amended elements of local securities legislation, in conjunction with the implementation of the Instrument. The provincial and territorial securities regulatory authorities may publish these proposed local changes separately in their jurisdictions.

Consequential amendments to rules or regulations in a particular jurisdiction, if applicable, are in Appendix H to this Notice published in that particular jurisdiction.

Some jurisdictions will need to implement the Instrument using a local implementing regulation. Jurisdictions that must do so will separately publish the implementing regulation.

Questions

Please refer your questions to any of:

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APPENDIX A

SUMMARY OF CHANGES

The Instrument

Part 1 Definitions and Application

1.2 "conflict of interest matter"

- For greater certainty, we amended the definition to specifically list – in new Appendix A to the Regulation – the provisions in securities legislation that could restrict or prohibit an investment fund, manager or an entity related to the manager from proceeding with a proposed action.

- We added Commentary to articulate our view that the reasonable person test encompassed in paragraph (a) of the definition does not capture inconsequential matters. We also added Commentary setting out our expectations of how a manager could assess conflict of interest matters.

- We added Commentary to clarify our view that, in connection with portfolio managers or advisers, paragraph (a) of the definition only captures those conflicts of interest faced by the portfolio manager that relate to its decisions made on behalf of the investment fund that may affect the manager's ability to make decisions in the best interests of the fund. We also added examples of the types of portfolio manager conflicts that paragraph (a) may capture.

- We added Commentary to clarify our view that paragraph (a) of the definition is not intended to capture conflicts of interest at the service provider level generally.

1.3 "entity related to the manager"

- We amended a portion of the definition to capture any person or company that can 'materially affect' the direction of the management and policies of the manager or the investment fund.

- We moved the reference to "ownership of voting securities" in paragraph (a) of the definition to the Commentary.

- We deleted reference to "agent" in paragraph (b) of the definition because we are satisfied that paragraph (a) captures the entities we intended. For greater clarity, we added Commentary to provide examples of entities captured under paragraph (a) of the definition, including third party portfolio managers.

1.4 "independent"

- We amended paragraph 3 of the Commentary to further clarify our views regarding the types of individuals who may or may not meet the definition.

1.5 "inter-fund self-dealing investment prohibitions"

- For greater certainty, we amended the definition to specifically list – in new Appendix B to the Regulation – the provisions in securities legislation that prohibit a portfolio manager or an investment fund from purchasing or selling securities of an issuer from or to the account of a responsible person.

1.6 “manager”

- To avoid confusion, we deleted from the Commentary the statement that there may be circumstances where more than one person or company is designated the manager. We also added examples in the Commentary of the types of managers the definition may capture.

- We added Commentary to articulate that we may examine an investment fund if it seems that it was structured to avoid the operation of this Instrument.

1.7 “standing instruction”

- We added a definition of standing instruction.

Part 2 Functions of the manager

2.1 Manager standard of care

- For greater certainty, we amended the section to better reflect the standard of care for managers in securities legislation.

2.2 Manager to have written policies and procedures

- We amended paragraph (1)(a) to add that in establishing its policies and procedures, the manager must have regard to its duties under securities legislation.

- We added a new subsection (2) that requires the manager, in establishing its policies and procedures under this part, to consider the input of the IRC, if any.

- We amended subsection (3) (previously subsection (2)) to specify that the manager must provide the IRC with a written description of any significant changes to its policies and procedures for IRC input before implementing the revised policies and procedures.

- We amended paragraph 1 of the Commentary to clarify that we expect the manager under this part to identify the conflict of interest matters it expects will arise and that will be referred to the IRC. We further amended paragraph 1 of the Commentary to clarify that this part requires the manager to establish policies and procedures for any other matters required by securities legislation to be referred to the IRC.

- We amended paragraph 2 of the Commentary to clarify that paragraph (1)(a) is intended to reinforce the manager’s obligation to make decisions in the best interests of the fund when establishing the fund’s policies and procedures.

- We amended paragraph 2 of the Commentary to clarify our expectation that written policies and procedures be designed to prevent, detect and correct violations of securities legislation in the areas addressed by the Regulation .

- We added a new paragraph 3 to the Commentary to articulate our expectation that the manager inform the IRC whether its proposed action adheres to its written policies and procedures when referring a matter to the IRC. We further specified in the Commentary our expectation that if an unanticipated conflict of interest matter arises for which the manager does not have a policy and procedure, we expect the manager to bring the matter and its proposed action to the IRC for its review and input at the time the matter is referred to the IRC.

2.3 Manager to maintain records

- We amended paragraph 1 of the Commentary to clarify our expectation that managers will keep their records in accordance with existing best practices.

- We added a new paragraph 2 to the Commentary to clarify our expectation that a manager is required to keep minutes only of any material discussions it has with the IRC or internally on matters subject to IRC review. We further specified in the Commentary that the manager and the IRC may share the record keeping and maintenance of records functions.

2.4 Manager to provide assistance

- We amended subsection (1) to clarify that this provision also applies when a manager refers its policies and procedures to the IRC.

Part 3 Independent review committee

3.1 Independent review committee for an investment fund

- For greater clarity, we amended the Regulation to say an investment fund must have an IRC.

- We amended paragraph 2 of the Commentary to expand upon our view that the Regulation does not prevent sharing of an IRC, nor a third party from establishing an IRC or IRCs for investment funds.

3.3 Vacancies and reappointments

- We created a new section in the Regulation, separating out the provisions regarding IRC vacancies from the provisions regarding the term of office for IRC members.

- We added a new subsection (3) that requires the IRC to consider the manager's recommendations, if any, in filling a vacancy on the IRC.

- We added a new subsection (4) mandating that an IRC member's total years of service on an investment fund's IRC must not be more than 6 years, unless the manager and the IRC agree. We also added to the Commentary to explain our view that a maximum term limit is intended to enhance the independence and effectiveness of the IRC.

3.4 Term of Office

- We amended the term of office provision. We now specify that an IRC member's term must be not less than 1 year and not more than 3 years.

3.6 Written charter

- We amended paragraph 1 of the Commentary to clarify our view that an IRC acting for more than one fund possesses flexibility regarding the adoption of written charters.

- We added to paragraph 3 of the Commentary our expectation that the written charter's policies and procedures would include a policy relating to an IRC member's ownership of securities of the investment fund, manager or in any person or company that provides services to the investment fund or the manager.

- We further added to paragraph 3 of the Commentary our expectation that the written charter's policies and procedures would describe how any subcommittee of the IRC delegated with any of the functions of the IRC is to report to the IRC.

- For greater clarity, we added a new paragraph 4 to the Commentary which states that the Regulation does not preclude the IRC and manager from agreeing that the IRC will perform functions in addition to those prescribed, however, the Regulation does not regulate any such additional functions.

3.7 Composition

- We added to paragraph 1 of the Commentary our expectation that the manager will seek the input of the IRC prior to changing the size of the IRC.

- We amended paragraph 2 of the Commentary to further clarify our expectations of the role of the IRC Chair.

3.8 Compensation

- We created a new section in the Regulation to exclusively address IRC compensation.

- We added subsection (1) to specify that the manager may set the initial compensation and expenses of the first IRC, or any subsequent IRC appointed by the manager under subsection 3.3(5).

- We further added provisions to require the IRC, in setting its members' reasonable compensation and expenses after their initial appointment by the manager, to consider its most recent assessment of its compensation and the manager's recommendations, if any.

- New Commentary was added to correspond with these changes.

3.9 Standard of care

- For consistency, we amended the section to reflect the changes made to section 2.1.

3.10 Ceasing to be a member

- For greater clarity, we rearranged the ordering of subsections (1) and (2).

- We amended subsection (3) by adding paragraphs (d), (e), and (f) which provide that an individual ceases to be a member of the IRC if they are prohibited from acting as a director or officer in Canada, if they are subject to any penalties or sanctions made by a court relating to provincial or territorial securities legislation, or if they are a party to a settlement agreement with a securities regulatory authority in Canada.

- Subsection (4) was amended to correspond to the changes made to subsections (1) and (2).

- We added a new subsection (7) to provide an IRC member who receives notice of a meeting of securityholders called to consider his or her removal, the right to provide the manager with a written statement giving reasons for opposing the removal and to require the manager to send a copy of the statement to securityholders.

- We added a new paragraph 1 to the Commentary to articulate our expectation that the removal of an IRC member by a meeting of securityholders called by the manager will not be routine.

3.11 Authority

- We moved the provisions previously contained in this section that dealt with IRC compensation into new section 3.8.

- We added a new paragraph (d) to subsection (1) and a new subsection (2) to reflect our view that an IRC should have the ability to delegate to subcommittees any of its functions, provided the subcommittees report to the IRC at least annually.

- We amended paragraph 1 of the Commentary to clarify our expectation that an IRC will use independent advisors selectively and only to assist, not replace, IRC decision-making. We also amended this paragraph to clarify our view that we expect the IRC's use of external counsel and other advisers will not be routine.

- We added a new paragraph 2 to the Commentary to articulate our expectations regarding the IRC's use of subcommittees, including that the IRC's delegation to a subcommittee does not absolve the IRC from its responsibility for that function.

- We amended paragraph 3 of the Commentary to clarify our view that the IRC has no obligation to report matters to the securities regulatory authority or regulator other than as prescribed in the Regulation and under securities legislation.

- We added a new paragraph 4 to the Commentary to clarify our view that the Regulation does not prohibit a manager from communicating with securities regulatory authorities or regulators with respect to any matter.

3.12 Decisions

- We created a new section in the Regulation to require that any IRC decisions must have the agreement of a majority of its members. This was previously discussed in the Commentary under section 5.1. This new section also sets out what decisions an IRC may make if it has vacancies and therefore has only one or two members.

3.13 Fees and expenses to be paid by the investment fund

- We amended this section by deleting previous paragraphs (a), (b), and (c) and replacing them with a general requirement for the investment fund to pay from its assets all reasonable costs reasonably incurred in complying with the Regulation.

- We amended paragraph 1 of the Commentary to articulate our expectation that a manager will allocate the costs associated with the IRC on an equitable and reasonable basis amongst the investment funds for which the IRC acts.

- We added a new paragraph 2 to the Commentary to clarify our expectation about what costs may appropriately be charged to the investment fund.

3.14 Indemnification and insurance

- We added a new subsection (1) to define "member" for the purposes of this section.

- We deleted the previous subsections (4) and (7) regarding the provision of indemnities with the approval of or upon application to a court.

- We amended paragraph 2 of the Commentary to further clarify our expectations regarding the application of this section.

Part 4 Functions of independent review committee

4.1 Review of matters referred by manager

- We amended subsection (2) by deleting paragraph (b) to clarify that the IRC is only obligated under the Regulation to perform functions required by securities legislation (including the Regulation). Any additional functions that the IRC undertakes are not regulated under the Regulation.

- We amended subsection (3) to provide the IRC with the discretion to choose whether it wishes to deliberate and decide on a matter in the absence of the manager, any representative of the manager and any entity related to the manager.

- We added a new subsection (4) that provides that, despite having discretion to exclude the manager under subsection (3), the IRC must hold at least one meeting annually without the manager, any representative of the manager and any entity related to the manager in attendance.

- For greater clarity, we amended paragraph 2 of the Commentary to further clarify that the Regulation does not preclude the IRC and manager from agreeing that the IRC will perform other functions in addition to those prescribed, however, the Regulation does not regulate any such additional functions that the IRC may undertake in addition to those prescribed by the Regulation.

- We amended paragraph 4 of the Commentary to clarify our view that the IRC's obligation to hold at least one meeting annually without anyone else present is satisfied if the IRC holds a portion of any meeting annually without the manager, any representative of the manager or any entity related to the manager in attendance.

4.2 Regular assessments

- We added a new paragraph (d) to subsection (1) to require that the IRC review and assess at least annually the adequacy and effectiveness of any subcommittee delegated by the IRC to perform any of its functions.

- We added a new subsection (2) that requires the IRC at least annually to review and assess the independence of each of its members and the compensation of each of its members.

- We amended paragraph 3 of the Commentary to clarify our expectation that the manager may provide IRC members with feedback that the IRC may consider as part of its self-assessment.

4.3 Reporting to the manager

- We replaced the word "suspects" in paragraphs (a) and (b) with "has reason to believe has occurred".

4.4 Reporting to securityholders

- We amended subsection (1) to set out additional items required to be included in the IRC's report to securityholders, such as: the basis for the determination that a member is independent if there is a reason to question the member's independence, the name of any other fund family on whose IRC the member serves, the percentage of securities a member holds in the fund or the manager, any indemnities paid to IRC members, the criteria used by the IRC to determine the appropriate level of its compensation, and a brief summary of any recommendations and approvals (not limited to standing instructions) the manager relied upon during the period.

4.5 Reporting to securities regulatory authorities

- We added a new paragraph 2 to the Commentary to clarify our expectation that an IRC will include in any notification under this section what steps the manager proposes to take, or has taken, to remedy the breach, if known.

- We added a new paragraph 3 to the Commentary to articulate our view that this notification mechanism is not intended to be used to resolve disputes or to raise inconsequential matters.

4.6 Independent review committee to maintain records

- We added a new paragraph (e) to specify that the IRC is required to maintain records of the decisions it makes.

- We added a new paragraph 2 to the Commentary to clarify our expectation that an IRC is required to keep minutes only of any material discussions it has with the manager or internally on matters subject to its review. We further specified in the Commentary that the IRC and the manager may share the record keeping and maintenance of records functions.

Part 5 Conflict of interest matters

5.1 Manager to refer conflict of interest matters to independent review committee

- We added a new subsection (2) to require that a manager provide a summary of the IRC's decision in the notice of meeting to securityholders, if the matter requires the prior approval of securityholders. This was previously discussed in the Commentary to this section.

- We amended paragraph 1 of the Commentary to clarify our expectations that it is not the role of the IRC to second-guess the investment or business decisions of the manager or an entity related to the manager.

- We added a new paragraph 3 to the Commentary to clarify our expectation that when a conflict of interest matter arises for which the manager does not have an existing policy, the manager will bring the matter and its proposed action to the IRC for its review and input at the time the manager refers the matter to the IRC.

- We deleted the discussion previously contained in paragraph 2 of the Commentary. The Regulation now sets out in section 3.12 the IRC composition needed to make decisions.

5.2 Matters requiring independent review committee approval

- We amended paragraph 1 of the Commentary to clarify that if the IRC has not provided a standing instruction, the manager must seek approval in each instance for a matter under subsection (1).

- We also added to the Commentary that an IRC may consider as guidance any conditions imposed in prior exemptive relief orders when contemplating the appropriate terms and conditions of its approval.

5.3 Matters subject to independent review committee recommendation

- We added to subsection (2) a requirement that the manager must notify the IRC in writing prior to proceeding with a proposed action which the IRC considers does not achieve a fair and reasonable result for the investment fund.

- We deleted former subsection (5) that required the manager to pay the costs associated with filing the notification to securityholders.

- We amended paragraph 1 of the Commentary to clarify our expectation that among the factors the manager will look to for guidance in identifying conflict of interest matters under this section will be industry best practices.

5.4 Standing instructions by the independent review committee

- We deleted the prior subsection (1). It was no longer necessary now that we have defined "standing instruction" in section 1.7.

- For greater clarity, we amended previous paragraph (3)(b) (now paragraph (2)(b)) to better reflect each of the steps we expect the IRC to conduct as part of its annual review of any standing instructions.

- We added a new subsection (3) to provide that the manager may continue to rely upon a standing instruction until the IRC notifies it that the standing instruction has been amended or is no longer in effect.

Part 6 Exempted Transactions

6.1 Inter-fund trades

- We moved up the definitions in this section to subsection (1).

- For greater clarity, we added a new subsection (5) to provide an exemption from the dealer registration requirement, to reflect our expectation that inter-fund trades made in accordance with this section are not required to be made through a dealer. This exemption is necessary only in Ontario and Newfoundland and Labrador. Other jurisdictions can rely on the exemption in Regulation 45-106. New Commentary was added as new paragraph 3 to correspond with this change.

- For ease of reference, we added a new subsection (6) to specify that "dealer registration requirement" has the meaning ascribed to that term under National Instrument 14-101 *Definitions*.

- We also added to the Commentary as new paragraph 4 that this section sets out only the minimum conditions for inter-fund trades to proceed without regulatory exemptive relief, and that an IRC may consider as guidance any conditions imposed in prior exemptive relief orders when contemplating the appropriate terms and conditions of its approval.

6.2 Transactions in securities of related issuers

- For ease of reference, we added a new subsection (3) to specify that "mutual fund conflict of interest investment restrictions" has the meaning ascribed to that term under Regulation 81-102 respecting Mutual Funds. This was previously contained in the Commentary.

- We added a new paragraph 4 to the Commentary to clarify our expectation that if the IRC subsequently withdraws its approval for additional purchases under this section, the manager will consider whether continuing to hold such securities previously obtained is a conflict of interest matter under paragraph1.2(a). We also specified in the Commentary our view that the ongoing holding of securities bought in accordance with this section is not subject to paragraph 1.2(b).

Part 7 Exemptions

7.2 Existing exemptions, waivers or approvals

- We amended this section to provide greater clarity that any exemption that deals with the matters that this Regulation regulates will expire one year after the Regulation comes into force. We also amended the Commentary to state that we consider all exemptions – not just those that deal with matters under subsection 5.2(1) – to expire

one year after the Regulation comes into force, whether or not they contain a 'sunset' provision.

Part 8 Effective date

8.2 Transition

- We amended subsections (1) and (2) to provide a transition period for all investment funds, whether or not established before the date the Regulation comes into force.

- We further amended subsections (1) and (2) by deleting the requirements for the IRC to adopt a written charter within three months from the date the IRC is formed, and to have its policies and procedures in place and begin referrals to the IRC within six months from the date the IRC adopts its written charter. Instead, the Regulation now provides for a transition period ending on the earlier of the date the manager informs the securities regulatory authorities or regulator it intends to comply fully with the Regulation, or one year after the Regulation comes into force. The requirement for the manager to appoint the first members of the IRC six months after the Regulation comes into force remains.

- We added a new paragraph 3 to the Commentary to clarify our expectation that investment funds that wish to rely upon the Regulation before the one year transition period expires, must be in complete compliance with the Regulation.

- We added a new paragraph 4 to the Commentary to clarify our expectation that for investment funds established before the expiry of the transition period, the manager will establish policies and procedures on all ongoing conflict matters and refer such matters to the IRC before the end of the transition period.

- We also added a new paragraph 5 to the Commentary to clarify our view that we do not consider a manager's initial decision-making in the organization of an investment fund to be subject to IRC review, unless the manager's decisions give rise to conflicts of interest concerning the manager's obligations to existing investment funds within the manager's fund family. We also noted in the Commentary that we anticipate the manager will wish to engage the IRC early in the establishment of the investment fund to ensure the IRC is adequately informed of potential new conflicts of interest.

- We added a new paragraph 7 to the Commentary to clarify our expectation that any new disclosure obligations arising out of the Regulation will be incorporated as part of the investment fund's annual prospectus renewal or continuous disclosure filing following the expiry of the transition period.

- For greater clarity, we added a new paragraph 8 to the Commentary to articulate our view that section 5.1 of Regulation 81-102 is not intended to capture the costs associated with a fund's compliance with new regulatory requirements.

Appendix A to the Regulation

- For greater clarity, we added a new Appendix A to specifically list the provisions in securities legislation referred to in paragraph 1.2(b) Definition of "conflict of interest matter".

Appendix B to the Regulation

- For greater clarity, we added a new Appendix B to specifically list the inter-fund self-dealing conflict of interest provisions in the securities legislation referred to in section 1.5 Definition of "inter-fund self-dealing investment prohibitions".

Appendix A to the Commentary

- We moved the decision tree previously contained in Appendix B to the Notice accompanying the 2005 Proposal into Appendix A to the Commentary.

Consequential Amendments

Regulation 81-101

Form 81-101F1

- We revised the amendment to Item 5 of Part A of Form 81-101F1 so that it now refers to the diagram or table. We also added to the disclosure the requirement to set out the composition of the IRC.

- We revised the amendment to Item 8 of Part A of Form 81-101F1 to provide for alternative disclosure in the Part B if the information required by subsection 3.1 of Item 8 is not the same for each mutual fund.

- We revised the amendment to Item 4 of Part B of Form 81-101F1 so that it now refers to the diagram or table. We also added to the disclosure the requirement to set out the composition of the IRC.

- We added a new subparagraph (f)(iii) to Item 5 of Part B of Form 81-101F1 that requires disclosure of the amount of fees and expenses payable in connection with the IRC if this information is not contained in the table required by Item 8.1 of Part A.

Form 81-101F2

- We added a new paragraph 10.1(h) to Item 10 of Form 81-101F2 that requires a description of the administration of the oversight of the manager of the mutual fund by the IRC.

- We added a new subsection (6) to Item 11 of Form 81-101F2 that requires disclosure of voting or equity securities held by IRC members in the mutual fund, the manager or in any person or company that provides services to the mutual fund or the manager.

- We revised the amendment to Item 12 of Form 81-101F2 by adding a new instruction (2) that provides that if the fund has an IRC, state in the disclosure that Regulation 81-107 requires the manager to have policies and procedures relating to conflicts of interest.

- For consistency with current requirements, we revised the amendment to Item 15 of Form 81-101F2 to add paragraphs (a) and (b).

Regulation 81-102

Definition of "mutual fund conflict of interest investment restrictions"

- We revised the amendment to paragraphs (a), (c), (d) and (e) to ensure consistency with existing securities legislation.

Section 4.1 Prohibited Investments

- We revised the amendment to subsection 4.1(4) of Regulation 81-102 to provide that only an investment made during the 60 day period following the distribution is required to be made on a stock exchange.

- We revised the amendment to paragraph 4.1(4)(d) to clarify that the requirement to file the particulars of each investment made by the fund under this section is with reference to the fund's most recently completed financial year.

- For greater clarity, we added a new subsection (5) to specifically list – in new Appendix C to Regulation 81-102 – the provisions of the securities legislation that are also exempted if investments are made in accordance with subsection (4).

Section 4.2 Self Dealing

- We moved the amendment previously contained in this section that dealt with an exemption from the self-dealing prohibition in section 4.2 into section 4.3.

- For consistency, we revised the exemption to reflect the corresponding exemption for inter-fund trading in section 6.1 of Regulation 81-107.

Part 5 Fundamental Changes

- For greater clarity, we revised the amendment to subsection 5.3(2) of Regulation 81-102 to specify which provisions of section 5.6 we expect the mutual fund to comply with.

Policy Statement 81-102

- We revised the amendment to section 7.7 of the Policy Statement to clarify our expectation that the manager will include a description of the independent review committee's determination in the written notice referred to in subsection 5.4(2) of the Regulation.

Appendix C

- We created a new Appendix C – Provisions contained in Securities Legislation for the Purpose of Subsection 4.1(5) – Prohibited Investments to specifically list the provisions of the securities legislation that are also exempted if investments are made in accordance with subsection 4.1(4).

Regulation 81-106

- We added a new line item requirement to the Statement of Operations in section 3.2 for IRC fees.

Regulation 13-101

- We revised the amendment to Appendix A of Regulation 13-101 to conform to SEDAR requirements regarding title names.

Regulation 81-104

Section 9.2

- For consistency with the disclosure requirements under Regulation 81-101, we revised the amendment to subsection 9.2(p).

APPENDIX B

SUMMARY OF PUBLIC COMMENTS ON REGULATION 81-107
AND COMMENTARY

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Summary of Comments

Background

On May 27, 2005, the CSA published for comment Regulation 81-107 respecting Independent Review Committee for Investment Funds ("the Regulation" or "the 2005 Proposal"). The comment period expired on August 25, 2005. We received submissions from the 36 commenters listed at the end of this table.

We have considered all comments received and wish to thank all those who took the time to comment.

The questions contained in the CSA Notice to the 2005 Proposal ("the 2005 Notice") and the comments we received in response to them are summarized below. The items and headings below correspond to the items and headings in the 2005 Notice. Below the comments which respond to specific questions in the 2005 Notice, we have summarized the other comments we received on the 2005 Proposal.

1. The Regulation now applies to publicly offered investment funds.
An Expanded Scope **We request comment on the expanded scope of the Draft Regulation and particularly seek feedback from those industry participants not included in the 2004 Proposal – scholarship plans, labour-sponsored or venture capital funds, and closed-end funds and mutual funds that are listed and posted for trading on a stock exchange or quoted on an over the counter market.** **Specifically, we would like to understand what conflicts of interest could exist in the management of these investment funds, the anticipated costs the Regulation could have on these funds, whether there are additional practical considerations for each of these investment funds structures that we should address, and what other mechanisms or approaches the fund managers of these investment funds use today or could use to address any conflicts of interest.**
An Expanded Scope **We request comment on the expanded scope of the Draft Regulation and particularly seek feedback from those industry participants not included in the 2004 Proposal – scholarship plans, labour-sponsored or venture capital funds, and closed-end funds and mutual funds that are listed and posted for trading on a stock exchange or quoted on an over the counter market.** **Specifically, we would like to understand what conflicts of interest could exist in the management of these investment funds, the anticipated costs the Regulation could have on these funds, whether there are additional practical considerations for each of these investment funds structures that we should address, and what other mechanisms or approaches the fund managers of these investment funds use today or could use to address any conflicts of interest.**

Comments	*Responses*
General Comments ***Agree*** We received considerable support for broadening the Regulation to encompass all investment funds, including labour-sponsored funds and closed-end funds listed and posted for trading on stock exchanges. Commenters specifically supported the notion that there should be a level playing field among investment funds and they should be subject to the same oversight regimes. One commenter remarked that as alternative products become more popular, parity in regulatory regimes becomes increasingly important, and investors should be entitled to expect that similar products are regulated similarly. ***Disagree*** Some commenters continued to question whether there will be any substantial benefit to investors as a result of the Regulation. Most of these commenters told us that IRCs should only be mandatory for managers who wish to benefit from the relaxation of the conflict of interest prohibitions. ***Exchange Traded Funds*** A manager of a family of exchange-traded funds and closed-end funds noted that the Regulation provides an appropriate regime to address real conflicts and that there is not a principled basis for excluding exchange-traded funds from the application of the Regulation. One stock exchange supported the introduction of a minimum, consistent standard of governance for exchange-traded funds and investment funds as listed issuers.	***Response*** We continue to believe that conflicts of interest exist in the management of all publicly offered investment funds. Accordingly, we have maintained the expanded scope of the Regulation to include exchange traded funds, LSIFs, and scholarship plans.

We were told that if the fund is a listed entity, it will already have independent directors on the board.	We acknowledge that some funds that are listed on the TSX may have some independent directors in place under TSX requirements. We do not believe that these requirements serve as a substitute for the requirements contained in the Regulation. We note, however, that to the extent an exchange traded fund already has directors in place that are independent, it's possible that those directors could also be independent under the Regulation and able to serve on the fund's Independent Review Committee ("IRC"). The Commentary to the definition of independence sets out our view that, depending on the circumstances, independent or former independent members of the board of directors of an investment fund may be independent.
Two commenters, remarked that certain types of funds such as split-share corporations or closed-end commodity funds with a single investment should be completely excluded from the Regulation.	We continue to believe that it is appropriate for the Regulation to apply to these entities. These entities may possess business conflicts and often use related brokers. We expect, however, that these entities would possess relatively fewer conflicts resulting in fewer referrals to the IRC.
LSIFs Another commenter specifically welcomed the inclusion of LSIFs in the scope of the Regulation, where conflicts of interest (valuation issues) noted by the commenter have already exhibited themselves.	We agree and have maintained the expanded scope so that the Regulation applies to LSIFs.

One manager of LSIFs told us it is not necessary for LSIFs to have an independent IRC that is separate and distinct from the fund's Board of Directors, since the majority of board members of certain LSIFs have no affiliation with the fund.	We continue to believe that it is important to put in place a consistent governance regime that applies to all funds equally. As discussed above in connection with exchange traded funds, to the extent an LSIF's Board of Directors already possesses independent members, it's possible that such members could also be independent under the Regulation and capable of serving on the LSIF's IRC. The IRC does not necessarily have to be separate and distinct from the fund's Board of Directors so long as it meets the requirements of the Regulation.
Scholarship Plans One sponsor and dealer of certain scholarship plans told us that scholarship plans should be excluded from the application of the Regulation because as 'not-for-profit' entities, scholarship plans do not encounter the conflicts that arise in 'for profit' investment funds. This commenter expressed concern that the Regulation is not sufficiently flexible in recognizing the corporate structures of its scholarship plans. We were told that for scholarship plan dealers, a model which includes a strong, independent board of directors will prove more effective than the model outlined in the Regulation.	Despite being "not –for –profit" entities, we believe it is appropriate for the Regulation to apply to scholarship plans. The managers of these entities may possess conflicts of interest. For instance, the plan managers generally receive compensation and set fees in connection with their management of the plans on behalf of their investors. We have also encountered plans that use advisors that are controlled by plan directors. As discussed above, however, if a scholarship plan possesses independent directors already, some of these directors may also be eligible to serve on the plan's IRC so long as the directors meet the requirements of the Regulation.

Other Types of Funds This commenter suggested that segregated funds and hedge funds should also be included in the Regulation, while another commenter expressed concern that 'similar products' such as pooled funds, are not subject to the Regulation.	We do not possess the legislative authority to regulate segregated funds as they fall under the jurisdiction of the Insurance Act. The Joint Forum of Financial Market Regulators continues to discuss issues in connection with segregated funds. The Regulation will apply to hedge funds that are reporting issuers. Consistent with our regulatory regime, the Regulation will not apply to hedge funds that are sold under prospectus exemptions in securities legislation.
Still, another commenter asked that we specify whether income trusts are excluded or included in the Regulation.	The Regulation would not apply to income trusts that are the subject of National Policy 41-201 – Income Trusts and Other Indirect Offerings such as business income trusts. The Regulation does, however, apply to income trusts that are investment funds such as exchange traded and closed end funds.

Smaller Investment Funds **We request additional comment on the impact of including smaller investment funds in the Regulation.** **Specifically, we would like feedback on our view that, with fewer conflicts of interest to address, an IRC will be less costly for smaller funds. We also seek specific data on the anticipated costs of complying with the Regulation for small investment funds, relative to the other costs of the investment fund.** **We would also like to understand what commenters consider 'smaller' – is it a test based on the size of the investment fund? Or the fund manager? Or the number of investors in the investment fund?** **The BC Securities Commission has additional questions they would like to ask on this subject. These questions are in the local cover notice published in British Columbia.**	
Comments	***Responses***
Inclusion of Small Funds under the Regulation Many commenters were supportive of the inclusion in the Regulation of smaller investment funds, telling us that despite the size of the fund, there will always be conflicts of interest that arise which need to be the subject of IRC oversight and review. Another commenter specifically told us that the size of a fund or fund complex should not determine whether investors do or do not enjoy the protections afforded by IRCs. We were told that the focus should be on the needs of the investor, and not on the fund companies.	***Response*** We agree with the commenters. The Regulation continues to apply to smaller funds.

Two commenters suggested that any conflicts of interest faced by smaller fund complexes can be adequately dealt with at the level of the board of directors of the manager and by the independent directors of that board. One of these commenters told us that the powers conferred upon the IRC should be attributed to the board of directors of the manager who would in turn see to the application of the Regulation for funds with less than $25 million in assets. As an alternative, this commenter proposed that the Regulation allow companies having less than $500 million under management to establish an IRC only if they do not comply with Regulation 81-102. In this commenter's view, whether or not an IRC should be required for small companies should be determined in relation to the commercial activities they plan to undertake. Another commenter suggested that if the appointment of an IRC is considered appropriate in all cases, a two-tier set of compliance requirements should be set out in a manner similar to the size-based two-tier structure used for compliance by venture exchange issuers as compared to other issuers under Regulation 58-101 respecting *Disclosure of Corporate Governance Practices*.	We generally disagree that independent directors of a fund manager's board are an adequate substitute for the independence brought to bear by an IRC. Even independent directors of a fund manager are, or certainly have the potential to be, conflicted in instances where the fund manager's shareholders' interests conflict with those of the fund's unitholders. One exception, however, as explained in the Commentary could be "owner-operated" investment funds, sold exclusively to defined groups of investors, such as members of a trade or professional association or co-operative organization, who directly or indirectly, own the manager. In these investment funds, the CSA view the interests of the fund manager's shareholders and fund investors as aligned. We have concluded that some form of two-tier structure similar to that imposed upon non-investment fund operating businesses under Regulation 58-101 would be inappropriate for investment funds. We believe that the nature of conflicts faced in the management of investment funds differ from those of regular operating businesses. In addition, the lower tier issuers under Regulation 58-101 are more easily defined and subject to alternative regulatory requirements designed for smaller issuers under the auspices of the TSXV. From a policy perspective, we cannot rationalize a two-tiered system given our view that unitholders of both large and small funds should be equally protected under the Regulation.

Anticipated costs for 'smaller' investment funds One commenter remarked that just as financial capital requirements are prerequisites to participate in the investment business, governance 'capital' should also be an essential prerequisite for participating in the fund industry. A number of commenters, however, continued to express concern about the cost to smaller funds of complying with the Regulation.	We continue to believe that every mutual fund family, large or small, faces business conflicts of interest which can benefit from IRC oversight. While we are sensitive to the cost concerns of an IRC for small mutual funds, we believe that with no structural conflicts and fewer business conflicts (if the fund employs a largely outsourced structure) the mandate and administration of an IRC for a small mutual fund will be much less burdensome than larger fund complexes, and therefore, less costly. For example, we expect fewer meetings of the IRC. Further, the Regulation does not prevent investment funds from sharing an IRC with another investment fund manager. Managers of smaller families of investment funds may find this a cost-effective way to establish IRCs for their funds.
Defining "smaller" Four commenters provided us with submissions regarding how to define 'smaller' investment funds. The commenters suggested that we look to the following factors: asset size, number of unitholders, the size of the mutual fund complex (affiliation with other entities), and the number of funds managed by the manager. One commenter suggested a threshold of $25 million of investments, which has been acceptable for a Toronto Stock Exchange (TSX) listing, and a 300 public holder threshold, which is comparable to the minimum number of holders required for a TSX listing. Another commenter suggested that assets under management of $100 million or less may be appropriately considered 'small'.	We thank the commenters for their submissions. We have, however, decided that the Regulation will apply to smaller investment funds.

2. The Regulation will keep existing conflict of interest and self-dealing prohibitions in securities legislation, and exempt specified transactions with IRC approval.	
Keeping Existing Regulations **We request comment on this approach and the exemptive provisions in the Draft Regulation and consequential amendments to Regulation 81-102.** **Specifically, we would like feedback on whether the drafting of these provisions effectively captures the conflict of interest exemptions the CSA has granted to date, and whether the conditions accompanying the exemptions in the Draft Regulation and Regulation 81-102 are appropriate.** **The BC Securities Commission has additional questions they would like to ask on this subject. These questions are in the local cover notice published in British Columbia.**	
Comments	***Responses***
Our Approach to keeping existing Regulations We generally received support from commenters on our approach to allow for exemptions from the current conflict of interest Regulations where the IRC has given its approval, subject to ongoing monitoring of the manager's compliance with its policies on such transactions. ***Conflict of Interest Exemptions*** One commenter sought clarification on the following provisions which seemed to contradict the terms imposed by the CSA in recent exemptive relief orders.	***Response*** We agree with the commenters and will maintain the existing conflict of interest and self-dealing prohibitions in securities legislation and exempt specified transactions with IRC approval.

Purchases during a distribution and purchases of private placements would not be permitted under section 4.1 of Regulation 81-102 because such purchases would not be on a stock exchange.	Consistent with the exemptive relief the CSA has granted to date, we have amended section 4.1 of Regulation 81-102 to clarify that a dealer managed fund may purchase during the distribution period if the distribution is under a prospectus or during the 60 day period following the prospectus qualified distribution if the fund makes the purchase on an exchange on which the class of equity securities of the issuer is listed and traded. However, funds must continue to apply for discretionary exemptions in connection with purchases under a private placement.
Purchases of both new issues and private placements would not be permitted under section 6.2 of the Regulation because such purchases would not be on a stock exchange. Another commenter asked us to consider expanding section 6.2(2) of the Regulation to include other types of investments prohibited under the "mutual fund conflict of interest investment restrictions" securities regulators have previously provided exemptions from.	We do not propose any change to section 6.2 of the Regulation in response to the comment provided. The exemption is consistent with the exemptive relief the CSA has routinely granted. Other types of prohibited transactions with which we have less familiarity will continue to require exemptive relief to proceed.
One commenter submitted that the IRC should not be permitted to approve transactions prohibited by securities laws.	We continue to believe it is important to give fund managers some flexibility to engage in these types of transactions. Based on our own experiences with exemptive relief granted to date, we are comfortable that IRC oversight and approval can be effective in addressing the conflicts of interest in these types of transactions. The Regulation is also expected to contribute to more efficient Canadian capital markets, by permitting fund managers to engage in certain types of conflict of interest transactions without prior regulatory approval, provided the IRC approves.

3. The Regulation now provides the IRC with effective methods to oversee and report on manager conflicts of interest.	
We request comment on this approach.	
Comments	***Responses***
Reporting Requirements Generally Several commenters expressed support for the reporting requirements in the Regulation noting they are an integral part of improving governance in the fund industry. ***Materiality and Confidentiality of Reports*** One commenter suggested that the reporting provisions in sections 4.3, 4.4, and 4.5 of the Regulation should be subject to a 'materiality' standard , and that they maintain appropriate confidentiality.	***Response*** We agree with the commenters and continue to believe that the reporting requirements are necessary to address previous concerns regarding the IRC's lack of effectiveness. We have, however, amended some of the provisions regarding reporting to the securities regulatory authorities as described below to clarify our expectations. We have not imposed a materiality standard in connection with these reports for several reasons. First, the report prepared under section 4.3 is provided to the fund manager with a view to assisting it in improving its policies and procedures. Secondly, the reports prepared under sections 4.4 and 4.5 relate to conflict of interest matters which, by definition, incorporate a reasonable person standard. We also expect IRCs will exercise good judgment with respect to the reports that they will prepare under sections 4.3, 4.4, and 4.5. The report prepared under section 4.3 is provided to the fund manager only. We continue to believe that investors are entitled to the information contained in the report to securityholders prepared under section 4.4. The notification provided to securities regulatory authorities under section 4.5 is not required to be publicly filed.

IRC Reporting to Securities Regulators Many industry commenters expressed reservation about the provisions which allow the IRC to communicate with securities authorities. Others raised a concern with the broad wording of section 3.9(1)(e) given the fund manager's existing fiduciary duty, with one commenter suggesting IRC communication should only be done in exceptional circumstances where the IRC believes that the manager is in violation of securities regulations.	We expect it will be rare that an IRC feels compelled to exercise its authority to report directly to us and expect that IRC's will exercise good judgment in this regard. We have added further guidance in the Commentary regarding the use of this authority. We have, however, consistent with previous discretionary exemptions that we have granted, maintained the requirement in section 4.5 that the IRC notify us in writing if it is aware of an instance were the manager acted in a conflict of interest matter under subsection 5.2(1) but did not comply with a condition or conditions imposed by securities legislation or the independent review committee in its approval. We continue to believe that this notification is important as the conflict of interest matters in subsection 5.2(1) are fundamental self dealing provisions under securities legislation. We have clarified our expectations in this regard in the Commentary to section 4.5.
Reporting to Securityholders One commenter suggested that the Regulation give a fund manager the right to include its own statement in the IRC's annual report on why it did not follow any particular IRC recommendation. This would provide a fair and balanced perspective, remarked the commenter.	We don't believe that it is necessary for the fund manager to provide its own statement in the IRC's annual report for it to be fair and balanced. As discussed above, we expect that IRC's will exercise good judgment in the reports that they prepare. In addition, a fund manager remains free to provide its perspective in other disclosure documents if it so chooses.

4. The Regulation now specifies the key governance practices we expect of the IRC and the manager.	
We request comment on this approach. Specifically, we would like feedback on whether these provisions are best suited for the Draft Regulation or should be moved into the Commentary.	
Comments	***Responses***
General While some industry commenters supported the specificity on minimum governance practices expected of the IRC and the fund manager other commenters told us that it should be left to the IRC to determine which specific governance practices to adopt, based on its knowledge of and its working relationship with the manager. Another commenter asked that the Regulation provide additional guidance on how securities regulators generally view Commentary in the Regulation from a legal and enforcement perspective. We were told that such guidance would be invaluable to the IRC in formulating their mandate and defining the scope of their obligations.	***Response*** We continue to believe that it is appropriate to include some mandatory minimum governance practices in the Regulation. We believe this approach will create consistent minimum standards and practices among IRCs and fund managers, and will allow for a meaningful comparison by investors of investment funds. The Commentary may explain the implications of the Regulation, offer examples or indicate different ways to comply with the Regulation. It may expand on a particular subject without being exhaustive. The Commentary is not legally binding, but it does reflect the views of the CSA. The Commentary always appears in italic type and is titled “Commentary” in the Regulation.

IRC Self-Assessment One commenter who expressed support for requiring IRC members to perform a self-evaluation, asked that we consider specifying the factors and criteria that should be used in the evaluation.	We believe the Regulation already imposes the necessary minimum factors and criteria that the IRC should consider in conducting its self-assessment.
Still another commenter told us they have found individual directors tend not to give meaningful or critical feedback of other directors unless they are assured that their comments will be confidential. Accordingly, this commenter suggested that only summaries of the assessments be available to the manager and to securities regulators, and that the chair of the IRC have the obligation to summarize the assessments.	Other than imposing the minimum criteria and factors that the IRC should consider, the Regulation does not mandate the manner in which the IRC must conduct its self-assessment. Consequently, the commenter could organize a self-assessment in the manner described. The Commentary now specifies our expectation that the self-assessment should focus on both substantive and procedural aspects of the IRC's operation. It further specifies that a manager may choose to provide the IRC with feedback on its performance as part of the IRC's annual self-assessment process.
Yet, another commenter urged us to consider mandating public disclosure of self-assessments.	We believe that the self-assessment process will likely be more effective if we do not mandate that they be publicly disclosed.
Continuing Education Another commenter requested the Regulation mandate that the IRC consider the necessity of attending continuing education programs as a part of its mandate and annually thereafter. This determination, remarked the commenter, should be left to the IRC. Additionally, section 3.12 should be amended to make clear that the funds are permitted to bear the cost of this education.	Section 3.15 of the Regulation provides that the IRC may reasonably supplement the educational and informational programs provided to its members. We leave it to the IRC to consider whether it wishes to consider continuing education as part of its mandate. We have, however, revised this section to require both the manager and the IRC to provide new IRC members with an orientation to enable the member to understand the role of the IRC as a whole and the role of the individual member. Section 3.13 provides that the fund must pay all reasonable costs and expenses incurred in compliance with this Regulation.

5. The Regulation addresses the liability of IRC members.	
We request feedback on this approach.	
Comments	***Responses***
Limitation on Liability One commenter remarked that limiting the scope of the IRC's mandate may limit the IRC's corresponding fiduciary duty and duty of care. A few commenters remarked the scope of liability of IRC members still remains largely undefined. An existing IRC asked us to include in the Regulation a further statement of our intent that the only duties of the members of the IRC are the duties listed in the Regulation. This IRC went on to suggest some changes to the draft Commentary to address what appeared to them to be discrepancies with our stated intent. We were told by a few commenters that a lack of appropriate insurance for IRC members would likely discourage otherwise qualified candidates.	***Response*** We continue to believe, based upon the advice we received, that the Regulation appropriately limits the IRC's fiduciary duty and duty of care based upon the unique and limited role that it will serve. We are satisfied that the Regulation clearly specifies the requirements of the members of the IRC, including that the IRC is only required to consider conflict matters that the manager refers to it. Accordingly, we have not made any significant changes to the Regulation. The Commentary has been expanded to clarify that while the Regulation does not preclude the IRC and manager from agreeing to IRC functions additional to those prescribed by the Regulation, the Regulation does not regulate those additional functions. We continue to believe, based upon our review and consultations with the insurance industry, that insurance coverage will be available for IRC members at reasonable cost.

6. The Regulation preserves investor votes for changes to the 'commercial bargain'.	
We request comment on this approach. Specifically, we would like feedback on the drafting of the draft amendments to Part 5 of Regulation 81-102.	
Comments	***Responses***
Our Approach Industry commenters seemed generally supportive of the concept that a securityholder vote only be required for changes to a mutual fund that affect the 'commercial bargain' between unitholders and the manager.	***Response*** ***Our Approach*** We agree with the commenters and have not changed our approach in this regard. Consequently, we have not changed the exemptions provided from the requirement to obtain securityholder approval under Regulation 81-102 based upon IRC approval. Exemptions continue to be provided in connection with a change of auditor and a reorganization between affiliated mutual funds. Otherwise, funds must still obtain securityholder approval for the other changes contemplated under section 5.1 of Regulation 81-102.
However, two commenters remarked that the requirement of both an IRC recommendation and a securityholder vote is both time consuming and expensive and will provide no meaningful added investor protection in circumstances where securities legislation normally requires unitholder approval, such as an increase in fees. If the manager of a fund is able to convince unitholders that a fee increase is appropriate, that should be sufficient, remarked one commenter.	We continue to believe that the manager (and ultimately the investment fund and securityholders) can benefit from the independent perspective and input of an IRC on all decisions that have an inherent conflict of interest for the manager, including those decisions which are subject to a securityholder vote under Part 5 of Regulation 81-102. We do not believe that the requirement to obtain IRC input will be expensive or time-consuming.
One commenter told us that we must ensure that IRC approvals or recommendations do not interfere with pre-existing contractual rights of securityholders. For example, the Regulation should not restrict employees of a manager or its affiliates from voting or redeeming their units in in a related mutual fund.	The Regulation is not intended to restrict voting or redemption rights. We do not expect IRC approvals to interfere with pre-existing contractual rights of securityholders in the normal course.

Other Comments on the Regulation

General Comments	
Comments	***Responses***
Support for the Regulation Overall, there was support for the Regulation. For instance, many commenters told us that the Regulation is a step in the right direction of improving governance in the fund industry now, and that the IRC requirement will be an efficient form of 'citizen oversight' of funds affecting a wide range of investors. An investor advocate further noted that investment funds are a unique product in that there is a fundamental conflict between the fund sponsor and the small retail investor, the most vulnerable and trusting of all investor classes. One commenter remarked that the IRC was 'unique to Canada' and had much merit. Another commenter saw the IRC as a key building block for the supervision of investment funds stretching out years into the future. Still another commenter said that independent oversight will enhance public confidence in investing in mutual funds and other investment funds, and may assist fund managers in continuing to meet their fiduciary standard of care. Another commenter told us they understand the overall objectives and role securities regulators have contemplated for the IRC and they support enhanced investor protection through independent oversight.	***Response*** We acknowledge the support of the commenters.
Opposed Certain commenters who consider themselves 'smaller' investment funds told us that small funds do not face the structural conflicts contemplated by the Regulation. One of these commenters told us they believe it is contrary to the interests of their unitholders to require all fund companies to meet the onerous requirements of the Regulation when it is the minority of	We continue to believe that the Regulation should apply to smaller funds for the reasons discussed above in our response to the specific comments received regarding the inclusion of smaller funds.

fund companies who have structural conflicts and existing prohibitions already address concerns related to these conflicts. We were also told that the Regulation does not go far enough to recognize the merits of existing governance structures and regulations. For a few commenters, the IRC was seen as an additional and redundant layer of regulation in the context of existing controls. ***Cost Benefit Analysis*** Those unsupportive of the CBA told us that the true costs of operating an IRC remain to be seen. We were told that the cost of recruiting, retraining, and insuring IRC members as well as the costs of experts, and the time of IRC members and other employees, were not adequately addressed in the CBA. We heard that the estimated costs related to an IRC's services could be higher than those projected in the CBA. We also heard from commenters who remarked that it is self-evident that investors are best served by having some form of independent oversight of the funds, and they are unpersuaded that an extensive cost/benefit analysis is required to prove a need for revisions to the existing regulatory framework for fund governance.	As discussed above in our responses regarding the expanded scope of the Regulation, we continue to believe that is appropriate to implement consistent governance standards for all funds. We acknowledge that there will be costs associated with implementing the Regulation. We continue to believe, however, that there are inherent conflicts of interest in the management of smaller investment funds that will benefit from the independent perspective brought to bear on such matters to an IRC. As stated above, in our view, the scope of IRC review for most smaller investment funds (where there are no structural conflicts of interest and where there may be fewer business conflicts, especially if many functions have been outsourced) would be much less burdensome than for larger investment funds, and therefore, less costly. In other words, we perceive the cost burden will be proportionate to the benefit of an independent perspective on conflict of interest matters. We also note the Regulation does not preclude the creation of shared IRCs amongst smaller fund complexes as a means of reducing costs.

Section		*Comments*	*Responses*
Part 1	**Definitions and Application**		
Section 1.3	*Meaning of 'conflict of interest matter"*	The majority of commenters supported the Regulation's principles-based approach to defining conflicts of interest. ***A Materiality Test*** Many commenters urged us to include a 'materiality' or 'significance' threshold in the definition. We were told, there could be matters not sufficiently important or material to warrant referral to or consideration by the IRC. It could also cause micromanagement by the IRC, or review by the IRC of numerous immaterial events which will entail much cost and time dealing with 'de minimus' matters for no material benefit. ***Resolution in Favour of the Fund*** One commenter suggested that the definition should make clear that it excludes any matters that the manager chooses to resolve in favour of the investment fund.	***Response*** We agree with the commenters and, consequently, have maintained the Regulation's principles-based approach. We have not added a materiality threshold into the definition. This does not mean, however, that we expect every conflict of interest to be referred to the IRC. The definition already incorporates a reasonable person test that is designed to provide some limit to the types of conflicts we expect the manager to refer to the IRC. In addition, we have added Commentary to set out our view that we do not consider the reasonable person test to capture inconsequential matters. We have also communicated our expectation that the manager should look to industry best practices, among other factors, for guidance in identifying conflict of interest matters to be referred to the IRC. For greater certainty, we have amended the definition to specifically list – in new Appendix A to the Regulation – the provisions in securities legislation that could restrict or prohibit an investment fund, manager or an entity related to the manager from proceeding with a conflict matter. As discussed above, we expect fund managers and IRCs to exercise good judgment in assessing potential conflict of interest matters. We do not necessarily agree, however, that the matter should not be submitted to the

			IRC just because the manager believes it has already resolved the matter in favour of the investment fund. We expect that the fund manager would still put the matter before the IRC including its description of how it has resolved the matter.
		Need for Dialogue One commenter told us that the decision as to which matters are material or significant should be allowed to develop as a healthy dialogue between the manager and the IRC. Another commenter suggested that as standards evolve in this area over time, it would be helpful for the CSA to continue to communicate its thinking on conflicts. Still another commenter suggested that securities regulators create and oversee an investment fund industry sub-group.	We encourage both fund managers and IRCs to communicate with one another with the goal developing a mutual understanding of what constitutes a conflict of interest matter for their particular fund. We intend to continue to communicate our thinking on conflicts, but believe that managers are better placed to assess conflict of interest matters based upon their particular circumstances. We expect industry best practices to develop regarding what constitutes a conflict of interest matter.
		Perceived Conflicts Another commenter expressed concern that the definition appears to include perceived conflicts rather than actual conflicts in fact through the use of words such as 'may conflict' and 'may impact'.	We agree with the commenter that the definition includes perceived conflicts. This is our intent. It may be, however, that after referring the matter to the IRC that the IRC and fund manager agree that the matter is not actually a conflict that requires any further action by the manager.
		Original Setting of Management Fees One commenter asked us to explicitly state in Commentary whether we consider the original setting of management fees to be a conflict of interest which is reviewable by the IRC.	We do not consider a manager's initial decision-making in the organization of an investment fund to be subject to IRC review, unless the manager's decisions give rise to a conflict of interest concerning the manager's obligations to existing investment funds within the manager's fund family. However, we anticipate that the fund manager may wish to engage the IRC early in the establishment of the fund to ensure the IRC is adequately informed of potential new conflicts of interest. We have revised the Commentary accordingly.

		Portfolio Managers One commenter repeated their comment from the 2004 Proposal that any conflicts of interest experienced by portfolio managers are not conflicts of the manager. We were told the Regulation needs further clarity about how it applies to potential conflicts at a portfolio manager level. ***IRCs as Audit Committees*** Another commenter queried whether securities regulators intended for an IRC to act as an audit committee concerning the investment funds under its authority. This commenter further queried whether preparation of financial statements and liaising with auditors is a 'conflict of interest' matter.	We have amended the Commentary to clarify our view that the Regulation captures conflicts at the portfolio manager level (or conflicts of any other entity related to the manager captured by the Regulation) only in relation to decisions made on behalf of the fund that may affect or influence the manager's ability to make decisions in good faith and in the best interests of the fund. We expect managers to have knowledge of these conflicts. We have also provided some examples in the Commentary of potential conflict of interest matters at the portfolio manager level that may be caught by the definition of 'conflict of interest matter'. At a minimum, conflict of interest matters would include transactions that the portfolio manager is prohibited from proceeding with by a conflict of interest or self dealing prohibition in securities legislation. We do not intend for the IRC to act as an audit committee. Of course, it always depends on the nature of the particular relationships, but we would not expect the preparation of financial statements and liaising with the auditors to be a conflict of interest matter.
Section 1.4	*Meaning of 'entity related to the manager'*	A few commenters told us that the definition of an 'entity related to the manager' is very broad and potentially captures service providers, such as custodians and transfer agents.	***Response*** We have amended paragraph (b) of the definition by deleting reference to "agent'. We have also amended the Commentary by adding a statement regarding our view that the Regulation is not intended to capture conflicts of interest at the service provider level generally. Additional guidance has also been added on the types of entities that may be captured by the definition of 'entity related to the manager'. We have also amended a portion of the definition to capture a person or company who can 'materially affect' the direction of the management and

		Commenters who remarked on this section told us that it is inappropriate and not practical to require a fund manager to be aware of, and refer to the IRC, any conflicts experienced at a third party portfolio manager level.	polices of the manager or the investment fund. We refer to our response above under section 1.3 regarding portfolio managers.
Section 1.5	*Meaning of 'independent'*	***Principles Based Approach*** Those who commented were generally supportive of the Regulation's principles-based approach to defining 'independence'. Commenters also expressed support for the removal of the list of prescribed material relationships set out in the 2004 Proposal, noting the list was prescriptive and not focused on whether a person possesses an independent mindset and is able to act without influence. One commenter, however, said that the value of the principles-based definition has been undermined by the detail in the accompanying Commentary. This commenter suggested deleting the Commentary to allow the definition to speak for itself and to be interpreted, as appropriate, in different circumstances. ***Securityholders of the Fund or its Manager*** One commenter suggested we amend this section to clarify that the 'independence' of IRC members is with respect to the manager or an entity related to the manager, not in relation to the fund. We were told it must be possible to select members of the IRC among	***Response*** We acknowledge the support of the commenters and have maintained the principles-based approach. We have maintained the Commentary, but do not intend it to serve as a substitute for the exercise of judgment by managers and IRCs. We encourage managers and IRCs, as the Commentary suggests, to interpret the definition and the Regulation based upon their particular circumstances. We have amended the Commentary to further clarify our views regarding the types of individuals who may or may not meet the definition of independence. We believe there may be material relationships with the fund that interferes with an individual's ability to judge conflicts of interest. For example, an executive officer of a fund would not likely be independent for the purpose of serving on the IRC. While the Commentary specifies that a material relationship within the

		securityholders [of the fund] without, however, making it an obligation. Another commenter suggested that Commentary specify that share ownership by IRC members in the fund manager or its parent does not automatically 'taint' the independence of those individuals, but rather that the fund manager and the individual should determine whether or not it is material. An investor advocate told us they would not support any compensation scheme that provides IRC members with compensation in the form of company stock or options. ***Existing Independent Boards and IRCs*** One commenter remarked it is important to recognize that members of the industry have already established independent boards in anticipation of the eventual implementation of the Regulation. ***Representatives of the Fund Manager or its Affiliates*** Another commenter suggested that we include additional language in the Commentary to clarify that it will be permissible for funds to seed their initial IRC with former directors of the manager who otherwise satisfy the definition of 'independent'. We were also asked by a few commenters to again consider	definition of independence may include ownership, we continue to expect that only those relationships which might reasonably be perceived to interfere with the exercise of a member's independent judgment to be considered material. We believe that ownership of a fund's or manager's securities potentially raises difficult issues, but does not necessarily taint an IRC member's independence depending upon the circumstances. For instance, at one end of the spectrum would be an IRC member that holds a small amount of securities through a fully managed account. At the other end, would be an IRC member that holds a large number of securities directly. An IRC member should be careful not to put themselves in a position where their securityholdings can reasonably be seen to compromise their judgment regarding a conflict of interest matter. We have determined not to add this point specifically to the Commentary. We agree. The Commentary specifies that, depending on the circumstances, independent members of an existing advisory board or IRC may be independent for the purposes of the Regulation. We agree and have amended the Commentary to explicitly provide that, depending on the circumstances, former independent members of the manager's board of directors or special committee of the board of directors of the manager may be independent for the purposes of the Regulation. We do not agree that it is appropriate for existing independent board members of a fund manager to act as members of the IRC. These board

		permitting existing independent fund manager board members to act as members of the IRC.	members owe a duty to the fund manager's shareholders in addition to the fund's securityholders. We continue to believe there may be instances where these duties conflict such as, for example, where there are competing takeover bids for the manager that impact the fund's unitholders differently. The Commentary recognizes that former independent members of the manager's board may be eligible to serve on an IRC.
		Another commenter also asked us to permit representatives of the manager to serve as IRC members. Representatives will bring context to IRC meetings and in-depth experience with the day-to-day functioning of investment funds we were told.	We agree that manager representatives will add value to the IRC based upon their experience. We continue to believe, however, that it is inappropriate for representatives of the manager to serve as IRC members. We encourage manager representatives to work with the IRC. We have also revised the Regulation to permit manager representatives to be present during IRC determinations if the IRC so chooses.
		We were told by one commenter that the definition of 'independent' and the Commentary seem to preclude independent directors of a manager's subsidiary or affiliate from acting as members of the IRC for that manager's investment funds.	We continue to believe that it is inappropriate in most instances for the independent directors of a manager's subsidiary to act as a member of the IRC for the reason discussed above. Such a director still owes a duty to the subsidiary's shareholder which, in this case, would be the manager itself. This duty could conflict with the duty owed to the fund's securityholders.
		Directors of Trust Company Another commenter remarked that the definition of 'independence' seems to prohibit a fund manager from using the Board of Directors of a registered trust company as its IRC, if that trust company were related to the fund manager (even if the directors are independent within the meaning of trust company legislation). This commenter requested the definition provided in subsection 2.4(4) and its related Commentary found in the 2004 Proposal be put back in.	The Commentary continues to provide our view that, depending on the circumstances, independent members of the board of directors of a registered trust company that act as trustee for an investment fund may be independent. Where the trust company is related to the manager, we believe the circumstances become potentially more difficult. The manager and IRC must assess whether the IRC member's role with the trust company could be seen to reasonably interfere with their judgment regarding a conflict of interest matter.

		Prescribed Period Still another commenter reiterated their comment from the 2004 Proposal that we introduce the 'prescribed period' concept found in Regulation 52-110 respecting Audit Committees so that individuals would only be considered non-independent under the Regulation if they have or have had a specified relationship during the prescribed period that begins after the Regulation becomes final. **LSIFs** We were told that labour sponsored investment funds and labour sponsored venture capital corporations already have independent representation on their boards from labour unions and it was suggested that the Regulation reference the existence of these representatives under this section and under the nominating criteria of section 3.3. ***Disclosure*** Finally, it was suggested by one commenter that the basis for the determination of an IRC member's independence be disclosed in a fund's annual AIF and a cross-reference to this AIF disclosure should be included in the IRC's annual report to securityholders.	As previously stated, the Regulation now allows individuals with existing relationships with the investment fund, manager or an entity related to the manager (as defined in the Regulation) to act on the IRC, provided they meet the 'principles' based definition of independence. We recognize that the 'principles based definition of independence in the Regulation has the effect of potentially barring an individual's participation on an IRC for a relationship which extends beyond the previously prescribed 'cooling off' period. We consider this outcome appropriate. Please see our discussion regarding LSIFs in the Expanded Scope section above. We still believe that it is appropriate for LSIFs to have an IRC. To the extent, however, that an LSIF already has independent members on its board, it's possible that these board members can serve on the LSIF's IRC. The Commentary to the definition of independence provides that, depending on the circumstances, independent members of a fund's board of directors may be independent. We agree with the relevance of this disclosure. We have amended section 4.4 of the Regulation to require the IRC to provide in its report to securityholders a description of any relationship that may cause a reasonable person to question the member's independence, and the basis used by the IRC for determining that the member is independent.
Section 1.7	*Meaning of 'manager'*	A number of commenters expressed confusion that the Commentary to the definition of 'manager' suggests the possibility of there being	***Response*** We have amended the Commentary to delete the reference to circumstances meriting the designation of more than one person or

		more than one manager of the fund.	company as "manager". It was not our intention to suggest that there may be more than one manager of the fund. We have added examples in the Commentary of the types of managers the definition may capture. We have also specified in the Commentary, that we may examine a fund if it seems that it was structured to avoid the operation of the Regulation.
Part 2	**Functions of the Manager**		
Section 2.2	*Manager to have written policies and procedures*	One commenter requested more guidance on minimum standards for policies and procedures to be adopted by managers. Another commenter further recommended that similar Commentary to that found in section 4.1 be included here, and suggested that the following concepts are missing from this section of the Regulation: • a fund manager must consider the input of the IRC and its fiduciary obligations in finalizing its policies and procedures • thereafter, the fund manager must follow these policies and procedures in dealing with any conflict of interest, and • if the fund manager wishes to take a different action which is not permitted under its policies and procedures it must take this proposed action to the IRC for review and input .	***Response*** We have not added more guidance regarding appropriate minimum policies and procedures. We continue to believe that it should be left to the manager to create appropriate policies and procedures based upon its particular circumstances. We have made some of the changes suggested. For example, we have added a new subsection (2) to require the manager, in establishing its policies and procedures, to consider input of the IRC, if any. We have also articulated our expectation that if an unanticipated conflict of interest matter arises for which the manager does not have a policy and procedure, we expect the manager to bring the matter and its proposed action to the IRC for its review and input at the time the matter is referred to the IRC. We remain satisfied that the Regulation appropriately sets out the steps a fund manager must follow.
Section 2.3	*Manager to maintain records*	We were asked by one commenter to clarify in subsection 2.3(a) whose meetings are being referred to, the manager's meetings, those of the board of directors, the IRC, or others.	***Response*** We have revised the Commentary to clarify that a manager is expected to keep minutes only of any material discussions it has at meetings with the IRC or internally on matters subject to the review of the IRC.

		This commenter also suggested we add a requirement for a record of the actions taken by the manager in respect of a conflict matter referred to the IRC and questioned the reference to "investment fund' in Commentary 1.	We have revised the Commentary regarding our view that the requirement for the manager to maintain records would include the actions it takes in respect of a matter referred to the IRC. We have also deleted the reference to investment fund in Commentary 1.
Section 2.4	*Manager to provide assistance*	One commenter remarked that this section gives a manager broad discretion to provide whatever information it wants to the IRC. The assumption, we were told, is full, true and plain disclosure, but a manager could skew any particular results by giving a different tone to whatever information is produced or provided to the IRC. One commenter suggested we similarly add the manager's proposed policies and procedures to subparagraph 2.4(1)(a)(ii) . This same commenter also urged us to delete or to provide greater clarity in subsection 2.4(2) on when a manager would be considered to have 'prevented' or 'attempted to prevent' the IRC from communicating with securities regulators.	***Response*** We do not believe that the section provides a manager with the discretion to provide whatever information it wants. The obligation is to provide the IRC with information sufficient for the IRC to properly carry out its responsibilities. We expect that, consistent with their fiduciary duty and standard of care, fund managers will fulfill this obligation in good faith. We have made the suggested change. We do not believe that additional clarity is needed.
Part 3	**Independent Review Committee**		
Section 3.1	*Independent review committee for an investment*	***Sharing IRCs*** Responding to Commentary 2, some commenters told us that for competitive reasons, they do not believe IRC members will be shared	***Response*** We recognize that some fund managers will not want to share IRC members. We continue to believe, however, that fund managers should

	fund	amongst fund managers. ***Creation of IRCs by 'for profit' firms*** We were also told of concerns regarding the development of 'for profit firms' being created for the sole purpose of providing shared IRCs to smaller fund managers.	have sufficient flexibility to determine how best to structure their IRCs in a manner suitable to their funds and business operations. We consider that sharing IRCs may be appropriate where warranted by circumstances such as the size of the manager, the funds or fund families. We continue to believe that the final determination as to how IRCs should be structured, rests with the fund manager. This view is captured in the Commentary. As indicated in Commentary, we continue to believe that managers of smaller funds may find this option to be a cost-effective way of establishing IRCs for their funds. We believe that concerns regarding for profit IRCs and their members are addressed through the minimum standards set out in the Regulation regarding, for instance, nominating criteria and composition. We also expect that concerns regarding the quality of IRC members will be addressed through the manager and IRC's initial orientation of IRC members mandated by the Regulation and through ongoing education and training. The Commentary expresses our view that the Regulation does not prevent a third party from establishing an IRC or IRCs for investment funds. Any IRC must comply fully with the Regulation.
Section 3.2	*Initial appointment*	***Reappointment of existing IRCs*** One commenter remarked this section is drafted as if no existing fund complex has an IRC. We were told this section should reflect that these managers are not required to 'reappoint' these members.	***Response*** We recognize that certain fund complexes already have existing IRCs in place. However, we expect a manager to turn their mind to appointing an IRC which complies with this Regulation. If an investment fund has an existing oversight body that complies with this Regulation, we expect the

			manager will appoint these members as the first IRC under the Regulation if they choose.
		We were also told that this section should also recognize that for some governance agencies, such as a board of directors of a registered trust company, the fund manager will have no ability to reappoint an IRC.	A manager must appoint the fund's first IRC and the IRCs must have the ability to appoint vacancies. We expect a manager to choose an IRC which will have the ability to comply with the Regulation.
		Appointment of IRCs Two commenters remarked they believe the fund manager should be responsible for the appointment of all IRC members, not just initial members as indicated in this section. The commenters understood the concerns of an appearance of bias, but they believe that the ability of the manager to appoint IRC members will serve as a check and balance and ensure a dysfunctional IRC cannot perpetuate itself indefinitely.	We continue to believe that IRC appointment of members on an ongoing basis (after initial appointment by the manager) is the best way to foster an independently-minded IRC. The Regulation, however, specifies that the IRC must consider the recommendations of the manager when filling a vacancy on the IRC or when reappointing a member of the IRC.
		We heard from another commenter who considered the ability of the manager to appoint even the initial IRC undermines its 'independence'. It was recognized, however, that in the absence of any mandatory appointments by securities regulators, there really is no other way.	As discussed under section 3.6, in response to hearing that there should be a 'check and balance' on IRC appointments, we have imposed a maximum term limit on IRC members. This term limit may only be extended upon agreement of the IRC and the manager.
Section 3.3	*Nominating criteria*	One commenter recommended that a fund's AIF include disclosure relating to the competencies and experience of IRC members.	***Response*** We continue to believe that our requirements to disclose the names and composition of the IRC are sufficient.
Section 3.4	*Written charter*		

		Further guidance and separate charters It was suggested by one commenter that we remove in the Commentary the securities regulators' expectation that there will be separate charters for each fund family. This commenter remarked it is likely that there will be greater differences across funds within a fund family rather than across fund families. Another commenter requested that we provide more guidance on the items which should be included in the IRC's charter. ***Broader mandate of the IRC*** Still another commenter recommended that the Regulation or the Commentary be revised to clarify that any role the IRC and the manager agree upon that is in addition to the role mandated by the Regulation, is not subject to the Regulation. It was suggested that Commentary similar to paragraph 3 of section 2.5 of the 2004 Proposal be reintroduced. Without this assurance, this commenter told us a fund complex or IRC member may be loathe to take on any roles additional to those prescribed by the Regulation. The commenter also urged us to provide further clarity on the meaning of the fourth bullet point in Commentary 3. ***Disclosure of charter*** Finally, one commenter suggested that the IRC's charter should be posted on a fund's website and disclosed in a fund's AIF to increase	***Response*** We have removed our expectation of separate charters for each fund family from the Commentary. Although such arrangements are not precluded by the Regulation, we have revised the Commentary to clarify that the Regulation permits, but does not require, separate charters for each fund family should a manager so choose. We have added further guidance in the Commentary regarding what should be included in the IRC's charter. For example, the Commentary now sets out our expectation that the written charter include a policy relating to IRC member ownership of units of the investment fund, manager, or any person or company that provides services to the mutual fund or the manager. We continue to believe, however, that the IRC should determine what to include in its charter based upon its particular circumstances. As noted under our discussion on liability, we have revised the Commentary to specify that while the Regulation does not preclude the IRC and manager from agreeing to IRC functions additional to those prescribed by the Regulation, the Regulation does not regulate those additional functions. We have revised the fourth bullet point in Commentary 3 to provide greater clarity. A summary of the IRC's mandate must be disclosed in an investment fund's prospectus. We consider this disclosure to be sufficient.

		transparency of the IRC's mandate and functions. Conflict of interest matters identified by the manager to be reviewed by the IRC in the normal course should also be disclosed in the IRC charter, remarked this commenter.	
Section 3.5	*Composition*	Commenters who responded were generally supportive of the Regulatio flexibility in allowing fund managers to determine how best to structure their IRCs. ***Responsibility of IRC chair*** Two commenters expressed concern about our expectations for the duties of an IRC chair outlined in paragraph 2 of the Commentary.	***Response*** We agree with commenters who concurred with the need for flexibility in the Regulation to allow managers to determine how to structure their IRCs. We continue to believe that the chair's responsibilities are appropriate within the context of the IRC's functions. We have, however, provided additional guidance regarding our view of the chair's responsibilities. In addition, we remind the commenters that responsibility for identifying and referring conflict of interest matters to the IRC rests with the manager, not IRC chair.
Section 3.6	*Term of Office and Vacancies*	***Term of office*** One commenter expressed their preference for more flexibility in the term of office because they elect directors for their mutual funds organized as corporations on an annual basis, and it is administratively easier if the terms can be consistent. ***Self-Perpetuating IRC*** Another commenter urged us to reconsider the potential development of self-perpetuating IRCs or entrenched boards.	***Response*** For greater clarity, we separated the provisions in the Regulation regarding vacancies and terms of office. We have revised this section to specify a minimum term of 1 year and a maximum term of 3 years. We reiterate our view that we consider self-selection of IRC members to be the most appropriate way to foster an independently-minded IRC. We

			were, however, persuaded by requests for manager input into the selection process for IRC members and concerns about an ineffective, entrenched IRC. Accordingly, the Regulation now requires the IRC to consider manager recommendations, if any, when filling a vacancy on the IRC or when reappointing a member of the IRC. In addition, the Regulation now specifies a maximum term limit for IRC members of 6 years on an investment fund's IRC, with reappointments beyond the maximum term only by agreement of the IRC and the manager. We consider the maximum term limit will enhance the independence and effectiveness of IRCs.
Section 3.7	*Standard of care*	A few commenters, among them an existing IRC, told us that the Commentary should include a clear statement that the only duties that are subject to the Regulation are the duties listed. One commenter remarked thisseemed consistent with our intent to limit IRC member liability. Another commenter recommended that the Commentary be modified to articulate what common law defences the securities regulators believe are available to IRC members. ***Limiting Liability*** Two commenters told us there should be a limit on the liability of IRC members to take into account the limited scope of their role.	***Response*** We are satisfied the Regulation clearly sets out the role of the IRC. We do not consider it appropriate to specify what defences should be applied to IRC members in the normal course. The successful use of these defences rests ultimately with the courts and judicial process. In response to concerns raised about the potential unlimited liability of IRC members, we retained legal counsel to provide us with advice on this issue. Based on this advice, the 2005 Proposal was revised to emphasize the limited scope of the IRC's mandate which in turn should limit the

		Liability and Standard of Care One of these commenters said they do not believe IRC members who are not corporate directors should be subject to the same liability as corporate directors when they do not have the same scope or the same duties.	IRC's corresponding fiduciary duty and duty of care. We were advised that by clarifying in the Regulation the very specific functions, duties and obligations of the IRC, we will have clarified that the IRC has a very limited role, particularly as compared to the role of corporate directors. We were also advised that the inclusion of a fiduciary duty and duty of care as well as language that mirrors certain defence provisions in corporate law statutes should serve to provide guidance to insurers and to the courts as to how we view the IRC's role. We agree with the commenter and continue to believe that to the extent the Regulation imposes liability on IRC members, that liability is commensurate with the narrow mandate of the IRC to review conflicts of interest. In accordance with the legal advice we received, an IRC member's exposure to liability in connection with the responsibilities mandated in the Regulation is limited, when compared with the exposure to liability of a corporate director. Also, the protection available to an IRC member under the Regulation with respect to the discharge of those responsibilities is no less than that available to a corporate director. We are satisfied that subsections (3) and (4) in this section provide guidance on how an IRC member meets the standard of care.
Section 3.8	*Ceasing to be a member*	Among the causes in subsection (3) that require IRC members to cease from continuing their membership, we were asked by one commenter to add when a member becomes subject to regulatory or criminal sanctions.	***Response*** We have added additional causes to subsection (3), among them, when a member is subject to penalties or sanctions made by a court related to securities legislation.

		Another commenter strongly recommended that the Regulation permit fund manager to remove an IRC member if that member becomes a member of an IRC for another fund complex. It should be permissive, we were told, but we should be sensitive to competition in the fund industry. This commenter also recommended we redraft subsection (3) to give the fund manager the ability to decide whether it believes an individual is no longer 'independent' and therefore can remove and replace that member. The manager, we were told, should have this responsibility and right. The commenter also remarked they did not see the necessity in 3(a) for the words "and the cause of the non-independence is not temporary..." since the test for independence is sufficiently clear and principles-based that either one is independent or one is not. ***Notification of changes in IRC membership*** Finally, this commenter reiterated their query made in the 2004 Proposal asking us to clarify why securities regulators want notification when an individual ceases to be an IRC member in certain circumstances. ***Change of manager*** Another commenter told us if the IRC is truly 'independent', a change manager or a change in control of manager should not necessitate a change in IRC membership or composition. Accordingly,	We disagree with the commenter. The manager already has the ability to remove an IRC member. We have, however, revised the Regulation to require the IRC to disclose in its report to securityholders the name of any other fund family on whose IRC the member serves. We consider that whether an IRC member is independent under the Regulation is a matter of fact. We note that a fund manager retains the right to remove an IRC member by securityholder vote. Accordingly, we have not revised the Regulation. We have, however, amended section 4.4 of the Regulation to require the IRC to provide in its report to securityholders a description of any relationship that may cause a reasonable person to question the member's independence. We disagree with the commenter. Newly named paragraph 3.10(3)(a) is intended to exclude a situation where a member may in fact, or be perceived to face, a conflict of interest with respect to a specific (one-time) conflict of interest matter being considered by the IRC. As previously stated, we believe that the resignation, removal or disqualification of one or more IRC members may be an early warning sign of a larger, more systemic problem with the IRC or manager. Upon receipt and review of such information, our intention is to determine if further follow-up with the IRC or manager is warranted. We consider this approach to be consistent with the CSA's increasing emphasis on continuous disclosure and compliance reviews. A change in manager could result in changes to the fund's operations, policies, and procedures. Consequently, we continue to believe that it makes sense for the new manager to set its mind to the role of the IRC.

		section 3.8(1)(f) and section 3.8(1)(g) should be removed.	We specify in the Commentary, however, that the new manager is not precluded from appointing members of an IRC used by the previous manager.
Section 3.9	*Authority*	***Communication with regulators*** A number of commenters expressed concern that the authority conferred by subsection (1)(e) for IRC members to communicate directly with securities regulators was too broad and potentially expanded the IRC's duties. ***Manager communications with regulators*** One commenter suggested that the Regulation should allow a manager communicate with securities regulators regarding the IRC. We were told that the Regulation should provide a mechanism for a manager to have recourse in the event that an IRC is not functioning effectively or is making decisions that are contrary to the best interests of either the funds or its investors. ***Searching out conflicts of interest*** Other commenters asked that additional clarity be added to indicate that the IRC is not responsible for making business and operational decisions of the manager and that the IRC has no duty to seek out potential conflict of interest matters. Yet, we also heard from an investor advocate who urged that an IRC be responsible for proactively searching out and reviewing conflict of interest matters, and not simply rely on the manager to bring conflict matters to it	***Response*** We continue to believe that an IRC should be able to communicate with securities regulators. We have added guidance in the Commentary to specify, however, that the IRC has no obligation to report matters other than those prescribed by this Regulation or elsewhere in securities legislation. We have revised the Commentary to specify that the Regulation does not prohibit the manager from communicating with securities regulators with respect to any matter. We are satisfied that the ability of the manager to remove an IRC member by vote at a securityholder meeting is sufficient recourse for the manager. Section 5.1 of the Regulation specifies that the manager is responsible for referring conflict matters to the IRC for its review. While we expect the IRC to bring a high degree of rigor and objectivity to its review of conflict of interest matters, we do not consider it to be the role of the IRC to second-guess the investment or business decisions of the manager or entity related to the manager. The Commentary has been revised to reflect this view.

		for review. ***Compensation and Experts*** Several commenters continued to express concern regarding the IRC's ability to set its own compensation. One commenter suggested that we revise subsection (d) to state that the IRC must take into account the manager's recommendations in setting its compensation. ***Experts and external counsel*** We were told that the Regulation should state that appropriate use of external counsel or other advisors should only be for specific items where the IRC determines the need for independent advice in warranted circumstances. Other commenters told us that the manager should have the power to set a limit on costs that can be incurred by the IRC. In cases where the IRC would propose to exceed this limit, the board of directors of manager should decide whether such costs are appropriate.	In response to comments, we have revised the Regulation to require the manager to set the initial compensation of the IRC. The IRC, going forward, is then expected to set its own compensation. The Regulation now also specifies that the IRC, in setting its compensation, must consider its most recent assessment of its compensation and the manager's recommendations, if any. The Regulation continues to require the IRC to disclose in its report to securityholders if in setting its compensation, it has not followed the recommendation of the manager and its reasons. The IRC report now additionally requires the IRC to describe the process and criteria it has used to determine its level of compensation. We continue to believe that an effective IRC must have at its disposal all of the tools necessary to assist the IRC in fulfilling its mandate under the Regulation. This includes the authority to hire experts and independent counsel as required to assist the IRC in making its determinations on conflict matters. It is not our expectation, however, that an IRC will routinely use external counsel or other advisors. We have revised the Commentary to clarify our expectation that independent advisors will be used selectively and only to assist, not replace, IRC decision-making. We continue to believe that a manager should not have the power to set limits on costs. We expect IRCs to conduct themselves consistent with the standard of care imposed by the Regulation.

		Other An additional item one commenter recommended we add to section 3.9 was to give the IRC the right to terminate a manager if it demonstrates gross incompetence, consistently underperforms the benchmark or peers, consistently fails to follow the fund's stated investment policy, or charges excessive fees. This commenter also asked that we clarify whether the IRC will have unimpeded access to internal audits, client complaint summaries, external auditors, and fund compliance officers in the performance of duties. We were also asked to clarify whether loans to or from related parties will be part of IRC oversight. ***Delegation by IRC*** Other commenters reiterated their comments from the 2004 Proposal that we expressly authorize an IRC to delegate defined responsibilities to a sub-committee of at least three members. This approach is consistent with corporate statutes, we were told, and is needed to allow the committee not to require the 'full' IRC's approval.	We do not propose to give the IRC the ability to terminate the manager. We consider the choice of manager to be an integral part of an investor's decision in purchasing an investment fund, and accordingly, do not believe that the IRC should have this authority. The Regulation specifies that a manager must provide the IRC with any assistance it reasonably requests in its review of matters referred to it. IRC oversight could extend to loans to or from related parties if they are conflict of interest matters, as defined in the Regulation. We were persuaded by this comment. Accordingly, we have revised the Regulation to expressly permit an IRC composed of more than three members to delegate any function to one or more committees of at least three members of the IRC, except for the removal of a member of the IRC. The Commentary has been amended to specify that despite any delegation, the IRC remains responsible for all functions delegated under the Regulation.
Section 3.10	*Fees and expenses to be*		***Response*** ***Allocation of Costs to Funds***

	paid by the investment fund	One commenter remarked that this section appears to assume all IRC costs will be paid for by one fund. We were asked to redraft this section to require fund managers to equitably and reasonably allocate IRC costs amongst the funds under an IRC's authority. While one commenter asked that the Regulation provide an exemption from the unitholder approval requirement for an increase in fees which result solely from complying with the Regulation, another commenter acknowledged our earlier response to this question, and urged us to include the response in the Commentary to this section to provide future clarity and guidance. ***Disclosure*** One commenter disagreed that there be disclosure in a fund's prospectus of whether or not a manager reimburses the fund for fees and expenses payable to the IRC. They said the current MER waiver disclosure that is already required is sufficient. ***Other*** One commenter told us that the manager should have the power to set a limit on costs that can be incurred by the IRC. In cases where the IRC proposes to exceed this limit, it should be up to the board of directors of the manager to decide whether those costs are appropriate, remarked this commenter.	We have revised the Commentary to set out our expectation that we expect a manager to allocate costs associated with its IRC on an equitable and reasonable basis amongst the investment funds for which the IRC acts. We have also clarified in the Commentary our view about what IRC costs may appropriately be charged to the investment fund. As we previously responded, we do not consider the expenses incurred by the introduction of the IRC in the Regulation to be caught by section 5.1 of Regulation 81-102. Our view is that the purpose of section 5.1 is not to capture the costs associated with compliance by an investment fund of new regulatory requirements. We have articulated this guidance in the Commentary to the transition section of the Regulation. We disagree with the commenter. We believe prospectus disclosure of how IRC fees and expenses are paid is important. We disagree with the commenter. We do not believe that the right of a manager to limit costs incurred by the IRC is consistent with the role of the IRC as an independent body.
Section 3.11	*Indemnification and insurance*	A few commenters told us not to regulate the form of indemnity or the payment of premiums the fund manager wishes to provide IRC members.	***Response*** Consistent with the legal advice provided to us, we have drafted this section in a way that is analogous to the CBCA to message that it be interpreted in a way parallel to the provisions in the CBCA. We have

		One of these commenters recommended that further analysis and consideration be given to how a claim under an indemnification obligation should be worked into a daily NAV calculation for an investment fund.	provided additional guidance in Commentary regarding indemnification of IRC members. Upon review, we would expect a claim for indemnity to be accounted for using appropriate accounting principles.
Part 4	**Functions of Independent Review Committee**		
Section 4.1	*Review of matters referred by manager*	***Deliberating and Deciding in the Absence of Management*** A number of commenters expressed concern at the requirement in subsection 4.1(3) requiring the IRC to make decisions in the absence of any manager or any entity related to the manager. ***Annual meeting in absence of manager*** One industry commenter agreed with the requirement for the IRC to hold at least one meeting annually in the absence of management. In fact, this commenter suggested we consider requiring more than one meeting, in order to promote trust, good group dynamics, and familiarity amongst IRC members and with the business of the funds. ***Taking minutes***	***Response*** We agree with commenters who told us that the IRC should have discretion to determine whether representatives of the manager should be present when the IRC deliberates. The Regulation has been amended accordingly. Consistent with governance principles, the Regulation continues to mandate at least one annual meeting of the IRC in the absence of the manager. We have clarified in Commentary that a portion of any IRC meeting without the presence of the manager will satisfy this requirement.

		Still other commenters expressed concern over who would be responsible for taking minutes at these 'in camera' IRC meetings. Another commenter asked us to consider whether the manager will be prohibited from viewing the minutes of the 'confidential' meeting described in subsection (5). ***Other*** One commenter suggested we delete subsection 2(b) noting that it would be a backward step for the Regulation to mandate an IRC to 'perform other functions as may be agreed in writing'.	The Commentary to section 4.6 now clarifies that we expect an IRC to keep minutes only of any material discussions it has at meetings with the manager or internally on matters subject to its review. The Regulation does not require, nor does it prevent, the IRC from sharing these minutes with the manager. We agree and have deleted this subsection. As noted, the Commentary specifies that while the Regulation does not preclude the IRC and manager from agreeing to IRC functions additional to those prescribed by the Regulation, the Regulation does not regulate those functions.
Section 4.2	*Regular Assessments*	While one commenter strongly urged us to consider requiring public disclosure of committee self-assessments, another commenter told us that individual directors tend not to give meaningful or critical feedback of other directors unless they are assured their comments will be confidential. ***Frequency of Assessments*** One commenter also asked that we clarify 4.2 to remove any doubt about whether the IRC has a duty to consider further assessments and requirements beyond the 'minimum' assessments referred to in this section and its Commentary.	***Response*** We continue to believe that IRC self-assessments should be confidential. We propose no change. An IRC is required to perform only those functions set out in the Regulation. The Commentary continues to provide that subject to the minimum requirements of the Regulation the IRC may establish a process for, and determine the frequency of, additional assessments as it sees fit.
Section 4.3	*Reporting to manager*	One commenter recommended that the words "or it suspects" be deleted as they are uncertain or vague.	***Response*** We agree, and have amended this section accordingly.

Section 4.4	*Reporting to securityholders*	One commenter remarked that as drafted, a fund complex with funds with March 31, June 30, September 30 and December 31 year ends, would require the funds' IRC to prepare four sets of annual reports, not likely the intention. Another commenter suggested that a manager should be permitted to draft its own response as to why it did not follow IRC recommendations for inclusion in the report to securityholders. This will allow for a fair and balanced perspective in reporting, we were told. ***Disclosure of membership on multiple IRCs*** It was also suggested by a commenter that the Regulation require disclosure of all other IRCs that each member is also a member of. Disclosure of this kind would be consistent with similar disclosure required under Form 58-101F1 *Corporate Governance Disclosure* of Regulation 58-101 respecting *Disclosure of Corporate Governance Practices.*	***Response*** We acknowledge that if different funds within the same fund complex possess the same IRC, but different financial year ends, an IRC may have to prepare more than one report. This outcome is no different than other financial reporting requirements for this fund complex. The Regulation does not prohibit a manager from responding in one of its disclosure documents to the IRC's report if it chooses. We continue to believe, however, that the IRC's report to securityholders should be prepared by the IRC only. We agree with the commenter. We have revised the Regulation to mandate this disclosure in the IRC's report to securityholders.
Section 4.5	*Reporting to securities regulatory authorities*	***Materiality*** A number of commenters expressed reservations about the requirement for the IRC to report to securities regulators. Some told us to include a 'materiality' concept in the IRC's reporting obligations under this section.	***Response*** We continue to believe, based upon our experience with the discretionary exemptions that we have granted to date in connection with the conflict of interest matters under subsection 5.2(1), that a materiality threshold is neither necessary nor appropriate. The Commentary provides guidance regarding our expectations on such reporting. IRC reports to securities regulators are not required to be publicly filed.

		Disclosure One commenter asked us to specify whether or not IRC reports to securities regulators will be made public. Two other commenters asked us to redraft the section to clarify the steps an IRC must take before reporting to securities regulators. For example, one commenter queried whether the IRC should carry out a review or investigation in appropriate cases. ***Manager right to communicate with regulators*** Still other commenters told us that the section should give managers the right to communicate with securities regulators about their IRCs.	We do not expect the IRC to conduct an investigation once they become aware of a breach under this section, only to report to securities regulators. The Commentary now specifies that if known, we expect the IRC to include in its report the steps the manager proposes to take or has taken to remedy the breach in each instance. We agree that the manager should have the right to communicate with regulators about their IRCs. The Regulation does not prohibit such communications between the manager and securities regulators with respect to any matter. We have clarified this point in the Commentary.
Part 5	***Conflict of Interest Matters***		
Section 5.1	*Manager to Refer conflict of interest matters to Independent review committee*	We heard from some commenters that we should include a 'materiality component in this section. One commenter noted that the process of having to seek IRC review and obtain IRC approval or recommendation could cause a manager to the opportunity to participate in a time-sensitive transaction.	***Response*** We do not believe a materiality standard is necessary. The definition of a conflict of interest matter already incorporates a reasonable person test that is designed to provide some limit to the types of conflicts we expect the manager to refer to the IRC. We believe the Regulation addresses time-sensitive matters by permitting the IRC to provide the manager with standing instructions.

		One commenter remarked that this section appears to suggest the fund manager will be regularly taking unique matters to the IRC that have not been dealt with via a conflicts policy and procedure. It also appears to suggest that a fund manager would be required to take each conflict matter to the IRC before taking any action, even though it proposes to follow its policies and procedures in managing that conflict of interest.	We expect unique matters to be referred to the IRC and have revised the Commentary to clarify this view. However, we also expect the IRC will give standing instructions in many instances to facilitate timely decisions by the manager that are in the best interests of the fund.
Section 5.2	*Matters Requiring independent review committee approval*	Commenters on this section focused on the test in subsection (2). One commenter asked why securities regulators care if a manager is free from influence as required in (2)(a) or is uninfluenced as required (2)(b) as the IRC must decide whether the manager's proposal will achieve a fair and reasonable result under (2)(d). Another commenter remarked that the IRC will be able to arrive at the first three criteria found in 5.2(2)(a)(b) and (c), as these determinations mostly concern procedure. Other commenters expressed concern with the IRC making a determination as to whether an action achieves a fair and reasonable result for the fund as required by (2)(d). ***Short Selling*** Finally, one commenter asked that we clarify whether transactions involving short-selling are captured under this section.	***Response*** We continue to believe that the conditions in subsection (2) are appropriate based upon our experience with the discretionary exemptions that we have granted to date. This section does not capture short-selling transactions in and of themselves. Short-selling transactions would be captured, however, if they are one of the conflict of interest matters cited in section 5.2(1).
Section 5.3	*Matters subject to*	***Notice Requirements***	***Response***

	independent review committee recommendation	One commenter asked that the Regulation provide greater flexibility to the IRC on the notice which it may require under (2) and (3) of this section, for example, so that the IRC may reduce the time period if it determines that notice by press release is sufficient. This commenter also asked that we clarify that the scope of the Regulation as it relates to the 'recommendation' category of conflicts of interest for third party portfolio advisors, is the conflicts the portfolio advisor has with the manager or its affiliates. Another commenter remarked that a fund manager should not be permitted to proceed with a proposed course of action if the IRC has provided a negative recommendation, unless the manager has obtained unitholder approval, ratherthan only notify securityholders.	We believe that if the IRC determines immediate notice to be appropriate, that notice should be a mailing similar to other notice requirements in securities legislation. As previously noted, the Commentary has been amended to clarify our view that the Regulation captures conflicts at the portfolio manager level only in relation to decisions made on behalf of the fund that may affect or influence the manager's ability to act in good faith and in the best interests of the fund. We have also provided some examples in Commentary of potential conflict of interest matters at the portfolio manager level. We continue to be satisfied that IRC notification – whether immediate or in its report to securityholders – is an appropriate response to a manager proceeding with an action despite the negative recommendation of the IRC. The Regulation reinforces that the manager remains ultimately responsible to make decisions in the best interests of the fund.
Section 5.4	*Standing instructions by the independent review committee*	Most commenters responded positively to the ability of the IRC to issue standing instructions. Yet, we also heard from an investor advocate who expressed concern that standing instructions will in effect, become 'entrenched' relief subject to conditions that may differ across IRCs. ***'Good until cancelled'*** A few commenters remarked subsection (3)(b) does not allow a fund	***Response*** We believe that the ability of the IRC to give standing instructions appropriately provides managers with greater flexibility to make timely investment decisions that are in the best interests of the fund (and ultimately investors). The Regulation requires the IRC to review and assess the adequacy and effectiveness of standing instructions at least annually. We agree with those commenters who asked that we clarify whether a

		manager to continue to follow standing instructions during the time of the IRC's regular assessment of these standing instructions. They further suggested such standing instructions be good until cancelled', subject to annual review by the IRC. We were also asked by a commenter to mandate the posting of each standing instruction on the manager's website. This commenter also suggested that we add as another bullet under Commentary 2, that securities regulators expect the IRC to have assessed the manager's internal control practices before providing or continuing a standing instruction. ***Use of prior exemptive relief orders as guidance*** Finally, one commenter told us that if it is our intent that prior orders granted by securities regulators can be used by an IRC for guidance, that intent should be clarified in Commentary 2.	manager can continue to follow standing instructions during the time of the IRC's regular assessments under the Regulation. The section has been revised accordingly. The Regulation currently mandates disclosure in the IRC's report to securityholders of a brief summary of any recommendations and approvals the manager relied upon during the period of the report. This would include any standing instructions. We contemplate that a manager's policies and procedures will speak to how internal control procedures will contribute to the manager's overall ability to handle a conflict of interest. We would not generally expect, however, an IRC to assess the sufficiency of the manager's internal control procedures. Internal controls, in our view, remain the responsibility of the manager. The Commentary specifies that an IRC may consider as guidance the conditions in past exemptive relief orders in considering what, if any, parameters to impose in a standing instruction. It remains the responsibility of the IRC to provide standing instructions based upon the particular circumstances.
Part 6	**Exempted Transactions**		
Section 6.1	*Inter-fund trades*	One commenter, while supportive of the inter-fund trading	***Response*** As previously stated, we believe the inter-fund trading exemption in the

		exemptions, reiterated their comments from the 2004 Proposal that we adopt the U.S. model for inter-fund trading and not attempt to "reinvent the wheel". Another commenter reiterated their remarks from the 2004 Proposal that the inter-fund trading provisions are overly-prescriptive, 'unnecessary', and do not adequately consider a manager's fiduciary obligations and the need for IRC input. These commenters both remarked that the inter-fund trading exemption should extend beyond funds subject to the Regulation to permit a broader universe of potential counterparties, which at the very least, should include U.S. mutual funds. Another commenter suggested we replace the word 'contrepartie' with the word 'compensation' in section 6.1 of the French version of the Regulation. One commenter remarked that section 6.1(1)(d) does not appear to permit processing costs as part of the cost of an inter-fund trade, and requested clarification in this regard. Another commenter told us they considered the discussion in Commentary 4 on 1(c) conflicts with (e)(ii), in that section 6.1(1)(c) permits use of a single pricing source if only one is available, whereas section 6.1(1)(e)(ii) requires use of more than one pricing source to arrive at certain average prices.	Regulation represents the minimum requirements necessary to mitigate the conflict of interest concerns inherent in such transactions and satisfies the capital market objectives of market integrity. We direct these commenters to our earlier responses published with the 2005 Proposal. Our comfort with the inter-fund trade exemption in the Regulation stems from the protection we believe is afforded to the securityholders by its conditions, including the review and approval by the IRC. Accordingly, we continue to believe that only investment funds subject to the Regulation should be permitted to inter-fund trade under this provision. On review, we propose no change to this section of the French version of the Regulation. We consider processing costs to be included in the reference to nominal costs incurred by the investment fund to print or display the trade in this section. We disagree with this commenter. The Commentary in 1(c) provides guidance on how we expect transparency of market price to be obtained, whereas (e)(ii) focuses on how the current market price is determined for non-exchange traded securities.
Section 6.2	*Transactions in securities of*	A few commenters told us that the 'mutual fund conflict of interest	***Response*** The exemption provided in the Regulation is based upon the recurring

	related issuers	restrictions' are much broader than related party investments, and therefore should extend to any investments prohibited under the 'mutual fund conflict of interest investment restrictions". Without this change, we were told, a fund manager would have to send the conflict to the IRC for its recommendation and apply for relief from the conflict of interest investment restrictions.	applications for discretionary exemptions that we have granted. We acknowledge that a fund manager may still need to apply for discretionary exemptions in connection with other transactions not exempted by this provision in the Regulation. We have amended the Commentary to articulate our view that if an IRC gives its approval for the fund to purchase securities under this section, and then subsequently withdraws its approval for additional purchases, we will not consider the continued holding of such securities to be subject to subsection 1.2(b) of the Regulation. We do, however, expect the manager to consider whether continuing to hold those securities is a conflict of interest matter that subsection 1.2(a) of the Regulation would require the manager to refer to the IRC.
		One of these commenters suggested that the Regulation be revised to state that if the IRC has approved a transaction, no reports under section 117 of the *Securities Act* (Ontario) and similar provisions in other provinces, need to be filed.	We believe that the reports required under section 117 still provide meaningful information not otherwise required under the reporting obligations of the Regulation. The requirement to comply with this reporting is consistent with the discretionary exemptions we have granted to date.
		This commenter also asked that we clarify whether regulatory approval is required for non-exchange traded derivative transactions (such as forwards) notwithstanding IRC approval.	We do not consider non-exchange traded derivative transactions to be captured in section 6.2.
		Another commenter recommended the disclosure of the particulars of the investment required by subsection 6.2(1)(c) be included in either the financial statements or the MRFP required by Regulation 81-106, and should not be a separate filing.	We continue to believe this disclosure should be filed on SEDAR. Accordingly, no change to the Regulation has been made.
Part 7	**Exemptions**		

Section 7.2	*Existing exemptions, waivers or approvals*	One commenter reiterated their comment from the 2004 Proposal, asking that we provide guidance in the Commentary that a fund manager may in fact stop relying on an order and consider itself no longer subject to the conditions to the order, once it has established an IRC and the IRC and the manager have agreed on a written charter. Another commenter remarked that previously granted exemptions, waivers, and approvals should not be revoked by the Regulation, as this could lead to unnecessary repetition of notices to securityholders, prospectus amendments, and related fees and expenses.	***Response*** We have revised this section to provide greater clarity that all exemptions, waivers or approvals that deal with the matters the Regulation regulates – not just those that deal with matters under subsection 5.2(1) - will expire one year after the Regulation comes into force.
Part 8	**Effective Date**		
Section 8.2	*Transition*	A few commenters told us that new funds may confront the same issues as existing funds in meeting the requirements of the Regulation. These commenters submitted we extend the transitional relief set out in section 8.2 to new funds for a reasonable start-up period. One commenter recommended that we delete subsection 8.2(4), questioning the purpose of this notification from a regulatory perspective. Some commenters asked for more guidance on the extent to which an IRC must revisit decisions and policies and procedures on conflict matters made prior to the formation of the IRC and prior to the	***Response*** We agree with these commenters and have revised the Regulation to provide the same transition period to new funds. We have also revised the transition period to the earlier of the date the manager notifies securities regulators it is complying with the Regulation and one year after the Regulation comes into force. We believe that notification by managers who intend to rely on the Regulation prior to the expiry of the transition period is appropriate. This will assist securities regulators in monitoring compliance with the Regulation. For a fund established before the Regulation comes into force, we do not expect an IRC to revisit decisions made prior to the formation of the IRC. The Commentary has been revised to clarify that we expect the manager

		implementation of the Regulation. ***Disclosure*** One commenter told us there should be a clear transition for disclosure obligations and mutual funds should not be expected to file an amendment to offering documents.	to establish policies and procedures on any ongoing conflict of interest matters, and to refer to the IRC these policies and procedures and any new decisions related to such matters. We have also added to the Commentary that we do not consider a manager's initial decision-making in the organization of the fund to be subject to IRC review, unless the manager's decisions give rise to a conflict of interest concerning the manager's obligations to existing investment funds within the manager's fund family.. However, we anticipate that the manager will wish to engage the IRC early in the establishment of the fund to ensure the IRC is adequately informed of potential new conflicts of interest. We have revised the Commentary to clarify our expectation that funds can incorporate any new disclosure obligations or changes arising out of the Regulation as part of their annual prospectus renewal filing or continuous disclosure filing.
Draft Amendments to Regulation 81-101		We heard from two commenters who remarked that there is no added value to investors in breaking out and disclosing the individual compensation paid to IRC members required by new section 15(2) of Form 81-101F2. One of these commenters queried why this form requirement is only included in the mutual fund prospectus form (including the prospectus for a commodity pool) and not for other types of investment funds, and strongly recommended that draft new subsection 15(2) be deleted.	***Response*** The disclosure relating to IRC members in section 15(2) of the Form is consistent with the disclosure required under this section for directors of a mutual fund. Accordingly, we propose no change.

Draft Amendments to Regulation 81-102		While industry commenters told us that the conditions found in our consequential amendments to section 4.1 of Regulation 81-102 *Mutual Funds* appropriately reflected the terms and conditions of exemptive relief granted in the past, a few commenters asked us to clarify certain parts of the amendments. Some commenters asked whether we intended the requirement to purchase securities on a stock exchange to apply during the distribution period, the 60-day period following same, or both.	***Response*** We have revised the exemption in section 4.1 of Regulation 81-102 to specify that only purchases made during the 60 days after the end of the distribution period must be made on an exchange.
		One commenter noted that we have granted discretionary exemptions in the past to permit purchases under private placements.	We have limited the exemption in section 4.1 to the most frequently occurring transactions from which we have granted discretionary relief to date. We will to continue to deal with other types of transactions on a discretionary basis.
		Another commenter remarked that the consequential amendments to Regulation 81-102 do not address non-exchange traded derivative transactions.	We have also included a new Appendix C to the Regulation to specifically list the provisions in the regulations of the CSA that are also exempted if investments are made in accordance with new subsection 4.1(4) of Regulation 81-102.
		We were also asked by a commenter to amend the wording of draft 4.1(4)(d) and 4.2(3)(d) in the French version of the Regulation.	We agree with the commenter and have added the word ‘ainsi’ after ‘placement’ in the French version of the Regulation.
		One commenter suggested the revisions to Part 5 should indicate that non-management fees are to be approved by the IRC, and not by securityholders. Also, there should be a clear distinction between third party fees and other operating expenses.	We note that section 5.3(1) (a) of Regulation 81-102 specifically excludes third party fees from a securityholder vote. We continue to believe that a securityholder should have the right to vote for changes to fees caught by section 5.1 of the Regulation.

		One commenter also suggested the consequential amendment adding section 5.3 to Regulation 81-102 should also reference paragraph 5.1(g) in addition to paragraph 5.1(f). ***Change of Auditor*** Finally, one commenter did not see why the right to select an auditor or change an auditor is being delegated to the IRC. This commenter told us that it is best practice to have fund auditors at arms length from manager or its parent. ***Polity Statement to Regulation 81-102 – Section 3.8(2)*** Another commenter remarked that it is inappropriate to provide, as set out in Commentary, that the IRC may satisfy itself that the price of the security is fair by obtaining at least one price quote from an independent, arms length purchaser or seller, immediately before the purchase or sale. We were told that a fund manager's policies and procedures would be expected to address the issue of obtaining price quotes in connection with the purchase or sale of securities.	We have chosen not to make this change. We believe that securityholders of the continuing fund should have the right to vote on a material change to their fund, resulting from a reorganization or merger. We believe a change of auditor to be a matter that can be appropriately reviewed by an IRC. The Commentary is intended only as guidance to the IRC on what to look for in judging whether the manager has achieved a fair price for the security under section 4.2(3).
Proposed OSC Rule 81-802		For greater certainty, one commenter suggested that rather than specifying in detail the sections to which a manager or investment fund or portfolio manager is exempt (as set out in sections 3.4 and 3.5), the Regulation should specify that these entities are exempt from sections 111 to 118 inclusive of the *Securities Act* (Ontario) (the "Act") to the extent that the IRC has approved a particular action that would otherwise be prohibited or restricted by these sections.	***Response*** The recent legislative changes to the Act now specifies in section 121.1 that, a prohibition under Part XXI (Insider Trading and Self-Dealing) does not apply to a transaction approved by an independent body, if the regulations or rules provide for this approval. OSC Rule 81-802 has been amended accordingly.

SUMMARY OF PUBLIC COMMENTS ON
DRAFT REGULATION 81-107 AND COMMENTARY

List of Commenters

AGF Funds Inc.
AIM Trimark Investments
Association of Canadian Pension Management
Barclays Global Investors Canada Limited
BMO Mutual Funds
Board of Governors of the RBC Funds and RBC Private Pools
Borden Ladner Gervais LLP
Brandes Investment Partners & Co.
Canadian Bankers Association
Canadian Imperial Bank of Commerce
Chou Associates Management Inc.
CIBC Independent Review Committee
Conseil des fonds d'investissement du Québec (CFIQ)
Fédération des caisses Desjardins du Québec
Fidelity Investments Canada Limited
Frank Russell Canada Limited
Franklin Templeton Investments Corp.
Fraser Milner Casgrain LLP
Frank Santangeli
GrowthWorks
Guardian Group of Funds
IGM Financial Inc.
Independent Review Inc.
Investment Funds Institute of Canada
International Scholarship Foundation/USC Education Savings Plan Inc.
Leith Wheeler Investment Counsel Ltd.
PFSL Investments Canada Ltd.

RBC Financial Group
Resolute Funds Limited
Small Investor Protection Association (“SIPA”)
Simon Romano
SEI Investments Canada Company
TD Asset Management Inc.
Toronto Stock Exchange
Tradex Management Inc. (“TMI”)
Westcap Management Limited