NOTICE OF PROPOSED CHANGES TO
NATIONAL INSTRUMENT 81-102
AND COMPANION POLICY 81-102CP
MUTUAL FUNDS

Substance and Purpose of Proposed National Instrument and Companion Policy

Introduction

On June 27, 1997, the Canadian Securities Administrators (the "CSA") published for comment proposed National Instrument 81-102 Mutual Funds (the "1997 Draft") and proposed Companion Policy 81-102CP (the "1997 Draft Companion Policy").(1)

During the comment period, which ended on October 31, 1997, the CSA received submissions on these instruments from a broad range of commenters. Appendix A of this Notice lists the commenters. Appendix B to this Notice contains a detailed discussion of the more substantive comments made. A summary, in tabular form, of all comments received, together with the CSA responses to those comments, are contained in Appendix C of this Notice. As the result of the consideration of those comments and as the result of further consideration of these instruments, the CSA are proposing a number of amendments to the materials published in June 1997, and are therefore publishing for a second time the proposed National Instrument and Companion Policy. In British Columbia, a number of consequential amendments to the *Securities Rules* are being published for the first time.

The proposed National Instrument and Companion Policy are a reformulation of National Policy Statement No. 39 ("NP39"), which they will replace.(2) Through these proposed instruments, the CSA seek to continue the regulatory regime applicable to publicly offered mutual funds currently embodied in NP39.

The proposed National Instrument and Companion Policy are initiatives of the CSA, and the proposed National Instrument is expected to be adopted as a rule in each of British Columbia, Alberta, Manitoba, Ontario and Nova Scotia, as a Commission regulation in Saskatchewan and as a policy in all the other jurisdictions represented by the CSA. The proposed Companion Policy is expected to be implemented as a policy in all of the jurisdictions represented by the CSA.

Terms used in the proposed Companion Policy that are defined or interpreted in the proposed National Instrument or a definition instrument in force in the jurisdiction and not otherwise defined in the proposed Companion Policy should be read in accordance with the proposed National Instrument or that definition instrument, unless the context otherwise requires.

Revocation of CSA Notice

Effective the date that the proposed National Instrument comes into force, the CSA Notice entitled "Mutual Funds: Section 16 Sales Communications" (CSA #93/5) will be revoked. This notice is superseded by the matters contained in the proposed National Instrument.

Background

This Notice summarizes in a general manner the changes made in the proposed National Instrument and Companion Policy from the 1997 Draft and 1997 Draft Companion Policy. As described above, the appendices to this Notice outline the comments received in respect of the 1997 Draft, together with CSA responses. Further background and explanation of changes are contained in the footnotes contained in the proposed National Instrument and Companion Policy.

As indicated in Appendix B and Appendix C to this Notice, the CSA received a large number of comments on the 1997 Draft. Many of these comments related to the need for change in the following seven areas:

Use of swap instruments by mutual funds;

Securities lending by mutual funds and the use of repurchase agreements by mutual funds;

Standardized regime for the structure of so-called "funds of funds";

Timing of transfers among financial institutions and among mutual funds;

Principal trading in securities between mutual funds and entities related to the manager of the mutual fund;

Acquisition of securities by mutual funds from underwriters related to the mutual fund manager; and

Inter-fund trading of securities.

The CSA propose to permit mutual funds to directly use swaps and the proposed National Instrument contains the proposed rules in this regard.

However, the CSA propose that the remaining issues be addressed as part of a parallel process that will enable sufficient public comment and industry consultation regarding any revised rules. The CSA propose to consider each of the comments not dealt with in the proposed National Instrument as expeditiously as possible and publish proposed rules later during 1999 or 2000 as amending instruments to the proposed National Instrument. The CSA consider that their anticipated process of dealing with these significant comments will permit appropriate regulatory and public consideration of the issues, as well as permit the timely replacement of NP 39, through the finalization of the proposed National Instrument in advance of finalizing the appropriate regulatory response to these significant comments.

National Instrument 81-101

In July 1998, the CSA published for comment proposed National Instrument 81-101 Mutual Fund Prospectus Disclosure ("Proposed NI81-101"), together with a proposed companion policy and related forms.(3) These materials are intended to replace National Policy Statement No. 36 ("NP36") and, when in force, would implement a new regulatory regime governing the disclosure provided by mutual funds in satisfaction of the prospectus requirements of securities legislation. The CSA intend that Proposed NI81-101 will contain all of the applicable prospectus disclosure requirements applicable to mutual funds, and so, the drafts of Proposed NI81-101 and the related forms published in July 1998 incorporate the prospectus disclosure requirements that were contained in the 1997 Draft. Those disclosure requirements have been deleted from the proposed National Instrument so that all prospectus disclosure provisions concerning conventional mutual funds will be contained in Proposed NI81-101 and the related forms. The proposed National Instrument is proposed to come into force at the same time as is Proposed NI81-101 and the CSA expect to publish a revised version of Proposed NI81-101 that reflects decisions made in response to comments received, for further comments, shortly.

Changes have been made to the proposed National Instrument to reflect the regime proposed by Proposed NI81-101, including clarifying what the CSA mean by their use of the phrase "fundamental investment objectives" of a mutual fund, which is a concept derived from NP 39 and referred to in Proposed NI81-101. However, the CSA have not amended the proposed National Instrument to refer to a "fund summary" or a "fund prospectus" in substitution for the terms "simplified prospectus" and "annual information form". The CSA are finalizing their review of the comments received on Proposed NI81-101 and wish to retain the flexibility to not change the names of the prospectus documents.

Substance and Purpose of Proposed Instruments

As was proposed by the 1997 Draft, the proposed National Instrument is designed to replace NP 39 and will regulate all publicly offered investment funds that fall within the definition of "mutual fund" contained in Canadian securities legislation. Accordingly, all publicly offered investment funds that give investors the right to redeem securities on demand at a price based on the net asset value of those securities will be required to comply with the proposed National Instrument. Specialized mutual funds such as labour sponsored investment funds, mortgage funds and commodity pools will generally be required to comply with the proposed National Instrument and also applicable securities regulation that is in addition to, or in partial substitution for, the provisions of the proposed National Instrument.(4)

The underlying purpose for the regulation of mutual funds proposed by the National Instrument and Companion Policy is discussed in the Notice published with the 1997 Draft (the "1997 Notice"). Additional background information is also provided in the 1997 Notice, as well as a complete explanation and description of the rules provided for in the 1997 Draft.

The purpose of the proposed Companion Policy is to state the views of the CSA on various matters relating to the proposed National Instrument.

Summary of Proposed Changes to the Proposed National Instrument from the 1997 Draft

This section describes changes made in the proposed National Instrument from the 1997 Draft. Changes of a minor nature, or those made only for purposes of clarification or drafting reasons, are generally not discussed.

For a detailed summary of the contents of the 1997 Draft, reference should be made to the 1997 Notice. Unless otherwise indicated, all section references in this section of this Notice pertain to the proposed National Instrument.

Section 1.1

The definition of *"acceptable clearing corporation"* has been added to mean a clearing corporation that is an acceptable clearing corporation under the *"Joint Regulatory Financial Questionnaire and Report"*, which is another new definition. These definitions are used in subsection 2.7(4), which limits the exposure that a mutual fund may have to any one counterparty in connection with specified derivatives transactions. Subsection 2.7(4) excludes from this limitation the exposure of mutual funds to acceptable clearing corporations.

The definition of *"approved credit rating organization"* now includes Thomson BankWatch, Inc. in response to comments received. The CSA note that this organization is recognized by the Securities and Exchange Commission ("SEC") in the United States as a "nationally recognized statistical rating organization" and by other securities and financial regulators throughout the world. The ratings categories for Thomson BankWatch, Inc. recognized in the proposed National Instrument as *"approved credit ratings"* are one level higher than the lowest investment grade category of Thomson BankWatch, Inc. This approach is consistent with the other organizations' rating categories that are recognized in the proposed National Instrument as approved credit ratings. The proposed National Instrument also reflects the name change of IBCA Limited to Fitch IBCA, Inc.

The definition of *"asset allocation service"* has been amended to recognize that asset allocation services may invest in other assets in addition to mutual funds. Section 2.1 of the proposed Companion Policy clarifies that this definition is intended to include only those specific administrative services in which an investment in mutual funds subject to the proposed National Instrument is an integral part.

The definition of *"cash cover"* has been amended in response to a comment to permit receivables, net of payables, arising from the disposition of portfolio assets, to be used for cash cover by a mutual fund.

The definitions of *"conventional convertible security"* and *"conventional warrant or right"* have been amended by the removal of the requirement that those instruments not be capable of being settled in cash. These definitions are used as exclusions from the definition of "specified derivatives", so that conventional convertible securities and conventional warrants or rights are not treated as specified derivatives under the proposed National Instrument. The CSA are satisfied that this treatment is appropriate for these instruments, even if they are capable of being settled in cash.

A definition of *"conventional floating rate debt instrument"* has been added. This definition was not in the 1997 Draft, although the term *"conventional floating rate debt instrument*" was used in the 1997 Draft in order to define instruments that were excluded from the definition of "*debt-like security*". It is not intended that the definition of "*debt-like security*" would include debt based on underlying interests commonly used in commercial lending arrangements, such as prime rates or LIBOR. This definition has been added for greater certainty.

The definition of *"debt-like security"* has been amended in two substantive ways.

First, paragraph (b) of this definition has been reversed from the 1997 Draft. The 1997 Draft provided that the value of the component of the debt-like security that was linked to an underlying interest must account for more than 20 percent of the value of the instrument in order that the instrument be considered a debt-like security. This definition now provides that the value of the component of the instrument that is not linked to the underlying interest must account for less than 80 percent of the purchase price of the instrument in order that the instrument be considered a debt-like security.

This amendment has been made to emphasize what the CSA consider to be the most appropriate manner to value these instruments. That is, one should first value the component of the instrument that is not linked to the underlying interest, as this is often much easier to value than the component that is linked to the underlying interest. The CSA recognize the difficulties of valuation that can arise if one attempts to value, by itself, the component of an instrument that is linked to the underlying interest.

Second, paragraph (b) of this definition has also been amended to provide that the calculation described above is to be made as of the date of purchase of the instrument by a mutual fund, rather than at the date of issue. This change is proposed to recognize that, for long-term instruments, the character of the instruments may change as the date of maturity approaches; the value of the component that is linked to the underlying interest may decrease in value, and the value of the non-linked component may increase in value as the maturity date approaches.

The definition of *"equivalent debt"* has been amended by the inclusion of references to swaps, made in connection with the amendment of the proposed National Instrument to permit the use of swaps by mutual funds.

The definition has also been amended by the deletion of the reference to commercial paper. This term is redundant in light of the general reference to evidences of indebtedness in the definition.

The definition of *"fundamental investment objectives"* has been added. The definition is based on the disclosure requirements of Form 81-101F1 under Proposed NI81-101. The CSA are of the view that any amendment to the matters required to be disclosed under that Item should trigger the requirement for securityholder approval under paragraph 5.1(c) of the proposed National Instrument. Specific reference is now made in the proposed National Instrument to changes in whether a mutual fund is managed to constitute foreign property under the Income Tax Act.

The definition of *"hedging"* has been amended to delete the requirement that a transaction be regarded as a hedge under Canadian GAAP in order to qualify as a hedge under the proposed National Instrument. The CSA understand that Canadian GAAP does not define transactions as hedges in a manner easily applicable to this Instrument. In addition, the former subparagraph (a)(i) of the 1997 Draft has been deleted. That subparagraph provided that the hedging position must provide equivalent underlying market exposure that is opposite to the position, or positions, being hedged. The CSA are satisfied that this subparagraph largely duplicated the combined effect of former subparagraph (a)(ii) and (iii).

The definition has also been amended to clarify which elements of the definition are to be satisfied based upon the intent of the person effecting the hedge, and which are to be satisfied using objective standards.

The definition of *"illiquid asset"* has been amended to provide that a portfolio asset is illiquid only if it cannot be sold for a price that "approximates" the value at which the mutual fund carries the investment, rather than at an amount that "equals" the carrying value, as provided for in the 1997 Draft. The CSA have made the change to recognize that the sale price of securities will be reduced by transaction costs.

The definition of *"index participation unit"* has been amended to delete the requirement that the unit be traded on and sponsored by a stock exchange in Canada. The definition now requires only that the security be traded on a stock exchange in Canada or the United States. Index participation units are excluded from the definition of "specified derivatives", and the CSA are satisfied that U.S.-traded index participation units, such as WEBs and SPDRs, may appropriately be acquired by mutual funds, subject to the investment limits established by sections 2.1 and 2.2 of the proposed National Instrument.

The definition of *"long position"* has been amended by inclusion of references to swaps, made in connection with the amendment of the proposed National Instrument to permit the use of swaps by mutual funds.

The definition of *"manager"* has been amended to remove the reference to "having the power" and "exercising the responsibility" to direct the affairs of a mutual fund that were contained in the 1997 Draft in order to clarify that the definition only applies to the person or company that actually directs the business of the mutual fund.

The term *"non-resident adviser"* has been amended to *"non-resident sub-adviser"* in order to clarify that for the purposes of section 2.10 of the proposed National Instrument, a non-resident adviser must provide advice through a registered portfolio adviser.

The definition of *"option"* and treatment of options under the proposed National Instrument have been amended in two ways. First, the CSA propose to permit both listed and unlisted warrants to be acquired by mutual funds as specified derivatives. As there is no longer a need to distinguish between listed and unlisted warrants in this Instrument, references to those terms have been deleted. It is noted that the requirements concerning options in the proposed National Instrument do not apply to *"conventional warrants or rights"*, which are excluded from the definition of *"specified derivatives"*.

In addition, the definition of *"over-the-counter option"* has been deleted; the use of that term has been replaced, where appropriate, with a reference to an "option other than a clearing corporation option".

The reference to an "office" in the definition of *"order receipt office"* has been replaced with reference to a "location" in order to accommodate delivery of orders to electronic or Internet sites established by mutual funds.

The definition of *"performance data"* has been amended to apply to performance information about any security, index or benchmark, and not merely to performance information about a mutual fund or asset allocation service. The CSA propose this change in order to ensure that the definition of this phrase is consistent with its use in Part 15 of the proposed National Instrument.

The definition of *"permitted derivative"* has been deleted from the proposed National Instrument. The CSA made this change in order to simplify the drafting and do not consider it to create any substantive amendment to the derivatives regime established in the proposed National Instrument.

Paragraph (e) of the definition of *"permitted gold certificate"* has been amended to allow gold certificates issued by banks to be *"permitted gold certificates"* even if they are not insured in the manner specified on the understanding that the banks are self-insurers against the specified losses.

A definition of *"purchase"* has been added to deal with the issue of whether the "purchase" tests contained in the proposed National Instrument should apply in circumstances in which a mutual fund acquires securities other than through a decision made and action taken by the mutual fund. Examples of circumstances in which this issue arises are contained in section 2.14 of the proposed Companion Policy.

The definition of *"sales communication"* has been amended to expand the list of documents considered not to contain sales communications to include those documents that are prepared in response to statutory requirements and hence are not primarily promotional material.

The definition of *"significant change"* has been amended to clarify its meaning without substantive change.

The definition of *"specified derivative"* has been amended by the inclusion of capital and income shares of subdivided equity or fixed income offerings in paragraph (e). Capital shares were included under the definition of *"listed warrant"* in the 1997 Draft; the latter phrase has been deleted from the proposed National Instrument as described above. The CSA believe that capital and income shares do not have the risk characteristics of other derivatives, and should be excluded from the definition of *"specified derivative"*.

The definition of *"standard investment restrictions and practices"* has been deleted since it is not used in the proposed NI nor in Proposed NI81-101.

A definition of *"swap"* has been added in connection with the amendment of the proposed National Instrument to

permit swaps.

Paragraph (c) has been added to the definition of *"underlying market exposure"* in connection with the amendment of the proposed National Instrument to permit swaps.

Part 2

Part 2 contains restrictions on the investments, including those in derivative instruments, that can be made by mutual funds. Part 2 has been reorganized into shorter sections to improve readability and clarity.

The effect of the prohibitions and restrictions applicable to the time a mutual fund is proposing to "purchase" a portfolio asset as contained in Part 2 must be read in connection with the definition of "purchase" now contained in the proposed National Instrument and discussed above.

Section 2.1

Section 2.1 is closely based on paragraph 2.1(1)(a) and subsection 2.1(5) of the 1997 Draft, and is largely unchanged from those provisions.

Subsection 2.1(3) requires a mutual fund to consider that it holds directly the underlying interest of a specified derivative or index participation unit in determining the mutual fund's compliance with the restrictions contained in the section. Subsection 2.1(3) is adapted from subsection 2.1(2) of the 1997 Draft and has been amended from that subsection to improve drafting clarity and to require mutual funds to treat index participation units in the same manner as derivatives. This is necessary as index participation units are not treated as specified derivatives under the proposed National Instrument. Subsection 2.1(4) is adapted from and consistent with subsection 2.1(3) of the 1997 Draft.

Section 2.2

Paragraph 2.2 (1) (a) is based on paragraph 2.1(1)(b) of the 1997 Draft. The 1997 Draft restriction would have continued to prohibit mutual funds from acquiring more than 10 percent of a series or class of security in substantially the same manner as in NP39. The CSA consider that the purpose of the restriction contained in NP39 is to prevent a mutual fund from acquiring securities of an issuer that would enable the mutual fund to exert control over the issuer. The CSA have noted that this test has become increasingly problematic in that it has operated to prevent mutual funds from acquiring securities or instruments that in no manner provided the mutual fund with the opportunity to exert control over the issuer. For instance, the CSA understand that this prohibition has prevented mutual funds from acquiring warrants proposed to be offered by issuers in private placement transactions as "sweeteners" simply because the fund would be acquiring more than 10 percent of the class of warrants. The CSA also have noted that it would be necessary to provide for a large number of exceptions to the prohibition, if the prohibition continued to be structured as it is in NP39.

The CSA therefore are proposing to amend the restriction so that it applies only to the acquisition of securities carrying more than 10 percent of the votes of an issuer, or to the acquisition of more than 10 percent of the equity securities of an issuer. The CSA consider that this amendment brings the restriction in line with the policy rationale behind the restriction.

Paragraph 2.2 (1) (b) is based on paragraph 2.1 (1)(h) of the 1997 Draft, which is consistent with the policy rationale behind both of the restrictions now provided for in subsection 2.2(1) of the proposed National Instrument.

In addition, the CSA have added subsection 2.2(2), which deals with the "involuntary" acquisition of securities by a mutual fund that might cause the mutual fund to exceed the securityholding limits prescribed by subsection 2.2(1). Subsection 2.2(2) provides that if a mutual fund acquires a security other than as the result of a purchase (as defined in the proposed National Instrument), and the acquisition results in the mutual fund exceeding the limits described in paragraph 2.2(1)(a), the mutual fund shall as quickly as is commercially reasonable, and in any event no later than 90 days after the acquisition, reduce its holdings of those securities so that it does not hold securities exceeding those limits. Acquisition of securities by a mutual fund through means other than a purchase as defined in the proposed National Instrument will not cause the mutual fund to contravene paragraph 2.2(1)(a).

Subsection 2.2(3) is similar to subsection 2.1(4) of the 1997 Draft, which required a mutual fund to assume the conversion of special warrants held by it. This provision has now been amended to add the requirement that a mutual fund consider that it holds directly the underlying securities represented by any American depositary receipts held by it. This subsection has been moved into section 2.2, as its application is primarily restricted to the control tests of that section.

Section 2.3

Section 2.3 continues those restrictions previously listed in paragraphs 2.1(1)(c),(d), (e), (i), (j), (k) and (l) and paragraph 2.2 (g) of the 1997 Draft. Other than described below, the restrictions listed in section 2.3 of the proposed National Instrument are unchanged from the 1997 Draft.

The general requirements concerning derivatives use have been amended from those contained in the 1997 Draft. The definition of *"permitted derivatives"* has been deleted in order to clarify the drafting of the proposed National Instrument. Paragraph 2.3(g) now prohibits the use of any *"specified derivatives"* other than in compliance with sections 2.7 to 2.11. Paragraph 2.3(h) contains the restriction against the use of commodity derivatives contained in the definition of *"permitted derivatives"* in the 1997 Draft.

Paragraph 2.3(i) has been amended from paragraph 2.2(g) of the 1997 Draft, which contained a prohibition against an acquisition of an interest in a loan syndication or loan participation by a mutual fund. The CSA recognize that there are few conceptual differences between these interests and the acquisition of evidences of indebtedness, so long as the mutual fund assumes no responsibility in administering the loan, such as managing the syndicate or dealing with the borrower, and are therefore proposing to permit the purchase of these interests with that condition. The CSA note that a mutual fund proposing to acquire such an interest should consider whether the interest is an illiquid asset within the meaning of the proposed National Instrument.

Section 2.4

Section 2.4 is based on paragraphs 2.1(1)(f) and (g) of the 1997 Draft. These restrictions have been amended from the 1997 Draft by providing that, although a mutual fund may not purchase an illiquid asset if it would exceed the 10 percent threshold at the time of purchase, the mutual fund may hold up to 15 percent of the aggregate value of its portfolio assets in illiquid assets. The CSA are proposing this five percent cushion so as to reduce the likelihood that market fluctuations will put mutual funds in a position in which they would be required to dispose of illiquid investments under unfavourable circumstances. The CSA note that the SEC imposes a 15 percent illiquid asset restriction on U.S. mutual funds, and are satisfied that a 15 percent limit is not excessive for Canadian mutual funds. If a mutual fund exceeds the 15 percent limit, it must take all necessary steps as quickly as commercially reasonable, to reduce its holdings of illiquid assets to 15 percent or less. In no event can a mutual fund exceed the 15 percent limit for more than 90 days. This time limit has been extended from the 1997 Draft, which proposed a 30 day time limit for mutual funds holdings of illiquid assets.

Section 2.5

Section 2.5 is based on paragraph 2.1(1)(m) of the 1997 Draft and is largely unchanged from the 1997 Draft.

Subsection 2.5(2) has been added to remove from the fund of fund rules any security of an issuer that may technically be a mutual fund, such as a subdivided offering or index participation unit, but that is not a conventional mutual fund and for which the fund of fund rules should not be applicable. Since those vehicles are virtually always listed on a stock exchange, the CSA have used this distinguishing feature to define the vehicles whose securities may be purchased by a mutual fund without regard to the fund of funds regime.

Section 2.6

Section 2.6 is based on section 2.2 of the 1997 Draft and largely does not change the restrictions described in the 1997 Draft.

Clauses 2.6(a)(ii) and (iv) permit a mutual fund to encumber its portfolio assets to post margin to effect a specified

derivative transaction or a transaction permitted under subsection 6.8(3). These amendments were made in response to comments that mutual funds should be permitted to encumber portfolio assets to effect derivative transactions instead of being restricted to posting margin.

The CSA note that, pending their proposals to permit mutual funds to engage in securities lending and to use repurchase agreements, paragraph 2.6(f) continues the prohibition on these activities.

Section 2.7

The derivatives sections of the proposed National Instrument, contained in section 2.3 of the 1997 Draft, have been reorganized for greater clarity and readability.

Subsections 2.7(1), (2) and (3) contain the term and credit limit rules that are applicable to all specified derivatives positions of a mutual fund, whether the positions are used for hedging or non-hedging purposes. These provisions are substantially the same as in the 1997 Draft, except that they now apply the term and credit limitations to swaps. These rules carry forward the rules previously proposed by subsections 2.3(3), (4) and (5) of the 1997 Draft.

Subsection 2.7(4) contains the prohibition against a mutual fund having an exposure to any counterparty in respect of its specified derivatives positions in excess of 10 percent of the net assets of the mutual fund. This subsection now exempts from its application transactions with an acceptable clearing corporation or a futures contract traded through a clearing corporation that settles transactions effected on a futures exchange listed in Appendix A of the proposed National Instrument.

Subsection 2.7(5) is based on subsection 2.3(7) of the 1997 Draft and outlines how the mark-to-market value of a specified derivatives position is to be determined for purposes of subsection 2.7(4). Paragraph 2.7(5)(b) is new and has been added to allow a mutual fund to use a net mark-to-market value in calculating its exposure to a counterparty with which the mutual fund has an agreement that permits netting or the right of set-off.

Section 2.8

Section 2.8 contains the applicable exposure limitation and coverage rules for specified derivatives transactions that are not entered into for hedging purposes. Although those rules are substantially the same as in the 1997 Draft, some drafting amendments have been made for clarification purposes. These rules carry forward the rules previously proposed in subsection 2.3(2) of the 1997 Draft.

In addition, paragraph 2.8(1)(f) is new, and imposes coverage rules for swaps. Paragraph 2.8(1)(f) in effect applies to swaps the rules that are contained in paragraphs 2.8(1)(d) and (e) for forwards. The rules applicable to a long position in a forward contained in paragraph 2.8(1)(d) are applicable for a swap when the mutual fund is in a net position in which it is owed money under the swap, and the rules applicable to a short position in a forward contract contained in paragraph 2.8(1)(e) are applicable for a swap when the mutual fund is in a net position in which it owes money under the swap.

Subsection 2.8(2) carried forward the rule proposed by subsection 2.3(6) of the 1997 Draft.

Section 2.10

Section 2.10 is based on subsection 2.3(8) of the 1997 Draft.

Section 2.10 deals with the ability of a portfolio adviser to take portfolio management advice concerning the derivative instruments specified from a non-resident sub-adviser. The section has been expanded from subsection 2.3(8) of the 1997 Draft in order to ensure that the liability regime for a portfolio adviser that assumes responsibility for actions of a non-resident sub-adviser is consistent with the general liability regime for managers of mutual funds now contained in section 4.4.

The Ontario Securities Commission notes that this section does not purport to provide an exemption from the

registration requirements imposed under the *Commodity Futures Act*. As noted in section 4.2 of the proposed Companion Policy, a non-resident sub-adviser should apply for an exemption under that Act if it wishes to carry out the arrangements contemplated by section 2.10 without being registered in Ontario under that legislation.

Section 3.2

This provision is new, and imposes a direct prohibition on a mutual fund in respect of satisfying the initial capitalization requirements that are required to be described in the simplified prospectus of the mutual fund under paragraph 3.1(1)(b). Although this section is new, it is consistent with and based upon rules imposed on mutual funds under NP39 and proposed in the 1997 Draft.

Sections 4.1 and 4.2

Section 4.1 has been divided into subsections to improve clarity and readability, but pending the CSA's review of this area as described earlier in this Notice, does not amend the rules proposed in section 4.1 of the 1997 Draft. Similarly, section 4.2 is unamended from section 4.2 of the 1997 Draft.

Section 4.3

Section 4.3 is new and is based on section 4.03 of NP39. Section 4.3 exempts from the operation of section 4.2 purchases or sales of a security by a mutual fund if the price payable for the security is not more than the public ask price, or not less than the public bid price, for the security in the case of a purchase or sale, respectively.

This provision is based on section 4.03 of NP39, but was not included in the 1997 Draft. The CSA did not include this provision in the 1997 Draft because the relief provided by the provision was never implemented in Ontario and because the CSA wanted to generally consider the provision in the context of a larger review of conflict of interest rules. For further information, reference should be made to the discussion contained in footnote 116 of the 1997 Draft.

The CSA understand that some mutual funds have been relying on section 4.03 of NP39, and the CSA consider it best to preserve the status quo in this area pending the more general review of conflict issues in the future discussed earlier in this Notice. In particular, the CSA will, as part of that review, be considering the appropriateness of this section, as outlined in footnote 116 of the 1997 Draft.

Section 4.4

Section 4.4 pertains to the standard of care to be followed by managers of mutual funds and the ability of mutual funds to relieve managers from that standard and to provide indemnity or insurance to managers. Section 4.4 is based on section 4.3 of the 1997 Draft. Subsections 4.4(1) and (2) have been amended to ensure that these provisions correspond to the statutory standard of care imposed on managers under Canadian securities legislation. Subsections 4.4(1) and (2) are designed to ensure that a manager remains responsible to the mutual fund for any breach of the statutory standard of care committed by it or anyone providing services to it or the mutual fund in connection with the mutual fund.

These subsections have been amended from the 1997 Draft to reflect more directly the statutory standard of care imposed on managers by securities legislation. The 1997 Draft made reference to negligence and wilful misconduct, which are not terms referred to in the statutory standard of care provisions.

Subsection 4.4(5) has been added to clarify that section 4.4 does not apply to the responsibilities of a manager for the actions of a custodian or sub-custodian of a mutual fund. A separate liability regime is imposed regarding those companies by section 6.6.

Part 5

Part 5 is based on Part 5 of the 1997 Draft, but its name has been changed to more accurately reflect the content of the rules provided for in this Part.

Section 5.1

Section 5.1 sets out a list of matters that cannot be implemented without securityholder approval and except as discussed below, is largely consistent with section 5.1 of the 1997 Draft.

The drafting of paragraph 5.1(a) has been amended from paragraph 5.1(1)(a) of the 1997 Draft without substantive change.

Paragraph 5.1(b) is unamended from the 1997 Draft, and requires securityholder approval in connection with the change in the manager of a mutual fund. The CSA remind market participants that transactions of the type contemplated by this paragraph may trigger provisions of securities legislation that also relate to changes in the ownership or control of certain persons or companies. For instance, the regulations of securities legislation of some jurisdictions provide that, upon a change in the ownership or control of an investment counsel, the investment counsel must give a written explanation of the change to its clients and inform the clients of their right to withdraw their account.

The CSA note that, as described above, a definition of "fundamental investment objectives" has been added to the proposed National Instrument. Accordingly, although the securityholder approval requirement proposed by paragraph 5.1(c) has not changed from the 1997 Draft or from NP39, mutual funds and their managers will be better able to gauge when this requirement is triggered by a particular change.

Paragraph 5.1(g) has been added to reflect the view of the CSA that the securityholders of a mutual fund that continues after a reorganization or transfer of assets (a so-called "fund merger") should be entitled to vote on the transaction if the transaction would be a significant change to that mutual fund. The definition of the phrase "significant change" must be considered in this context. The requirement proposed by paragraph 5.1(1)(f) of the 1997 Draft that securityholders in the terminating fund of a proposed fund merger be given voting rights in advance of the completion of the transaction has been carried forward substantively unchanged in paragraph 5.1(f).

Paragraph 5.1(1)(g) of the 1997 Draft has been deleted. That paragraph required securityholder approval to be given in circumstances in which that approval was required by the constating documents of the relevant mutual fund. The CSA have deleted that provision on the basis that it is unnecessary to have the proposed National Instrument duplicate the requirements of constating documents.

Subsection 5.1(2) of the 1997 Draft has also been deleted, and replaced by subsection 5.8(1). Subsection 5.1(2) of the 1997 Draft required securityholder approval for changes of control of a manager. The CSA are proposing that notice be given to securityholders of a proposed change of control of a manager, and have accepted comments that a requirement for securityholder approval would be too onerous, particularly in the case of changes of control that will have little or no impact on the operations or management of the mutual fund as a whole. However, the CSA remain concerned about the potential impact on fund securityholders of a change in control of manager. The CSA will be considering what additional approvals, if any, are appropriate in the context of their work to develop regulatory options to achieve better fund governance for mutual funds. As part of this review, the CSA will reconsider subsection 5.8(1).

Section 5.5

Section 5.5 sets out the changes that require the approval of a securities regulatory authority. The provisions of the 1997 Draft relating to applications to the securities regulatory authorities for permission to suspend redemptions in circumstances other than those provided for in section 10.6 have been moved from Part 10 of the 1997 Draft to paragraph 5.5(1)(d) and subsection 5.7(2). No substantive change in these provisions has been made through this move.

Section 5.6

Section 5.6 functions as an exception to paragraph 5.5(1)(b), setting out the reorganizations and transfers for which the approval of the securities regulatory authority is not required. Section 5.6 of the proposed National Instrument appeared as subsection 5.5(2) of the 1997 Draft, and has been moved into a separate section with its own identifiable heading for ease of reference. Except as noted below, it has not been substantively amended from subsection 5.5(2) of the 1997 Draft.

In conjunction with the addition to section 5.1 of a securityholder voting requirement for securityholders of continuing funds in merger transactions, the CSA have deleted clause 5.5(2)(a)(v) of the 1997 Draft from section 5.6. This clause would have allowed only those mergers where a smaller fund was merging with a bigger fund to take advantage of this "pre-approval" mechanism. Clause 5.6(1)(e)(ii) contemplates that paragraph 5.1 (g) may be applicable.

Section 5.7

In conjunction with the move of the rule requiring securities regulatory approval for suspensions of redemptions into Part 5 from Part 10 of the 1997 Draft, subsections 5.7(2) and (3) have been added. These subsections, although drafted differently, do not change the procedures proposed by subsections 10.6(3) and (4) of the 1997 Draft.

Section 5.8

Section 5.8 provides that a mutual fund shall provide 60 days notice to securityholders for a change in control of manager of the mutual fund, or in connection with a termination of a mutual fund. In the case of a change of control of manager, the mutual fund is required to provide to its securityholders the information that it would be required by law to provide if securityholder approval of the change were required to be obtained.

As described above, this provision, as it relates to the change in control of a manager, replaces subsection 5.1(2) of the 1997 Draft, which required securityholder approval for changes of control of a manager.

The CSA are proposing the requirement concerning notice of termination of a mutual fund to reflect the view of the CSA that a termination of a mutual fund is sufficiently important to require notice to be given to securityholders. The CSA understand that most constating documents of mutual funds require that this notice to be given. Subsection 5.8(3) has been added to require notice to the securities regulatory authorities of a termination of a mutual fund in order to ensure that records of the securities regulatory authorities are maintained up to date and largely reflects existing staff administrative positions.

Section 6.1

The references to the "delegation of custodial authority" contained in Part 6 of the 1997 Draft, used with reference to the appointment of a sub-custodian, have been replaced in the proposed National Instrument with references to the "appointment of a sub-custodian", in order to use more direct language and avoid confusion over the legal meaning of the term "delegation".

Subsections 6.1(4) and (5) have been added in response to comments noting that subsection 6.1 (3) of the 1997 Draft, which required the consent of a mutual fund or custodian to the appointment of a sub-custodian, would require separate documentation in connection with the appointment of each sub-custodian. This approach was not practical or necessary in the context of the appointment of a global custodian or sub-custodian, where it is expected that the international network of affiliates of the global custodian would provide sub-custodians for the assets of a mutual fund located in different countries. Therefore, subsections 6.1(4) and (5) are proposed to permit a mutual fund or custodian to consent generally to a list of sub-custodians that form the network of the global custodian or sub-custodian being appointed.

The CSA note that these provisions do not relieve custodians or sub-custodians from the requirements of sections 6.2 or 6.3.

Section 6.2

Section 6.2 sets out the requirements for entities that are qualified to act as custodian or sub-custodian for assets held in Canada.

The proposed National Instrument proposes to permit "affiliates" of banks or trust companies to be custodians or sub-custodians under prescribed conditions, rather than "wholly-owned subsidiaries" as in the 1997 Draft. The CSA are proposing this change to recognize the holding structure of a number of major international financial organizations, in which the entity providing custodial services may be an affiliate of, but not a wholly-owned subsidiary of, a bank or

trust company. The CSA note that the bank or trust company must still assume responsibility for the custodial obligations of the affiliate unless the affiliate satisfies the shareholders' equity requirement.

The proposed National Instrument also has been amended from the 1997 Draft to require that a bank or trust company "assume responsibility for the custodial obligations" of an entity proposing to act as custodian or sub-custodian, rather than guarantee those obligations. This amendment has been made in recognition that the banking law of some countries prevents banks from providing guarantees, but it permits a bank to support the obligations of another entity in its corporate group in other ways.

Section 6.3

Amendments corresponding to those made to section 6.2 have been made to section 6.3.

Section 6.4

Section 6.4 prescribes the contents of custodian and sub-custodian agreements to ensure that, in particular, non-Canadian sub-custodians are required to comply with the applicable provisions.

Paragraph 6.4(1)(c) has been added to require the provisions concerning lists of sub-custodians contained in subsection 6.1(5) are reflected in custodian and sub-custodian agreements.

Subsection 6.4(4) of the 1997 Draft, which required the manual delivery of custodian and sub-custodian agreements to the securities regulatory authorities, has been deleted as unnecessary.

Section 6.5

Section 6.5 sets out a number of general requirements for the holding of portfolio assets and the payment of fees.

Subsections 6.5(1) and (4) were amended to delete the following phrases: "or subcustodian or the applicable nominee" and "or a subcustodian of the mutual fund or their respective nominees". This was done in order to clarify that the CSA do not object to the use of omnibus accounts by sub-custodians or their nominees so long as appropriate records of ownership are maintained by the custodian.

Subsection 6.5(5) is new, and provides that a mutual fund shall not pay a fee to a custodian or sub-custodian for the transfer of beneficial ownership of portfolio assets of the mutual fund. This subsection has been added in order to impose a direct prohibition on mutual funds concerning these matters. The 1997 Draft contained only a requirement that such matters be dealt with in the custodian or sub-custodian agreements.

Section 6.6

Section 6.6 imposes a standard of care on custodians and sub-custodians, and limits the ability of a mutual fund to relieve those companies from liability resulting from a breach of that standard of care or to indemnify or insure them for liability resulting from a breach of that standard of care.

Section 6.6 has been amended from section 6.6 of the 1997 Draft to more closely conform to section 4.4 of the proposed National Instrument in order to ensure that all service providers to a mutual fund are held, to the extent possible, to similar standards of care. Paragraph 6.6(1)(a) is new and sets out, in effect, a minimum standard of care which is intended to be an objective standard. Paragraph 6.6(1)(b) retains the requirement of subsection 6.6(1) of the 1997 Draft and requires those custodians using a higher standard of care in the safekeeping of their own assets, to use that higher standard in the custodianship of assets held by the mutual funds for which they act as custodian.

Section 6.8

Section 6.8 largely carries forward section 6.8 of the 1997 Draft, but makes two amendments to that section in response to comments.

First, paragraph 6.8(2)(b) has been deleted as being virtually impossible for mutual funds to monitor and ensure compliance with, and second, subsection 6.8(4) has been amended to clarify the obligations of the mutual fund in this context.

Section 7.1

Subparagraph 7.1(a)(i) now provides that incentive fees payable by a mutual fund must be calculated with reference to a benchmark or index that reflects the fundamental investment objectives of a mutual fund. Section 7.1 also now clarifies that the rules applicable to incentive fees apply to incentive fees paid directly by securityholders to managers.

Section 9.1

Section 9.1, together with section 10.2, continues the regime established by NP39 that generally requires purchase or redemption orders to be transmitted by dealers to an "order receipt office" on the day the order is received, subject to exception, via courier, priority post, telephone or other electronic means.

Section 9.1 is largely unchanged from the 1997 Draft. The reference to an "office" in the 1997 Draft has been amended in sections 9 and 10 to refer to a "location" to recognize both the possibility of the receipt of orders electronically or at a location other than an office.

The CSA understand that many purchase and redemption orders are being placed through the electronic order processing system represented by FundSERV Inc. and that the longer time periods permitted by the proposed National Instrument may be superseded by the efficiencies of this electronic order processing system. The CSA also understand, however, that paper delivery systems are still used in the mutual fund industry to transmit purchase and redemption orders and accordingly, have retained the outside time periods required for delivery of paper orders.

Subsection 9.1(4) is new, and provides that a participating dealer or principal distributor that sends purchase orders electronically may specify a time on a business day by which a purchase order must be received in order that it be sent on that business day, and may send electronically purchase orders received after that time on the next business day. A corresponding change has been made by the addition of subsection 10.2(4) in connection with redemption orders. These changes have been included in response to comments that suggested that a cut-off time for the electronic transmission of orders is necessary for some dealers.

In addition, subsection 9.1(7) has been added to require a principal distributor or participating dealer to ensure that a copy of each purchase order received in a jurisdiction is sent to a compliance officer of that dealer in the jurisdiction by the time that it is sent to the order receipt office of the relevant mutual fund. Subsection 9.1(7) has been added to ensure that an appropriate compliance review of an order is possible for a dealer in the relevant jurisdiction.

Section 9.2

The time period within which a mutual fund can reject a purchase order has been reduced from the two day period provided for in paragraph 9.2(a) of the 1997 Draft to 24 hours.

Section 9.3

Section 9.3 provides that the issue price of a security of a mutual fund to which a purchase order pertains is the net asset value of a security of that class or series, next determined after the receipt by the mutual fund of the order. This section has been simplified from the version contained in the 1997 Draft, and a discussion of backward pricing moved to section 10.4 of the proposed Companion Policy.

Section 9.4

Section 9.4 sets out specific timing requirements for delivery to mutual funds of money received by participating dealers in respect of purchase orders. Section 9.4 also contains other requirements relating to the delivery of money for the purchase of securities and the settlement of purchases.

Subsection 9.4(1) has been simplified to respond to comments received that the timing provisions in the 1997 Draft were overly complex and that it is only necessary to reflect the industry practice of T+3 settlement. Subsection 9.4(1) now provides that all dealers, whether participating dealers or principal distributors, shall forward money received for payment of the issue price of securities of a mutual fund to an order receipt office of the mutual fund as soon as practicable and in any event no later than the third business day after the pricing date of the transaction. The 1997 Draft contained separate requirements that depended on when the money was received by the relevant dealer.

Subsections 9.4(4), (5) and (6) have been amended to deal with circumstances in which a cheque received for payment of securities of a mutual fund is returned NSF after the issue date of the relevant securities. These subsections require a mutual fund to reverse the transaction in the same manner as if money were never received by the settlement date. These subsections have been added to reflect comments received that if payment of a purchase order is made by cheque, it may be well after the third business day after the pricing date before an NSF cheque is returned to the mutual fund.

Paragraphs 9.4(6)(a) and (b) relate to the obligation of a principal distributor or participating dealer to pay to a mutual fund the amount of any deficiency resulting from a reversed transaction following a failure to settle a transaction. These paragraphs have been amended to provide that a principal distributor or participating dealer need not pay any deficiency owing by them until they have been notified by the mutual fund of the amount of that deficiency.

Part 10

In addition to the changes discussed below, changes corresponding to those made in Part 9 in relation to purchase orders, generally have been made in Part 10 in relation to redemption orders.

Throughout Part 10, and to a lesser extent, Part 9, the rules refer to a "securityholder" of a mutual fund. Certain of the comments the CSA received on the 1997 Draft indicated confusion on the part of the commenters as to the meaning of that word. In order to alleviate any confusion, the CSA have added section 10.2 to the proposed Companion Policy, which emphasizes that the proposed National Instrument is intended to regulate the relationship between mutual funds and their "registered" securityholders. The proposed National Instrument does not generally deal with the relationships between participating dealers and their clients that are governed by applicable securities law principles.

Section 10.1

Section 10.1 clarifies what requirements are applicable to mutual funds before they may pay redemption proceeds. It permits mutual funds to establish their own additional reasonable requirements as to what they must receive before they will either pay redemption proceeds or consider that a redemption order has been received.

Subsection 10.1(3) has been revised from the 1997 Draft to clarify that it is the manager's responsibility to provide a statement to securityholders outlining the requirements of the mutual fund regarding redemptions.

Section 10.6

As discussed above, subsections 10.6(3) and (4) of the 1997 Draft have been moved to Part 5 of the proposed National Instrument, without substantive change.

Part 11

Part 11 contains the requirements that a principal distributor of a mutual fund must satisfy in its dealings with money received by it or by a person or company providing services to the mutual fund for investment in, or upon the redemption of, securities of the mutual fund, or upon the distribution of assets of the mutual fund. Section 11.2 contains similar requirements applicable to a participating dealer or a person or company providing services to a mutual fund.

In British Columbia, consequential amendments are proposed to Section 58 of the *Securities Rules*, which deals with trust accounts.

Sections 11.1 and 11.2

Sections 11.1 and 11.2 have been amended as a result of comments received that it is necessary to take into account those third party service providers to a mutual fund that have been retained to process purchases and redemptions on behalf of the mutual fund.

Subsection 11.1(4) has been amended from the 1997 Draft to restore the ability of a principal distributor or person or company providing services to a mutual fund to pay interest on these funds to investors, or to mutual funds, pro rata according to cash flow. A discussion on the meaning of these terms has been added as subsection 11.1(5) of the proposed Companion Policy. An analogous change has been made to subsection 11.2(4) in connection with participating dealers. The provisions have also been amended to minimize the sending of small cheques.

Section 11.3

Section 11.3 is new and sets out the requirements concerning the operation of the trust accounts required to be established by sections 11.1 and 11.2.

The section contains requirements concerning the identification of such an account as a trust account and the access to the account. In addition, the section requires the dealer operating the account to advise in writing the financial institution with whom the account is opened that the money in the account is not to be used to cover shortfalls in any accounts of the dealer. The section also requires that the account bear interest at market rates and that no charges are to be taken out of the account.

The section is intended to clarify the responsibilities of dealers to establish "trust accounts". Neither the 1997 Draft nor NP39 contained any guidance as to what was intended by the term "trust account".

Section 11.4 of the 1997 Draft

Section 11.4 of the 1997 Draft has been deleted and replaced with references to service providers in sections 11.1 and 11.2. The CSA consider this a more direct way of ensuring that money handled by service providers to dealers are subject to the rules applicable to dealers handling money.

Section 12.1

Section 12.1 sets out the compliance report requirements, which are essentially unchanged from those contained in the 1997 Draft. Mutual funds, principal distributors and participating dealers must report on their compliance with the applicable sections relating to sales and redemption procedures and commingling of money requirements.

Subsection 12.1(1) has been amended to provide that the compliance report of a mutual fund that does not have a principal distributor shall be completed and filed within 140 days of the mutual fund's financial year end, rather than within 120 days as in the 1997 Draft. This change has been made as a result of comments received that this time period should be consistent with the time period within which mutual funds are required to file their financial statements under securities legislation.

Section 12.1 now requires that audit reports filed with compliance reports be in the form shown in appendices to the proposed National Instrument. Separate forms of audit reports, reporting on the compliance of mutual funds, principal distributors and participating dealers, are included in Appendix B to the proposed National Instrument.

Subsection 12.1(4) provides that subsection 12.1(3), which requires a participating dealer to file a compliance report in connection with its distribution of securities of a mutual fund in a financial year, is not applicable to members of certain specified SROs. This exemption reflects the CSA agreement with a comment received that the value of the reports contemplated by this section does not justify the costs of requiring IDA and stock exchange members to prepare them, in light of the level of supervision exercised by these SROs over their members. This exemption does not exclude SRO members who act as principal distributors of a mutual fund from the requirement to file compliance reports under subsection 12.1(2). The CSA will review the dealer requirements of this Part once all dealers, except for dealers in

Quebec, are members of an SRO.

Section 13.1

Subsection 13.1(4) requires that a mutual fund that arranges for the publication of its net asset value in the financial press shall ensure that its current net asset value is provided on a timely basis to the financial press. This provision is new, and has been added to reflect the views of the CSA that mutual funds should ensure that outdated net asset values not appear in the financial press.

Section 13.5

Section 13.5 contains valuation requirements for specified derivative positions of a mutual fund. Paragraph 6 has been added to section 13.5 to require that the value of a swap shall be the mark-to-market value of the swap.

Section 14.1

Section 14.1 contains the proposed requirements for establishing record dates for the making of distributions and payment of dividends by mutual funds. Section 14.1 has been amended from section 14.1 of the 1997 Draft by the deletion of references to record dates for the issue of rights by mutual funds. This change had been made for purposes of improving the clarity of the section and having regard to the fact that mutual funds rarely, if ever, issue rights to their securityholders. This section has also been redrafted to state more directly the applicable rule.

Part 15

Part 15 has been reorganized into smaller sections to improve readability and clarity. This section of this Notice describes only the substantive changes made to the provisions of Part 15. Reference should be made to the footnotes to Part 15 for cross-references to the comparable provision in the 1997 Draft.

Section 15.2

Section 15.2 contains the general requirements relating to sales communications.

Subsection 15.2(2) has been amended from subsection 15.2(4) of the 1997 Draft to require the text of a written sales communication to be at least as large as 10-point type, rather than 8-point type.

Section 15.3

Section 15.3 consolidates the various prohibitions concerning disclosure in sales communications that were contained in Part 15 of the 1997 Draft. The provisions of section 15.3 are substantially the same as in Part 15 of the 1997 Draft, with some amendments.

Subsection 15.3(1) is based on subsection 15.2(2) of the 1997 Draft and prohibits a sales communication from comparing the performance of a mutual fund or asset allocation service with any other benchmark or investment unless the sales communication presents data for the same time periods and provides appropriate disclosure concerning the comparability of the investments. Paragraph (d) has been added to this subsection to require that if a comparison is made to a benchmark, the benchmark had to exist and be widely available during the period for which the comparison is being made. The CSA have included this provision to address the practice of some mutual fund companies of providing a "comparison" of the past performance of a mutual fund with a hypothetical benchmark created by the mutual fund or the manager or portfolio adviser of the mutual fund.

Subsection 15.3(2) is new, and provides that a sales communication for a mutual fund or asset allocation service that is not yet permitted to disclose its own performance data may not provide performance data for any benchmark or investment other than a mutual fund or asset allocation service under common management with the mutual fund or asset allocation service to which the sales communication pertains.

Drafting changes have been made to subsections 15.3(3), (4), (5) and (6), without material substantive change. Subsection 15.2(5) has been revised to respond to a comment received by the CSA to clarify that a mutual fund may advertise itself as a money market fund if it meets the definition of that term either under NP39 or under the proposed National Instrument. The proposed National Instrument, as proposed in the 1997 Draft, changes the definition of a money market fund from that contained in NP39.

Section 15.4

Section 15.4 consolidates the mandatory disclosure requirements of the proposed National Instrument for sales communications. The required disclosure required by section 15.4 of the 1997 Draft and the warnings required by section 15.6 of the 1997 Draft have been combined, where possible, in this section, to order to reduce duplication. A number of small substantive changes have been made to the disclosure.

Subsection 15.4(1) has been amended from subsection 15.2(3) of the 1997 Draft to require a written sales communication to bear the name of the principal distributor or participating dealer that distributed the sales communication.

The statement that "past performance may or may not be repeated" contained in a number of the warnings of section 15.6 of the 1997 Draft has been replaced with a requirement to state that "how the fund has performed in the past does not necessarily indicate how it will perform in the future", which is based on a required disclosure statement under Proposed NI81-101.

Subsection 15.4(5) mandates a disclosure statement for asset allocation services. This provision is new, and replaces the general requirement contained in subsection 15.6(7) of the 1997 Draft to modify the prescribed mutual fund warnings, where required, for asset allocation services.

Subsection 15.4(7) mandates the required disclosure for sales communications relating to money market funds for which performance data is provided. Paragraph (b) of this subsection requires a statement to be given, immediately following the performance data, about the annualized return nature of the performance data, and the fact that the data does not represent an actual one year return.

Subsection 15.4(10) mandates disclosure requirements for sales communications for a mutual fund or asset allocation service that purports to guarantee or arrange for insurance, in either case, in order to protect all or some of the principal amount of an investment in the mutual fund or asset allocation service. This subsection requires disclosure of the material details of the guarantee or insurance arrangements, and has been included by the CSA in response to the development of guaranteed or insured mutual funds during the last year.

Subsection 15.4(11) states that a sales communication that does not contain performance data may contain a reduced warning if the full warning required by subsection (1) through (9) would constitute more than 50 percent of the text of the sales communication, area of a sign or if the sales communication is a radio or television advertisement.

In addition, the requirement of the 1997 Draft that mandated warnings contained in the subsection be included in sales communications "in close proximity" to the related performance data has been deleted, as the CSA consider it unnecessary except in the case of performance data of money market funds.

Section 15.5

Section 15.5 contains disclosure requirements concerning distribution fees, and is substantially similar to section 15.3 of the 1997 Draft.

Subsection 15.5(2) has been amended from the 1997 Draft. In the 1997 Draft, this subsection provided that a sales communication that referred to the existence or absence of fees must provide a summary of the types of fees and charges that exist; those requirements were not applicable in the case of references to "no load" or to mandated disclosure under the 1997 Draft. This provision has been amended so that a sales communication that refers to a mutual fund as "no load", shall include a summary of the fees and charges paid by the mutual fund and disclose the existence of any trailing commissions paid by a member of the organization of the mutual fund. The CSA believe that this

amendment is appropriate in order to avoid possible investor confusion.

Section 15.6

Section 15.6 contains the general requirements concerning the ability of a sales communication to contain performance data of a mutual fund or asset allocation service. The section is largely unchanged from paragraphs 15.4(1)(a) through (d) of the 1997 Draft and continues the prohibition contained in NP39 against so-called "young funds" disclosing performance data in sales communications. The clarifications discussed above in this Notice concerning the exclusions from the definition of the term "sales communications" were made in response to comments about the difficulties of young funds being able to comply with this prohibition.

The CSA have changed paragraph 15.6(b) from paragraph 15.4(1)(b) of the 1997 draft. That paragraph in the 1997 Draft stated that any standard performance data was to be provided in type "at least as prominent" as that used to present other performance data. The same requirement applied to money market funds disclosing both current yield and effective yield. Paragraph 15.4(1)(b), and the definition of standard performance data in subsection 15.10(2), have been revised to respond to comments received by the CSA to clarify that "at least as prominent" meant that the type size used to disclose standard performance data or current yield could not be smaller than that used for the other performance data or effective yield.

Section 15.7

Section 15.7 contains specific rules concerning advertisements of mutual funds or asset allocation services. This section restricts comparison of performance information of a mutual fund or asset allocation service in an advertisement to performance information of mutual funds or asset allocation services under common management or administration, or that have similar fundamental investment objectives, or with indices.

This section is a restriction on the general rules relating to comparisons contained in subsection 15.3(1).

The CSA have deleted from the proposed National Instrument the prohibition against the disclosure of performance data in an advertisement broadcast on radio or television. Performance data broadcast in those advertisements is proposed to be permitted, subject to the ordinary requirements of Part 15.

Section 15.8

Section 15.8 contains the requirements concerning the performance measurements periods for which standard performance data is to be given in a sales communication. The time periods for which such data is to be given are as in the 1997 Draft, except that the section now provides that for mutual funds or asset allocation services in existence for less than 10 years, standard performance data must be provided from inception.

Section 15.9

Section 15.9 imposes disclosure requirements for circumstances in which there has been a change to a mutual fund or asset allocation service during a performance measurement period for which performance data is given that could have materially affected the performance data.

Subsection 15.9(1) is substantially similar to paragraph 15.4(1)(i) of the 1997 Draft, except that it refers generically to changes in the business, operations or affairs of a mutual funds, in place of listing the types of changes that could have affected performance data.

Subsection 15.9(2) is new and has been included in order to clarify the nature of the performance data that may be provided for mutual funds that have continued after a merger or other reorganization with another mutual fund. The subsection provides that, a mutual fund continuing after a transaction that was or would have been (had the proposed National Instrument been in effect at the time the transaction was completed) a significant change for that fund may disclose performance data for periods before the transaction only if similar performance data is provided for the other mutual fund or mutual funds in the transaction. Also, if that continuing mutual fund does not wish to provide

performance data for the period before the transaction, then it must be treated as a new mutual fund and not disclose performance data until at least 12 months after the transaction. In no circumstances, however, may any performance data that "straddles" the transaction be presented.

Sections 15.10 and 15.11

Sections 15.10 and 15.11 set out the requirements applicable to the calculation of standard performance data, and are substantively unchanged from the 1997 Draft.

Subsection 15.10(6) was amended so that all performance data (i.e. not just standard performance data) must be calculated to the nearest one-tenth of one percent (or one-hundredth of one percent for a money market fund).

Part 16

Part 16 contains the general requirements concerning the calculation of a mutual fund's management expense ratio. These provisions have been moved from Proposed NI81-101 into the proposed National Instrument because these provisions apply beyond the prospectus context. No substantive comments were received on these provisions in connection with the comments received on Proposed NI81-101 and accordingly, the CSA have not amended these provisions in a material fashion, other than to add subsections 16.1(5) and (6) and section 16.2.

Subsection 16.1(5) provides that rebated management fees shall not be deducted from total expenses of a mutual fund in determining the management expense ratio of the mutual fund. The provision clarifies the views of the CSA in this regard.

Subsection 16.1(6) provides that a mutual fund that has separate classes or series of securities shall calculate a separate management expense ratio for each class or series in accordance with section 16.1, modified as appropriate. This provision is new and reflects existing practice in the industry.

Section 16.2 prescribes how the total expenses of a mutual fund that invests in securities of other mutual funds is to be calculated for purposes of calculating the management expense ratio. It is based on, but clarifies, similar provisions contained in NP39.

Parts 16 and 17 of the 1997 Draft

Parts 16 and 17 of the 1997 Draft have been deleted, as they related to aspects of prospectus disclosure now provided for in Proposed NI81-101. Those requirements have been included, as appropriate, in Proposed NI81-101.

Section 18.1

Section 18.1 was numbered as section 19.1 in the 1997 Draft. Section 18.1 requires a mutual fund that is not a corporation to maintain certain records.

Section 18.1 has been amended to require that the records contemplated by this subsection must be maintained for at least as long as the mutual fund is in existence.

The reference to a "register" in the 1997 Draft has been amended to refer to "records", to clarify that the information required to be maintained by this section does not need to be contained in a single place.

Section 18.2

Section 18.2 was numbered as section 19.2 in the 1997 Draft. Section 18.2 requires a mutual fund that is not a corporation to make the records referred to in section 18.1 available for inspection in certain circumstances.

Subsection 18.2(1) has been amended to ensure that securityholder records need only be made available for appropriate purposes, comparable to the provisions of corporate law.

Part 19

Part 19 was numbered as Part 20 in the 1997 Draft. Part 19 contains the provisions concerning the granting of exemptions and approvals.

Section 20.2 of the 1997 Draft has been deleted. It provided that, in certain circumstances, the granting of an exemption by the regulator or securities regulatory authority, could be evidenced by the issuance of a receipt for the prospectus or simplified prospectus of a mutual fund. The CSA are of the view that it is appropriate that a separate approval document be issued by the CSA to evidence exemptions from, or orders given under, the proposed National Instrument.

Subsection 20.3(4) of the 1997 Draft was deleted. It provided the regulators or securities regulatory authorities with the authority to limit or remove the ability of a mutual fund to rely upon exemptions or approvals given under NP 39 if considered in the public interest to do so. The CSA are of the view that mutual funds should be able to rely upon past exemptions or approvals granted for similar provisions contained in NP39. However, the CSA have discretion under applicable securities legislation to revoke an exemption or waiver previously granted. Therefore, subsection 19.2(1) is designed to clarify this point.

Part 20

Part 20 was numbered as Part 21 in the 1997 Draft. Part 20 contains provisions designed to facilitate the transition from NP39 to the proposed National Instrument.

Section 20.1 specifies the date on which the proposed National Instrument will come into force. This date will be completed when the proposed National Instrument is finalized later in 1999.

Section 20.2 allows sales communications, other than advertisements, that were printed before a specified date in 1999 to be used until a specified date in 2000. Again, these dates will be completed when the proposed National Instrument is finalized.

Section 20.3 provides that the proposed National Instrument does not apply to reports to securityholders that were published before the proposed National Instrument came into force.

Section 20.4 provides an exemption for existing mortgage funds from the provisions of the proposed National Instrument that limit the ability of a mutual fund to invest in mortgages. This section grandfathers mortgage funds that comply with National Policy Statement No. 29 ("NP29") and that are in existence and have a prospectus on the date that the proposed National Instrument comes into force. A person or company seeking to start a new mortgage fund after the proposed National Instrument comes into force, but before a new National Instrument replacing NP29 is in force, will be required to seek an exemption from paragraphs 2.3(b) and (c) of the proposed National Instrument. The CSA are engaged in preparing National Instrument 81-103 Mortgage Funds, which will replace NP29.

Section 20.5 provides that certain provisions of the proposed National Instrument do not come into force until specified dates.

Subsection 20.5(1) will provide that the following provisions do not come into effect until one year after the date on which most of the proposed National Instrument is to come into force:

(a) subsection 2.4(2), which prohibits mutual funds from holding more than 15 percent of their net assets in illiquid assets. The delayed coming into force of this provision is designed to give mutual funds adequate time to implement systems to monitor holdings of illiquid assets on an ongoing basis;

(b) subsection 2.7(4), which limits the exposure of a mutual fund to any counterparty in specified derivatives positions to 10 percent of the net assets of the mutual fund. The delayed coming into force of this provision is designed to give mutual funds adequate time to implement systems to monitor derivatives exposure to individual counterparties; and

(c) subsection 6.4(1), which prescribes the contents of custodian and sub-custodian agreements of a mutual fund. The

delayed coming into force of this provision is designed to permit mutual funds adequate time to amend all custodian and sub-custodian agreements to reflect the matters contemplated by section 6.4.

Subsection 20.5(2) will provide that subsection 4.4(1) does not come into effect until six months after the date on which most of the proposed National Instrument is to come into force. Subsection 4.4(1) requires that any agreement or declaration of trust by which a person or company becomes manager of a mutual fund contain certain provisions relating to the liability of the manager. The delayed coming into force of this provision is designed to allow mutual funds and persons and companies providing services to mutual funds adequate time to amend agreements to reflect these requirements.

Section 21.2 of the 1997 Draft, in effect, grandfathered prospectuses that were receipted before the proposed National Instrument came into force from the disclosure provisions previously required by the 1997 Draft. This provision has been deleted, and is dealt with in Proposed NI81-101.

Sections 20.2 through 20.5 are new.

Appendix A

Appendix A has been amended by the deletion of clearing corporations from the list. The concept of "acceptable clearing corporation" contained in subsection 2.7(4) of the proposed National Instrument has instead been introduced.

Appendix B

Appendix B now contains both the compliance reports and forms of audit reports to be used in connection with the requirements of Part 12.

Summary of Proposed Changes to the Proposed Companion Policy from the 1997 Draft Companion Policy

This section describes the material changes made in the proposed Companion Policy from the 1997 Draft Companion Policy. Changes made in order to ensure that the proposed Companion Policy conforms to the proposed National Instrument are not described here. For a detailed summary of the contents of the 1997 Draft Companion Policy, reference should be made to the 1997 Notice. Unless otherwise indicated, all section references in this section of this Notice pertain to the proposed Companion Policy.

Section 2.1

Section 2.1 is new, and has been added to provide guidance on how an "asset allocation service" under the proposed National Instrument differs from such products or services as wrap accounts or discretionary portfolio management.

Section 2.4

Section 2.4 is new, and has been added to provide guidance on the calculation required under paragraph (b) of the definition of "debt-like security" contained in the proposed National Instrument.

Section 2.5

Section 2.5 is new, and has been added to clarify that the component of the definition of "fundamental investment objectives" that indicates those objectives which distinguish a mutual fund from other mutual funds does not imply that the fundamental investment objectives for each mutual fund must be unique.

Section 2.7

Subsection 2.7(2) is new, and has been added to provide discussion on the requirement contained in the definition of "hedging" contained in the proposed National Instrument that a transaction or series of transactions be maintained.

Section 2.10

Section 2.10 was numbered as section 2.7 in the 1997 Draft Companion Policy. It has been amended to clarify that the definition of "manager" contained in the proposed National Instrument does not apply to persons or companies that do not actually direct the business of the mutual fund, such as a trustee or portfolio adviser.

Section 2.11

Section 2.11 is new, and has been added to discuss the definition of "option". Section 2.11 of the proposed Companion Policy states that the term "option" includes warrants, whether or not the warrants are listed on a stock exchange or quoted on an over-the-counter market.

Section 2.14

Section 2.14 is new and provides examples of types of transactions that the CSA would consider to constitute, or not to constitute "purchases" of securities.

Section 2.16

Subsection (4) has been added to this section to discuss paragraph (b) of the definition of "sales communication" in order to clarify that when extra information is added to a statutorily-required document, that extra information may constitute a "sales communication" under the proposed National Instrument.

Section 2.19

Section 2.19 is new, and states that the CSA are of the view that the definition of "swap" contained in the proposed National Instrument includes conventional interest rate and currency swaps, as well as equity swaps.

Section 3.2

Section 3.2 is new and discusses the requirement of subsection 2.2(3) of the proposed National Instrument that a mutual fund assume the conversion of each special warrant it holds.

Section 3.3

Section 3.3 is new and has been added to discuss the exclusion from the fund of fund rules contained in section 2.5 of the proposed National Instrument available to entities that fall within the definition of "mutual fund" found in securities legislation, but that are listed and posted for trading on a Canadian stock exchange and to index participation units that also fall within the definition of "mutual fund".

Section 4.2

Paragraph 4 has been added to section 4.2, in order to clarify that section 2.10 of the proposed National Instrument does not exempt a non-resident sub-adviser from the registration requirements in Ontario.

Section 4.3 of the 1997 Draft Companion Policy

This section discussed how the economic effects of swaps could be achieved by mutual funds even though swaps were not permitted derivatives under the 1997 Draft. This section has been deleted as the CSA propose to permit mutual funds to use swaps.

Part 5

Part 5 is new, and comments on the liability and indemnification provisions contained in Part 4 of the proposed National Instrument. The primary purpose of section 5.1 of the proposed Companion Policy is to emphasize that a

manager of a mutual fund is to be responsible for any losses resulting from its own failure, or the failure of a person or company providing services to the mutual fund or manager, to satisfy the statutory standard of care.

Section 6.3

Section 6.3 is new and clarifies the view of the CSA that the phrase "basis of the calculation of a fee or expense" used in paragraph 5.1(a) of the proposed National Instrument includes any increase in the rate at which a particular fee is charged to a mutual fund.

Section 7.2

Section 7.2 is new and clarifies that the definition of "fundamental investment objectives" includes the disclosure required under the simplified prospectus of Proposed NI81-101. That disclosure is to include both details about the fundamental nature of the investments to be made by the mutual fund and whether the mutual fund will be managed so as to constitute foreign property under the ITA. Section 7.2 clarifies that any change to the mutual fund requiring a change to that disclosure would trigger the requirement for securityholder approval under paragraph 5.1(c) of the proposed National Instrument.

Section 7.4

Section 7.4 discusses some aspects of the requirements imposed by the proposed National Instrument on mergers and other reorganization transactions between mutual funds and is based on the discussion contained in section 6.3 of the 1997 Draft Companion Policy.

Subsection 7.4(1) has been amended from the 1997 Draft Companion Policy to note that the CSA, in reviewing applications concerning proposed mergers or reorganizations that do not fall within the "pre-approved" merger provisions of the proposed National Instrument, will be looking to ensure adequate disclosure is given to investors. Statements made in the 1997 Draft Companion Policy relating to securityholder rights to redeem without penalty have been deleted.

Subsection 7.4(2) is new and notes that the CSA consider that a merger or reorganization in which a mutual fund merges into a smaller continuing mutual fund generally would constitute a significant change for the continuing mutual fund, thereby triggering the securityholder approval requirements of paragraph 5.1(g) and the disclosure obligations contained in section 5.10 of the proposed National Instrument.

Section 6.4 of the 1997 Draft Companion Policy

Section 6.4 of the 1997 Draft Companion Policy and statements concerning the performance of merging mutual funds contained in section 6.3 of the 1997 Draft Companion Policy have been deleted, since the CSA have proposed new rules dealing with performance data of continuing funds following a merger transaction in subsection 15.9(2) of the proposed National Instrument. However, subsection 6.4(3) of the 1997 Draft Companion Policy has been retained in the proposed Companion Policy as subsection 12.2(4).

Section 7.5

Section 7.5 is new, and has been added to state the views of the CSA on significant changes. The section states that the CSA believe that the departure of a portfolio adviser of a mutual fund will generally constitute a significant change for the mutual fund. Also, the departure of a high-profile individual from the portfolio adviser of a mutual fund may constitute a significant change for the mutual fund, depending on the circumstances.

Section 8.1

Section 8.1 has been amended from the 1997 Draft Companion Policy to note that the standard of care imposed on custodians and sub-custodians in the proposed National Instrument may require those entities to consider steps necessary to protect assets under custodianship from creditors, having regard to applicable bankruptcy and insolvency

legislation.

Section 8.3

Section 8.3 is new, and pertains to paragraph 6.7(1)(c) of the proposed National Instrument, which requires the custodian of a mutual fund to make any changes necessary to ensure that the custodian and sub-custodian agreements comply with Part 6. Section 8.3 clarifies that the necessary changes referred to in paragraph 6.7(1)(c) of the proposed National Instrument could include a change of sub-custodian.

Section 10.2

Section 10.2 is new, and has been added to clarify that references to "securityholder" in the proposed National Instrument, particularly in Parts 9 and 10, should be read as "registered securityholder". Section 10.2 also emphasizes the scope of the regulation of relationships in a mutual fund complex represented by the proposed National Instrument.

Section 10.4

Section 10.4 is new, and has been added to emphasize that the issue price and redemption price of a security of a mutual fund cannot be based upon any net asset value calculated before receipt by the mutual fund of the relevant order.

Section 11.1

Section 11.1 is new, and contains a discussion concerning some aspects of the operation of the trust accounts required to be established under Part 11 of the proposed National Instrument.

In particular, the section reminds dealers that the proposed National Instrument prohibits dealers from using money in the trust accounts from financing their operations in any way and describes other practices that the CSA consider to be in violation of the requirements of Part 11 of the proposed National Instrument.

Subsection 11.1(5) elaborates on the meaning of the phrase "pro rata based on cash flow" contained in Part 11 of the proposed National Instrument.

Parts 11 and 12 of the 1997 Draft Companion Policy

Parts 11 and 12 of the 1997 Draft Companion Policy have been deleted. They related to prospectus disclosure requirements and the review of simplified prospectuses by the CSA, which are now being dealt with in Proposed NI81-101.

Section 12.1

Section 12.1 contains discussion of a number of the sales communications rules contained in the proposed National Instrument. It is largely consistent with section 10.1 of the 1997 Draft Companion Policy, except subsection 12.1(5) is new and clarifies the relationship between performance data in sales communications with that required to be provided in a simplified prospectus by Proposed NI81-101.

Section 12.2

Section 12.2 also contains a discussion of sales communication rules contained in the proposed National Instrument. It is largely consistent with section 10.2 of the 1997 Draft Companion Policy, except that subsection 12.2(1) is new and gives examples of certain changes in the business, operations and affairs of mutual funds that could materially have affected performance data, if those changes had been place during the performance measurement period.

Section 13.1 of the 1997 Draft Companion Policy

Section 13.1 of the 1997 Draft Companion Policy has been deleted. Section 13.1 set out the procedure to obtain, in more than one jurisdiction, an approval under, or an exemption from, the 1997 Draft. This provision has been deleted because all such applications will be dealt with under proposed National Policy 12-201 Mutual Reliance Review System for Exemptive Relief Applications, which was published for comment by the CSA in November 1998.

Authority for Proposed National Instrument (Ontario)

In those jurisdictions in which the National Instrument is to be adopted or made as a rule or regulation, the securities legislation in each of those jurisdictions provides the securities regulatory authority with rule-making or regulation-making authority in respect of the subject matter of the proposed National Instrument.

In Ontario, the following provisions of the *Securities Act* (Ontario) (the "Act") provide the Ontario Securities Commission ("OSC") with authority to make the proposed National Instrument. Paragraph 143(1)13 of the Act authorizes the OSC to make rules regulating trading or advising in securities to prevent trading or advising that is fraudulent, manipulative, deceptive or unfairly detrimental to investors. Paragraph 143(1)31 of the Act authorizes the OSC to make rules regulating mutual funds or non-redeemable investment funds and the distribution and trading of the securities of the funds, including in connection with certain enumerated matters. Paragraph 143(1)35 authorizes the OSC to make rules regulating or varying the Act in respect of derivatives, including prescribing requirements that apply to mutual funds. Paragraph 143(1)39 of the Act authorizes the OSC to make rules requiring or respecting the media, format, preparation, form, content, execution, certification, dissemination and other use, filing and review of all documents required under or governed by the Act, the regulations or the rules and all documents determined by the regulations or the rules to be ancillary to the documents.

Alternatives Considered

The CSA have not seriously considered any alternatives to the making of the proposed National Instrument. The only alternative methods of achieving the regulatory goals contained in NP39 would be through the amendment of the securities legislation of the various provinces and territories or through the adoption of a specific mutual funds statute either at the provincial or the federal level. These approaches are not considered to be practical at the present time.

Related Instruments

The proposed National Instrument and Companion Policy are related to each other.

Unpublished Materials

In proposing the National Instrument and Companion Policy, the CSA have not relied on any significant unpublished study, report, decision or other written materials.

Anticipated Costs and Benefits

Mutual fund issuers and service providers to mutual funds should benefit, over the longer term, from the proposed National Instrument and the Companion Policy. The intent of the CSA in preparing the proposed National Instrument is to (i) clarify the mandatory rules applicable to mutual funds and their related service providers and (ii) to update those requirements to reflect current administrative practice and the views of the CSA. For the most part, the proposed National Instrument does not impose rules on mutual fund issuers and their service providers that are substantially different from those rules and policies under which mutual funds and their service providers have historically been governed. Accordingly, the proposed National Instrument and Companion Policy should not impose significantly greater compliance costs than are currently borne by mutual funds and their service providers, and may result in a lessening of those costs, assuming the CSA have been successful in their aim to achieve legislative certainty and clarity in the rules. The CSA anticipate that mutual funds and their service providers may experience a transition period in which costs are incurred in reviewing and understanding the rules provided for in the proposed National Instrument, but that such transition period will not be materially different from the transition period for any rule of the CSA replacing an existing rule or policy of the CSA.

Some of the changes from NP39 that are contained in the proposed National Instrument may create some compliance

costs for mutual funds and their service providers. For instance, under the proposed National Instrument, a mutual fund will be required to

(a) monitor the ongoing level of its illiquid assets to ensure that it does not breach the ongoing 15 percent restriction;

(b) monitor its exposure to counterparties in derivatives transactions to ensure that it does not breach the new restriction against exposure of more than 10 percent of its net assets to a counterparty other than an acceptable clearing corporation or a clearing corporation that clears and settles transactions made on a futures exchange listed in Appendix A to the proposed National Instrument;

(c) incur costs associated with compliance with the proposed disclosure requirements for "significant changes" to a mutual fund contained in the proposed National Instrument.

Mutual funds and service providers may also incur costs to amend material contracts in order to conform with the requirements of the proposed National Instrument. However, as discussed above, section 20.5 of the proposed National Instrument prescribes transitional periods to provide adequate time for such changes.

In addition, a money market fund may be required to sustain costs making adjustments to its portfolio in order to continue to fall with the definition of "money market fund" in the proposed National Instrument. Also, certain reorganization transactions that are capable of being completed under NP39 without securityholder approval may require securityholder approval under the proposed National Instrument.

Principal distributors and participating dealers may incur costs related to the removal of the provisions contained in NP39 that permit them to recover amounts paid in connection with failed sales and redemptions of securities of mutual funds.

On the other hand, the CSA expect that certain regulatory costs may be reduced, since the CSA have not brought forward into the proposed National Instrument requirements currently provided for in NP39 to seek prior Canadian securities regulatory authorities in respect of a number of matters. For instance, the proposed National Instrument substitutes specific rules for the necessity to seek prior Canadian securities regulatory approvals in respect of in specie purchases, incentive fees, certain prescribed mergers and investments in certain instruments, among other things.

Industry participants and investors in mutual funds should benefit from the modernization of the rules applicable to public mutual funds and from any reduction in costs incurred by mutual fund issuers and their service providers in complying with these rules. For example, by permitting the use of swaps, mutual funds will no longer have to incur the costs of entering into a series of forward contracts in order to simulate the effect of a swap.

Regulations to be Revoked or Amended

The OSC will request the Lieutenant Governor in Council to revoke the references to NP39 contained in sections 52 and 81 of the Regulation.

Comments

Interested parties are invited to make written submissions with respect to the proposed National Instrument and Companion Policy. Submissions received by May 18, 1999 will be considered.

Submissions should be sent to all of the Canadian securities regulatory authorities listed below in care of the Ontario Securities Commission, in duplicate, as indicated below:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
The Manitoba Securities Commission
Ontario Securities Commission

Office of the Administrator, New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland
Securities Registry, Government of the Northwest Territories
Registrar of Securities, Government of the Yukon Territory

c/o Daniel P. Iggers, Secretary

Ontario Securities Commission

20 Queen Street West

Suite 800, Box 55

Toronto, Ontario M5H 3S8

E-mail: diggers@osc.gov.on.ca

Submissions should also be addressed to the Commission des valeurs mobilières du Québec as follows:

Claude St. Pierre, Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square
Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montréal, Québec H4Z 1G3
E-mail: claude.stpierre@cvmq.gouv.qc.ca

A diskette containing the submissions (in DOS or Windows format, preferably WordPerfect) should also be submitted. As securities legislation in certain provinces requires that a summary of written comments received during the comment period be published, confidentiality of submissions cannot be maintained.

Comments may also be sent via e-mail to the above noted e-mail addresses of the respective Secretaries of the Ontario Commission and to the Commission des valeurs mobilières du Québec, and also to any of the individuals noted below at their respective e-mail addresses.

Questions may be referred to any of:

Robert Hudson
Manager and Senior Legal Counsel
British Columbia Securities Commission
(604) 899-6691
or (800) 373-6393 (in B.C.)
E-mail: rhudson@bcsc.bc.ca

Noreen Bent
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Proposed National Instrument and Companion Policy

The text of the proposed National Instrument and Companion Policy follow, together with footnotes that are not part of the proposed National Instrument or Companion Policy, but have been included to provide background and explanation.

DATED: March 19, 1999.

APPENDIX A
LIST OF COMMENTERS ON PROPOSED NI 81-102 MUTUAL FUNDS AND PROPOSED COMPANION POLICY 81-102CP

MUTUAL FUNDS
PUBLISHED FOR COMMENT JUNE 1997

1. American Stock Exchange

2. Bank of Montreal Investment Management Limited

3. Brown Brothers Harriman & Co.

4. Canadian Imperial Bank of Commerce and State Street Trust Company Canada (one submission)

5. CIBC Wood Gundy Securities Inc.

6. Cassels Brock & Blackwell

7. Fasken Campbell & Godfrey

8. Fasken Campbell Godfrey on behalf of Beutel Goodman Managed Funds Inc.

9. Fidelity Investments Canada Limited

10. Investors Group Inc.

11. Joe Killoran

12. la Société financière Azura Inc.

13. McCarthy Tetrault

14. McMillan Binch

15. McMillan Binch on behalf of Royal Mutual Funds Inc. and Royal Bank Investment Management Inc.

16. Manulife Securities International Ltd.

17. Morgan Stanley & Co. Incorporated

18. Osler Hoskin & Harcourt (two submissions)

19. Quebec Professionals Fund (fonds des professionnels inc.)

20. RBC DS Global Markets

21. Royal Bank Investment Management Inc.

22. Royal Trust Corporation of Canada

23. Sceptre Investment Counsel Limited

24. Scotia Securities Inc.

25. Thomson BankWatch, Inc.

26. Trimark Investment Management Inc.

27. The Association of Global Custodians

28. The Canadian Bankers Association (three submissions)

29. International Swaps and Derivatives Association, Inc.

30. Investment Dealers Association of Canada (two submissions)

31. The Investment Funds Institute of Canada

APPENDIX B
SUMMARY OF COMMENTS RECEIVED ON PROPOSED NATIONAL INSTRUMENT 81-102 MUTUAL FUNDS
AND
PROPOSED COMPANION POLICY 81-102CP
MUTUAL FUNDS
AND
RESPONSE OF
THE CANADIAN SECURITIES ADMINISTRATORS

1. INTRODUCTION

In June 1997, the Canadian Securities Administrators (the "CSA") released for public comment proposed National Instrument 81-102 Mutual Funds (the "1997 Draft NI") and proposed Companion Policy 81-102CP Mutual Funds (the "1997 Draft CP"). During the comment period on the 1997 Draft NI and the 1997 Draft CP, which ended on October 31, 1997, the CSA received 35 submissions from 32 commenters. The commenters can be grouped as follows:

Mutual fund management companies:	10
Stock exchanges and rating agencies:	2
Brokers and dealers:	6
Law firms:	5
Financial Institutions:	3
Trade Associations:	5
Individuals:	1
TOTAL:	**32**

The five trade associations listed each made submissions in respect of the 1997 Draft NI and the 1997 Draft CP on behalf of their respective members.

Copies of the comment letters may be viewed at the office of Micromedia, 20 Victoria Street, Toronto, Ontario (416) 312-5211 or (800) 387-2689; the office of the British Columbia Securities Commission, 200-865 Hornby Street, Vancouver, British Columbia (604) 899-6660; the office of the Alberta Securities Commission, 10025 Jasper Avenue, Edmonton, Alberta (403) 427-5201; and the office of the Commission des valeurs mobilieres du Quebec, Stock Exchange Tower, 800 Victoria Square, 22nd Floor, Montreal, Quebec (514) 940-2150.

The CSA have considered the comments received on the 1997 Draft NI and the 1997 Draft CP and thank all commenters for providing their comments. The nature and extent of the comments received indicates the care and thought given by industry participants to the issues addressed in the 1997 Draft NI and the 1997 Draft CP. The CSA considered the comments very helpful in their further development of the proposed National Instrument and the proposed Companion Policy.

Many of the commenters provided detailed comments on specific sections of the 1997 Draft NI and the 1997 Draft CP. Some comments were of a very technical, non-substantive nature. This Appendix B to the Notice of Changes is a summary of the substantive comments received, together with the CSA's responses and, where applicable, the changes

adopted by the CSA. Appendix C to the Notice of Changes contains a summary of all comments received, including all comments of a non-substantive technical nature.

2. GENERAL COMMENTS

A number of commenters, including The Investment Funds Institute of Canada ("IFIC"), noted that the 1997 Draft NI and the 1997 Draft CP contained a number of changes and simplifications that have been discussed and raised with the CSA over the past several years. These commenters indicated that they believed the revised rules would be helpful to mutual funds in removing unnecessary regulatory burdens.

On the other hand, several commenters, including IFIC, noted that the 1997 Draft NI and the 1997 Draft CP did not propose rules to deal with several outstanding issues, such as fund of funds structures, the use of repurchase agreements and inter-fund trading, all of which, among others, have been the subject of discussion between the commenters and the CSA over the past several years.

As described in the Notice for the 1997 Draft NI (the "1997 Notice"), the CSA sought to reformulate National Policy Statement No. 39 with the 1997 Draft NI and the 1997 Draft CP and did not wish to address new rules where policy projects were ongoing.

As noted in the Notice of Changes, the CSA received a large number of comments concerning the need for change in the following seven areas:

- Use of swap instruments by mutual funds;
- Securities lending by mutual funds and the use of repurchase agreements;
- Standardized regime for the structure of so-called "funds of funds";
- Timing of transfers among financial institutions and among mutual funds;
- Principal trading in securities between mutual funds and entities related to the manager of the mutual fund;
- Acquisition of securities by mutual funds from underwriters related to the mutual fund manager;
- Inter-fund trading.

The CSA have described how they propose to deal with these comments in the Notice of Changes. The applicable comments were primarily to the effect that greater flexibility should be built into the proposed National Instrument to permit mutual funds to engage in the activities indicated. The CSA will consider the comments received relating to these issues when developing the proposed rules contemplated in the Notice of Changes. The CSA considered the comments received in respect of the need to permit mutual funds to use swap instruments when developing the rules proposed in the proposed National Instrument.

3. COMMENTS ON SPECIFIC PROVISIONS

Section references in this section of this Appendix are to the section numbers of the 1997 Draft NI and 1997 Draft CP, unless otherwise noted.

Part 1 - Definitions and Application

Section 1.1 - Definition of "advertisement"

A commenter noted that the definition of "advertisement" is too broad since it appears to capture all written sales communications. The 1997 Draft CP states that the term "public medium" will be interpreted to include all forms of print. The result is that all written sales communications (such as brochures and prospecting letters) are treated

the same as advertisements and subject to the stricter rules on the disclosure of performance data. The commenter does not believe that this was the intention of the CSA. The proposed National Instrument retains the distinctions between advertisements and sales communications as in NP39. The definition of "sales communication" has been narrowed from that in NP39 to be a communication (both written and oral) by named parties associated with a mutual fund. An "advertisement" is a subset of "sales communication". It is published or designed for use on or through a "public medium".

Definition of "approved credit rating" and "approved credit rating organization"

It was recommended that Thomson BankWatch, Inc. be included in the definition of "approved credit rating organization" and that its ratings of B or better should be included in the definition of "approved credit rating". It was submitted that this would enlarge the universe of persons with whom Canadian mutual funds may deal without adding inappropriate credit risk. Thomson BankWatch, Inc. ratings are accepted by Securities and Exchange Commission in the United States and other regulators. The CSA have made this change. The rating categories for Thomson BankWatch, Inc. recognized in the proposed National Instrument as "approved credit ratings" are one level higher than the lowest investment grade category of Thomson BankWatch, Inc.

Definition of "asset allocation service"

A commenter expressed concern that this definition would include services not provided by a registrant (for example, portfolio management services offered on an exempt basis) and recommended that the definition be amended to clarify that it only applies to a service offered by a registrant. Another commenter also thought that the definition was too broad and that the definition should be limited to situations where a fund manager or an affiliate chooses a combination of its own or affiliated funds in accordance with its strategy with a view to meeting the goals of an investor. It was also suggested that the term "asset allocation strategy" be defined. The CSA has amended the definition to recognize that an "asset allocation service" may invest in other assets (GICs etc.) in addition to investing in mutual funds that are subject to the proposed National Instrument. The definition includes only specific administrative services in which an investment in mutual funds (which are subject to the proposed National Instrument) is an integral part. The definition does not include general investment services such as discretionary portfolio management that may, but are not required to, invest in mutual funds subject to the proposed National Instrument. The CSA decided that a definition of "asset allocation strategy" was not required in order for the term "asset allocation service" to be understood. Further explanation of this definition has been added to section 2.1 of the proposed Companion Policy.

Definition of "cash equivalents"

A commenter recommended that the definition should include fund receivables that may arise from the disposition of portfolio securities and the acceptance of purchase orders for mutual fund securities. When a mutual fund disposes of portfolio securities it should be permitted to replace immediately the market exposure as it would on a subsequent purchase of portfolio securities. If not permitted to do so, a mutual fund could be required to reduce its exposure in certain situations even though no leverage is being used, thereby leaving the fund potentially under-invested. The CSA have amended the definition of "cash cover" to permit receivables, net of payables, arising from the disposition of portfolio assets, to be used for cash cover by a mutual fund. Receivables related to purchase orders have not been included in the definition because the CSA believe the risk that the mutual fund may not actually receive these monies is greater than the added efficiencies to mutual funds this proposed change would permit.

Definition of "conventional convertible security"

A commenter stated that the definition did not cover certain preferred shares and other convertible securities that include a "soft retraction" feature allowing the issuer to settle the conversion with a cash payment. As a result, these instruments fall within the definition of "specified derivative". It was suggested that the cash settlement exclusion in the definition be deleted so as not to restrict the ability of funds to acquire such convertible securities. The CSA have made this change. A similar change has been made to the definition of "conventional warrant or right".

Definition of "debt-like security"

A commenter recommended that the term "conventional floating rate debt instrument" be defined and commented that the term is not used elsewhere in the 1997 Draft NI. Also, the definition seems to encompass certain types of derivatives that do not entail any leverage or other characteristics that should necessitate their use being subject to the restrictions applicable to debt-like securities. Other commenters recommended including a method to determine the derivative component of the debt instrument. The CSA have defined the term "conventional floating rate debt instrument" in response to this comment. Also, paragraph (b) of the definition has been amended to provide that the value of the component of the security that is not linked to the underlying interest must account for less than 80% of the purchase price in order for the security to be considered a "debt-like security". Paragraph (b) has also been amended to provide that the calculation is made at the date of acquisition of the security by the mutual fund, rather than at the date of issue.

Definition of "hedging"

Commenters stated that the requirement to maintain a position is potentially problematic if a portion of the hedge is removed for tactical reasons or if part of the underlying exposure being hedged is reduced. The commenters requested an explanation of the rationale for this requirement. The CSA have addressed this comment through the additional explanation given in subsection 2.7 of the proposed Companion Policy. This section clarifies that the component of the definition that requires the "maintaining" of a hedge position does not mean that a mutual fund is locked into a specified derivatives position. Instead, it means that the specified derivatives position must continue to satisfy the definition of "hedging" in order to receive hedging treatment under the NI.

Definition of "illiquid asset"

A commenter stated that over-the-counter ("OTC") options and forwards could be considered illiquid because they are not disposed of through market facilities on which public quotations in common use are available. This may be an undesirable result if the positions have other features that "effectively" make them liquid (for example, the terms of the option or forward and the required credit rating of the counterparty). Another commenter also stated that the requirement for disposal through market facilities on which public quotations in common use are widely available should not be imposed in all cases. Some assets such as convertible debentures and special and purchase warrants do not trade through market facilities but can be disposed of readily at an amount at least equal to the amount at which the asset is valued for net asset value ("NAV") purposes. Such assets should not be classified as illiquid. It was also recommended that the definition should contemplate that the sale price of a security can be reduced by transaction costs. Another commenter questioned why the illiquid test applies to derivatives used for non-hedging purposes but not to derivatives used for hedging purposes.

The CSA note that NP39 deemed all options to be illiquid. The proposed National Instrument considers options to be liquid if they satisfy the test. The CSA recognize that OTC options probably do not have a market facility with a public quotation in common use and that the effect of the section is that such options are illiquid assets. The CSA believe that an objective test is necessary (i.e. a fund must be able to sell at any time via an auction market at a quoted price) and have not amended the proposed National Instrument in this regard.

The words "at least equal to" have been deleted and replaced with the words "that at least approximates". The CSA made this change to recognize that the sale price of securities will be reduced by transaction costs.

Definition of "index participation unit"

Commenters recommended that the definition include "foreign" index participation units. It was also recommended that the definition require units to be traded on an exchange but not require that such units be sponsored by an exchange. The CSA have made this change and accordingly, the definition includes index participation units listed (but not necessarily sponsored by) on a stock exchange in Canada and the United States.

Definition of "manager"

A commenter stated that the definition inadvertently captures third party advisors who may have certain powers

and responsibilities with respect to a fund. The CSA have amended this definition to ensure clarity. The CSA note that the definition does not apply to a person or company whose duties are limited to acting as a service provider to a mutual fund. Further explanation is given in section 2.10 of the proposed Companion Policy.

Define/clarify the meaning of "office"

Commenters recommended that the word "office", used in Parts 9 and 10 of the 1997 Draft NI, be clarified so that it includes remote or "virtual" offices. This is necessary because some representatives of participating dealers service remote, rural areas and therefore have "mobile" offices. The CSA do not consider it necessary to define the word "office", however, Parts 9 and 10 of the proposed National Instrument have been amended by replacing the word "office" with word "location" to recognize both the possibility of the receipt of orders electronically or at a location other than an office.

Definition of "order receipt office"

A commenter recommended that the definition be amended to make sure that it permits the use of technology to timestamp and verify orders that are placed electronically (i.e. no physical office or premises is involved in the process). The definition has been amended by replacing the reference to "office" with a reference to "location" in order to accommodate delivery of orders to electronic sites.

Definition of "permitted derivatives"

A number of commenters recommended including swaps in the definition. It was submitted that a swap can be a more effective and less expensive hedging device than other types of derivatives. The distinction between swaps and permitted derivatives in the 1997 Draft disadvantages mutual funds by exposing them to unwanted market risk and the increased transaction costs of entering into multiple forward contracts (in order to replicate a swap). The existing guidelines could be easily adapted to permit the use of swaps by requiring mutual funds to maintain "cash cover" for any net obligation the mutual fund may have with respect to its swaps. It was also submitted that the Canadian swap market is efficient, mature, highly liquid and relatively easy to understand. Swaps are a proven risk management tool and, at least initially, their use should be permitted for hedging purposes only. Other rules in the proposed National Instrument could be amended to include swaps but term limits should not be imposed. If a term limit is imposed 15 years would be appropriate, at least until further comfort is developed with the use of swaps by mutual funds.

Some commenters questioned whether it was necessary to define swaps since the term has a clear and accepted meaning. However, it was suggested that if a definition of swaps was considered necessary, the CSA should consider the term "contract for differences" which is included in section 1.1 of the Ontario Securities Commission's Proposed Rule 91-504 - Over-the Counter Derivatives.

Another commenter questioned why the definition of permitted derivatives includes listed warrants but not unlisted warrants. It was suggested that unlisted warrants be added to the definition of "permitted derivatives" and that they be subject to s. 2.3(2)(a) restrictions.

The CSA have deleted the term "permitted derivative" from the proposed National Instrument in order to improve clarity. Mutual funds can invest in "specified derivatives" subject to the investment restrictions and conditions set out in Part 2 of the proposed National Instrument.

The CSA also have amended the proposed National Instrument to permit the use of swaps by mutual funds. Swaps can be used for hedging or non-hedging purposes and are subject to a 5 year term limit, in a fashion similar to other derivative instruments.

The CSA propose to permit both listed and unlisted warrants to be acquired by mutual funds as specified derivatives. The terms "listed" and "listed warrant" have been deleted since it is no longer necessary to distinguish between listed and unlisted warrants in the proposed National Instrument.

A number of commenters questioned why mutual funds are not permitted to use derivatives (for hedging and

non-hedging purposes) with underlying interests in commodities other than gold. Derivatives that have physical commodities as their underlying assets can be very valuable in reducing risk and diversifying a mutual fund's risk exposure. The use of commodity derivatives may be governed in the same way as "permitted derivatives" with cover requirements, counterparty restrictions and position limits. Concerns about delivery requirements that accompany physically settled derivatives could be addressed by restricting mutual funds to cash settled derivative products. The CSA have not made this change. The proposed National Instrument prohibits mutual funds from investing in physical commodities other than gold. Therefore mutual funds should be prohibited from investing in physical commodities other than gold through the use of derivatives.

Definition of "permitted gold certificates"

A number of commenters recommended removing the insurance requirement from the definition since it "effectively excludes gold certificates issued by banks". Banks do not specifically insure the precious metal against loss or bankruptcy. There is no policy reason for the insurance requirement provided the issuer of the certificate has an approved credit rating. One commenter also suggested that a mutual fund also be permitted to purchase metal certificates representing silver, platinum, palladium, rhodium and iridium. The CSA have amended the definition to specifically permit the acquisition of gold certificates from a bank listed in Schedule I or II of the *Bank Act* (Canada) without the need for specified insurance. The CSA have not amended the proposed National Instrument to permit a mutual fund to invest in other precious metals. The restriction on investing in physical commodities other than gold is continued from NP39.

Definition of "pricing date"

Some commenters questioned whether the definition should be applicable for redemptions as well as sales. The CSA consider that no change is required since the definition is only for the delivery of funds and settlement related to the sale of mutual fund securities and the rules applicable to redemption of mutual fund securities are comprehensible without a definition of "redemption date".

Definition of "sales communication"

A commenter suggested that the words "to the mutual fund or asset allocation service" be deleted and replaced with the words "any of the above". It was also suggested that the qualification in clause (a)(ii) that the communication be made to induce a purchase of mutual fund securities should apply to existing securityholders (see (a)(i)). A commenter questioned why the definition was more narrow than the NP39 definition which covered communications made by any person or company. Another commenter suggested that paragraph (b) of the definition should exclude communications contained in financial statements. Concern was expressed that the new definition would include statements of account and information notices that do not include financial statements of the relevant fund. This would require the inclusion of warnings in such communications. The CSA have made several changes to the definition in response to these comments, although no change was made to clause (a)(i).

Definition of "significant change"

Some commenters noted that the definition differed from the definition of "material change" relating to investment funds that was published in Request for Comment 51-901 - Report of the Toronto Stock Exchange Committee on Corporate Disclosure and Proposed Changes to the Definitions of "Material Fact" and "Material Change". They questioned why the definition would be different. It was suggested that the term be renamed as "material change". A concern was raised about paragraph (b) of the definition and the requirement in section 5.8 of the 1997 Draft NI to file an amended prospectus disclosing the "significant change". The commenter objected to a requirement that would cause a mutual fund to amend its prospectus to disclose a "significant change" prior to board approval. The CSA have amended the definition to clarify its meaning without substantive change. The CSA will ensure that any proposed legislative changes to the definition of "material change" in a mutual fund context conform to the proposed National Instrument. If legislative amendments are made, the CSA will amend the proposed National Instrument as appropriate. The CSA note that paragraph (b) of the definition is consistent with current securities legislation.

Definition of "specified derivative"

A commenter stated that the definition should exclude index participation units of a stock exchange or customized indices listed and traded on a stock exchange (TIPS, HIPS, WEBS, etc).

Another commenter suggested that unlisted equity dividend shares also be excluded. The commenter also questioned why "listed warrants" are not also excluded. A commenter recommended excluding listed capital shares of subdivided equity securities. The CSA have amended the definition of "index participation unit" in response to comments and have made changes to the definition of "specified derivative" in response to these comments. The reference to "listed" subdivided shares and the definition of "listed warrants" have been deleted. All warrants may be acquired as specified derivatives (as "options") except for "conventional warrants or rights" which are excluded from the definition of "specified derivative".

Definition of "synthetic cash"

A commenter suggested deleting paragraphs (a) and (b) because they unnecessarily limit the means by which such a position is achieved. It was recommended that the definition should be flexible enough to include other structures that may be identified in the future to create synthetic cash. The CSA have not made this change. The technique listed is a conservative technique for creating synthetic cash that is in keeping with the objective for cash cover and its need where mutual funds are using derivatives. The CSA are not comfortable with permitting mutual funds to derive their own techniques without any regulatory guidance.

Section 1.2 - Application

A commenter recommended extending the application of the proposed National Instrument to all investment products similar to mutual funds, including wrap accounts offered through brokerages, segregated funds offered by insurers, labour sponsored investment funds as well as asset allocation services. All products of similar characteristics should be covered under the same regime with the same standards for review, disclosure and fees. The CSA have not changed the application of the proposed National Instrument. This recommendation is beyond the scope of the proposed National Instrument.

Sections 2.1 and 2.2 (general)

The CSA received a number of comments recommending the adoption of a "prudent person" test for mutual fund investments in place of a list of investment restrictions and practices. A number of commenters argued that a "prudent person" standard has been adopted as an acceptable standard of regulation for pension funds. The CSA consider that it would be premature to remove the listed investment restrictions and practices. The CSA are of the view that certain investment restrictions and practices are necessary to ensure that the essential nature of a mutual fund (that is, the right of investors to redeem securities on demand) is maintained. A primary purpose of investment and borrowing limitations on mutual funds is to ensure that a mutual fund has sufficient liquidity to meet redemption requests and to address the fund's risk profile. The CSA understand that most international mutual fund regulators impose some form of investment restrictions on mutual funds instead of following a broad "prudent person" standard.

Furthermore, the analogy to pension fund regulation may not be entirely appropriate since a pension fund is not faced with the same liquidity requirements as a mutual fund which must be able to process redemption requests on demand. The CSA further note that pension fund investments in Canada continue to be subject to investment restrictions and not to a broad "prudent person" standard. For example, in Ontario the regulations under the Pension Benefits Act impose quantitative restrictions on investments by pension funds. It is important to note that the proposed National Instrument does not impose a "legal for life" regime on mutual fund investment. A mutual fund can and must be managed prudently albeit subject to the investment restrictions and practices set out in the proposed National Instrument. The proposed National Instrument also has broadened the scope of permissible investments by permitting mutual funds to invest in swaps.

Section 2.1(1)(a)

Some commenters stated that the restrictions on investments in government debt of countries other than Canada and the U.S. are inflexible and unduly restrictive. It was recommended that a "prudent person" standard be adopted to some degree to allow more latitude for investing in foreign bonds by international bond and income funds provided there has been adequate disclosure to investors. Instead of requiring applications for *ad hoc* relief, the circumstances articulated in the proposed Companion Policy in which the CSA will provide relief should be re-characterized as permitted deviations from the investment restrictions. The CSA have not changed section 2.1.

Section 2.1(1)(a)

A commenter questioned why supranational and country debt cannot be used as cash cover without being subject to the 10% restriction in section 2.1(1)(a) since there is no limit on the use of such debt for hedging purposes (section 2.3). The CSA have not made this change and consider that there is no compelling reason to exempt securities used for cash cover purposes, other than a "government security", from the 10% restriction.

Section 2.1(1)(b)

A number of commenters recommended deleting the 10 percent restriction on holdings of a series of a class of securities. The restriction on holding more than 10 percent of a class was considered sufficient. One commenter recommended that section 2.1(4) be expanded to include listed permitted derivatives, conventional rights and warrants, and conventional convertible securities so that a fund is not in violation of the 10 percent limit if, upon conversion, the fund would continue to hold less than 10 percent of any class of an issuer's securities. Another commenter questioned what constitutes a "class or series of a class" of debt securities. It was noted that section 2.1(6) permits aggregation of short term debt. It was suggested that aggregation be permitted for more than just short-term debt and that the aggregation of "like-debt" (i.e. debt that has the same essential elements -- same covenant of the issuer, same security (or lack thereof), same priority *inter se*) be permitted. A typical example is a debt facility created under a single indenture or like instrument where the individual debt securities may be issued over time and may vary in only narrow respects (usually term to maturity and coupon rate). The application of the 10 percent restriction in such cases could mean that mutual funds cannot purchase medium term notes which are often issued to a single purchaser on a given day, designated under a separate CUSIP number and identified by a specific series designation. Another commenter raised concerns about the treatment of share purchase warrants acquired in the context of special warrant offerings. Treating such share purchase warrants as a separate class of securities and therefore subject to the 10 percent limit is unduly restrictive. Instead, such purchase warrants represent a position in the underlying security and the concentration should be measured at that level.

The CSA have amended section 2.2 of the proposed National Instrument to respond to these comments. Section 2.2 applies only to the acquisition of securities carrying more than 10 percent of the votes of an issuer, or to the acquisition of more than 10 percent of the equity securities of an issuer. The purpose of the restriction is to prevent a mutual fund from acquiring securities of an issuer that would enable the mutual fund to exert control over the issuer.

Section 2.1(1)(f)

A commenter stated that under NP39 "restricted securities" were not deemed to be illiquid assets as they are in the NI. Therefore, it was conceivable that a fund could have 10 percent of its assets in restricted securities and 10 percent of its assets in illiquid assets. The proposed National Instrument should distinguish between assets that are inherently illiquid and those that are temporarily restricted from being sold in the open market (for example, restricted securities that cannot be sold for a period of 6 months or less). The CSA have not changed section 2.4 of the proposed National Instrument in this regard.

Section 2.1(1)(g)

A number of commenters recommended that the section be changed to require that the excess illiquid assets be disposed of as quickly as is commercially practicable and reasonable since the current requirement may force a manager to dispose of assets on unfavourable terms. If a prescribed time period is to be retained the 30 day period is insufficient and should be increased to at least 90 days. One commenter suggested that in lieu of this

requirement funds should be required to immediately file a notice with their principal jurisdiction whenever their holdings of illiquid assets exceed 15 percent of their net assets for a continuous period of 30 days. It was suggested that such a requirement would encourage funds to divest of illiquid assets if they were in danger of exceeding the 15 percent threshold. Another commenter recommended deleting the requirement and only applying a test at "time of purchase".

The CSA have amended section 2.4 of the proposed National Instrument to provide a five percent "cushion" to ensure that market fluctuations do not put mutual funds in a position in which they would be required to dispose of illiquid investments under unfavourable circumstances. The provision has also been amended to require disposition as soon as commercially reasonable and in any event within 90 days.

Section 2.1(1)(l)

A commenter recommended eliminating the restriction on the purchase or sale of physical commodities other than gold and permitted gold certificates. The CSA have not made this change. The CSA consider that it is not appropriate to eliminate the prohibition on the investment by mutual funds in physical commodities other than gold. A mutual fund can apply for discretionary relief if it believes that such investments are appropriate in light of its fundamental investment objectives.

Section 2.1(1)(m)

A number of commenters criticized the 10 percent restriction on investments in other mutual funds as being a significant change from the *status quo* that could affect the management of existing funds. It was stated that similar products such as segregated funds and pooled funds are not subject to the same restrictions and that this puts mutual funds at a competitive disadvantage. They urged the CSA to address the issue of fund of fund arrangements. It was recommended that the proposed National Instrument establish criteria for actively managed fund of fund arrangements and thereby eliminate the need for *ad hoc* relief. At a minimum, the proposed National Instrument should set criteria for passively managed fund of fund arrangements to recognize the *ad hoc* relief currently being granted. It was also submitted that investment funds and certain other products (such as index participation units, HIPS, TIPS etc.) are not mutual funds and therefore should not be captured by the fund of fund provisions. Also, listed securities of investment funds should be specifically excluded and treated like any other liquid security.

A number of commenters recommended that the definition of "index participation unit" be expanded to include similar interests traded on non-Canadian stock exchanges.

The CSA agree that the fund of funds arrangements must be addressed and propose to deal with the major comments received in respect of this section as described in the Notice of Changes. Changes to the definition of "index participation unit" have been made to respond to the other comments noted. In addition, the "funds of funds" restrictions have been amended to clarify that an "index participation unit" held by a mutual fund is exempt from the restrictions (regardless of whether it is technically a mutual fund). Section 2.5 of the proposed National Instrument has also been amended to exclude securities of an issuer that may technically be a mutual fund but is not a conventional mutual fund (for example, subdivided offering).

Section 2.2(a)(ii)

A commenter described this provision as too restrictive and recommended that mutual funds be permitted to encumber portfolio assets to effect derivative transactions instead of posting margin. It was stated that posting margin with an offshore counterparty may affect the limit on foreign investments that a fund could make (i.e. Income Tax Act foreign content limit). Consequently, it may be more advantageous for a fund to provide security rather than posting margin. Another commenter stated that the provision does not fit with subsection 6.8(3). Subsection 6.8(3) permits a mutual fund to deposit portfolio assets with a counterparty as collateral in OTC options and forwards (posting assets as collateral creates an encumbrance on the assets). This is not reflected in section 2.2(a). It was recommended that the provision be amended to permit a mutual fund to encumber portfolio assets where permitted under section 6.8(3). The CSA have amended subsection 2.6(a) of the proposed National Instrument in light of these comments.

Section 2.2(b)

A commenter questioned why this section along with subsections 6.8(1) and (2) effectively prohibits the purchase for non-hedging purposes of listed warrants and debt-like securities on margin under any circumstances. The CSA have made no change to subsection 2.6(b) of the proposed National Instrument in response to this comment. The CSA consider that a mutual fund cannot acquire securities on margin, except where the only way a mutual fund can acquire a specified derivative is via margin.

Section 2.2(f)

A number of commenters recommended permitting mutual funds to enter into repurchase agreements and engage in securities lending. Suggestions were made concerning how to address concerns about such transactions (for example, risks). The CSA have made no change to the proposed National Instrument and will consider the comments as described in the Notice of Changes.

Section 2.2(g)

Some commenters recommended that the proposed National Instrument not prohibit acquiring interests in loan participations. Other provisions relating to liquidity, concentration of investments, and obligations to make additional contributions adequately address concerns about loan participations. Provided that a loan syndication or participation is structured such that the mutual fund has no obligation to make an additional contribution there is no reason to prohibit such transactions which are, in essence, substantially similar to other forms of debt. The CSA have amended subsection 2.3(i) of the proposed National Instrument to respond to this comment.

Section 2.3

Commenters stated that the approach in the 1997 Draft NI to derivatives use was inappropriate. They recommended a move to a "prudent person" standard and a move away from "legal list" regulation. Such an approach has been adopted in the areas of insurance, trust and pension regulation. The 1997 Draft NI was compared to the regulation of mutual funds in the United States where there is no list of prohibited derivatives. Instead U.S. regulators restrict illiquid investments and the use of leverage by mutual funds and rely on risk disclosure to "promote effective self-governance". The CSA have made no changes in their regulation of derivatives use by mutual funds. See the CSA's discussion about the comments on the "prudent person" standard above.

Section 2.3(3)

A number of commenters remarked that the maximum term of five years is arbitrary and ought to be deleted. The fund manager should be permitted to decide the appropriate term after considering all relevant factors. A commenter stated that the five year term maximum does not reduce risk since market risk does not increase as the term of the option or forward contract increases. Credit risk does increase as the term to maturity increases but that risk is adequately addressed by other restrictions (for example, approved credit ratings and counterparty exposure limits). The five year restriction prevents a fund from hedging longer term risks and may force a fund to accept market risk it could otherwise avoid.

The CSA have not changed section 2.7 of the proposed National Instrument. The CSA consider that the five year limit is acceptable since, among other things, derivatives with terms exceeding five years are not very prevalent. The CSA disagree with the comments concerning risk and its relationship to the term of an investment.

Section 2.3(7) and Appendix A

One commenter suggested that the list of clearing corporations in Appendix A be expanded to include the Chicago Board Options Exchange and exchanges in France, Norway, Portugal, South Korea, South Africa, Malaysia and Kuala Lumpur. It was also suggested that the list be flexible enough to permit future additions to the list. The CSA have deleted the list of clearing corporations from Appendix A and the concept of "acceptable clearing corporation" (defined in section 1.1) has been introduced. Subsection 2.7(4) of the proposed National

Instrument now exempts from its application any futures contracts traded through an acceptable clearing corporation or a clearing corporation that settles transactions effected on a futures exchange listed in Appendix A.

Section 2.3(7)

One commenter recommended that the test should apply to "net" not "gross" exposure to a counterparty provided that there is a netting agreement or a right of set off in place. It was also argued that the 30 day time period may not be sufficient for highly customized derivatives. One commenter suggested a 90 day period instead. Another recommended that the requirement be to dispose of such excess positions as quickly as possible. Another commenter recommended that the provision be amended to restrict a fund from entering into additional positions with the same counterparty once its aggregate exposure to that counterparty exceeds 10 percent of assets. One commenter expressed concern that managers will be required to monitor and manage this exposure on a daily basis. Some commenters argued that the requirement that counterparties maintain an appropriate credit rating addresses any risks this provision is intended to address.

The CSA have amended subsection 2.7(4) to allow a mutual fund to use a net mark-to-market value in calculating its exposure to a counterparty with which the mutual fund has an agreement that permits netting or the right of set-off. The CSA have not changed the 30 day period.

Section 2.3(8)

A commenter expressed concern that the 1997 Draft NI did not carry forward s. 2.07(5)(c)(ii) of NP39 and recommended that the existing arrangements based on approvals previously obtained under s. 2.07(5)(c)(ii) be "grandfathered". The CSA have not made any change to the derivatives provisions and repeat their statement in the Notice to the 1997 Draft NI, that this provision is inappropriate and will not be brought forward. The CSA will consider, on an individual basis, the effect on any mutual fund organization of not carrying forward this provision.

Part 4 (general)

Commenters remarked that the regulation of related party transactions requires a clear articulation of policy and the associated technical provisions. The 1997 Draft NI is not clear as to whether the trend in regulation is toward liberalization or toward the "corporate governance" model. Another commenter stated that a comprehensive review of all conflict of interest provisions in connection with mutual funds is required. The commenter encouraged the CSA to deal with this matter expeditiously since the current regulatory regime is too restrictive and does not advance the best interests of investors. The CSA agree that these issues need to be addressed and will proceed as described in the Notice of Changes.

Section 4.1

One commenter raised concerns that the conflict of interest provisions are unduly harsh, especially since they may affect the ability of funds to make investments that would benefit securityholders. It was argued that the 60 day period seems unnecessarily long to guard against potential conflicts of interest. The commenter recommended that the CSA consider a 30 day period instead. Another commenter stated that the prohibition creates significant, systemic disadvantages to one group of investors (i.e. those investing in mutual funds sponsored by financial institutions with affiliated investment dealers). Exceptions to the prohibition should be permitted in cases where potential conflicts of interest have been minimized (for example, where a fund has an independent board of trustees that has passed conflict of interest procedures providing for regular review of applicable transactions). Another commenter also recommended that the rule be relaxed and that, at a minimum, the proposed Companion Policy should include a discussion about the possibility of obtaining exemptive relief. Conditions for exemptive relief should be considered by CSA staff (for example, review by an independent board) and articulated in the proposed Companion Policy. One commenter remarked that the prohibition is "inequitable and anachronistic" and argued that the protection intended to be provided by the prohibition would be better provided by implementation of "firewalls" to ensure structural independence and compensation schemes for portfolio managers based on individual and mutual fund manager performance. Another commenter

stated that the conflict of interest provisions applicable to mutual funds in the United States are more flexible than the rule.

The CSA agree that these issues need to be addressed and will proceed as described in the Notice of Changes.

Section 4.2

A number of commenters recommended that the provisions be amended to permit inter-fund trading of portfolio securities. It was argued that inter-fund trading is a strategy that offers cost savings to investors since no commissions on equity purchases or spreads on fixed income transactions are payable. This should reduce a fund's commission expenses, eliminate the market effect costs of trading in portfolio securities and consequently enhance returns and thereby directly benefit investors. It was suggested that the U.S. regulations are an excellent model that should be considered by the CSA. A number of commenters also objected to the decision to delete section 4.03 of NP 39. It was argued that it is unfair of the CSA to continue the principal trading prohibitions without also bringing section 4.03 of NP 39 forward.

The CSA agree that inter-fund trading and principal trading should be examined and will proceed with this issue as described in the Notice of Changes. The CSA agree that the status quo should be preserved pending their review and accordingly the proposed National Instrument includes section 4.3 of the proposed National Instrument, which is based on section 4.03 of NP39.

Section 4.3

One commenter stated that the provisions are reasonable but that the intent could be more easily accomplished if service providers had to met a standard of care similar to section 116 of the *Securities Act* (Ontario). Another commenter stated that the provision mandates a negligence standard of care which replaces the gross negligence standard often articulated in constating documents or material agreements for mutual funds. The provision places the burden on a service provider to prove that (i) any action or inaction was in the best interests of fund and (ii) such action or inaction was actually considered to meet this standard. This represents a significant evidentiary burden that may be difficult to discharge in practice. One commenter questioned why the words "willful misconduct" are used in this provision but in section 6.6 the words "wrongful act" are used. Some commenters remarked that the conditions in (a) and (b) should be mutually exclusive (separated with an "or"). The tests should stand alone and allow a mutual fund company to provide relief from and indemnify against actions or inactions that are either not negligent or in good faith determined to be in the best interests of the mutual fund. A number of commenters remarked that this section may require changes to a fund's material contracts therefore transitional relief should be provided to permit such changes to be made in a cost and time effective manner.

The CSA have amended subsections 4.4(1) and (2) of the proposed National Instrument to ensure that they correspond to the statutory standard of care imposed on managers under Canadian securities legislation. The subsections are designed to ensure that a manager remains responsible to the mutual fund for any breach of the statutory standard of care committed by it or anyone providing services to it or the mutual fund in connection with the mutual fund. Subsection 20.5(2) of the proposed National Instrument provides a transition period to allow mutual funds and persons and companies providing services to mutual funds adequate time to amend agreements if such action is necessary.

Some commenters remarked that it is not appropriate for custodians to make a "good faith" determination that an action or inaction was in the best interests of the fund. Custodians are obligated by contract to follow instructions that are received from their clients and not empowered to exercise discretion such as contemplated by making a "best interests" determination. Also, a custodian is not in a position to determine what is in the best interests of the fund since few of the relevant variables are within its control (or even its knowledge). Contractual arrangements between custodians and mutual funds generally recognize that the custodian is obligated to exercise reasonable care and will be liable for losses resulting from failure to do so (ie. losses resulting from negligence). Where the custodian has not acted negligently contracts do not normally require any additional showing in order to avoid liability.

The CSA have added subsection 4.4(5) of the proposed National Instrument to clarify that section 6.6 of the

proposed National Instrument governs custodians and sub-custodians and their relationship with the fund and the fund manager.

Section 5.1 (general)

Commenters remarked that securityholder approval is expensive and in many situations impractical. They suggested that paragraphs 5.1(a), (d) and (f) should permit the changes listed therein to be made by any one of the following methods: securityholder approval, independent board approval, or "other acceptable approval process".

The CSA have not made these changes to Part 5 of the proposed National Instrument. The CSA will consider applications for *ad hoc* relief to permit different procedures in appropriate circumstances, but continue to be of the view that securityholder approval requirements place a necessary discipline on the managers of mutual funds proposing fundamental changes to mutual funds and that securityholders should retain their rights to approve these fundamental changes.

Section 5.1(1)(a)

Some commenters recommended that the proposed National Instrument establish a "*de minimus* level of increases" below which securityholder approval would not be required. They recommended requiring securityholder approval only when investors would be faced with a material increase in costs based on its current asset level. It was recommended that a *de minimus* threshold be established for fees paid to arm's length service providers. Securityholder approval should be required for any changes resulting in an increase in fees paid to a fund's manager or other non-arm's length parties. It was suggested that the threshold be any increase in fees that would be deemed to be a "significant change" as defined and that examples be provided in the proposed Companion Policy. The proposed National Instrument also should require that securityholders be notified within six months of any increase covered by the *de minimus* exemption. This would allow such notice to be mailed with annual or semi-annual statements.

The CSA have made no changes to this requirement. The CSA are of the view that a *de minimus* exception would raise more problems of application than the current provisions. In appropriate circumstances, mutual funds can apply for *ad hoc* relief from this requirement.

Section 5.1(1)(d)

A number of commenters recommended that securityholder approval should not be required for changes in auditors of mutual funds, especially where there has not been a reportable event, given the costs and time associated with holding a securityholder meeting to approve the change.

One commenter stated that the board of directors of the manager of a mutual fund should have the ability to change auditors subject to reporting requirements of the CSA. Alternatively, such discretion could be given to a mutual fund's independent advisory committee (where a fund has one). Some commenters opposed the idea of having the CSA develop an approved list of acceptable auditing firms from which a manager would select a fund's auditor, while other commenters recommended this change, provided the names of all major auditing firms were included on such a list. Other commenters noted that where there is an auditing disagreement, a change of auditors should be approved by securityholders, an independent board or some other acceptable approval process.

The CSA have not changed this provision. As described above, the CSA are of the view that securityholder meeting requirements impose a discipline on mutual fund operators and ensure that investors continue to have voting rights in respect of fundamental changes to their funds. The CSA are of the view that a change of auditors of a mutual fund constitutes a fundamental change to that fund.

Section 5.1(1)(f)

Some commenters remarked that securityholder approval should not be required in the case of no-load funds. Instead, investors should be given 60 days notice in order to permit them to redeem their investments should they

wish to do so. Given the significant cost incurred in acquiring or disposing of units of a load fund, approval by securityholders of a terminating load fund should be required. Some commenters argued that securityholders of a continuing mutual fund should not be required to approve a merger unless it results in a "significant change" to the affairs of the continuing mutual fund.

The CSA have not changed the requirement for securityholder approval by securityholders of terminating mutual funds. The CSA propose paragraph 5.1(g) of the proposed National Instrument, which requires securityholder approval for a continuing fund where the transaction would constitute a significant change to the mutual fund.

Section 5.1(2)

Some commenters expressed concern that there is no definition of "control" or "change of control"in the 1997 Draft NI and that the provision could compromise private property rights of shareholders of managers that are public companies (i.e. mutual fund securityholders could potentially control what happens to the public company at the expense of the shareholders of the public company who have a private property interest in the company). What about changes that occur as a result of operation of law (for example, upon death or bankruptcy)? The commenters recommended that the CSA consider alternatives and discuss in the proposed Companion Policy the situations in which the CSA would like to see disclosure, and perhaps approval by securityholders. For example, it was suggested that only notice be required with respect to no-load funds. Another commenter stated that the requirement for unitholder approval should be restricted to those situations where a change in control clearly impacts unitholders (i.e not in the case of some corporate restructurings that have no impact on a manager's approach to management of a fund). One commenter remarked that securityholders of a fund should not have a veto over the change in control of a manager. Concerns were raised about what happens if all funds in a fund "family" do not approve a change.

The CSA have replaced subsection 5.1(2) of the 1997 Draft NI with section 5.8 of the proposed National Instrument. Section 5.8 requires a notice containing proxy level disclosure concerning a direct or indirect change of control of a manager to be sent to securityholders at least 60 days in advance of the transaction. As noted in the Notice of Changes, the CSA remain concerned about the regulatory issues raised by changes in control of manager and will consider this rule further.

Section 5.2

A number of commenters opposed the suggestion that securityholders who disagree with a proposed fund merger be entitled to a refund of sales charges paid (for a limited period of time). It was argued that allowing redemptions with refunds or waivers of sales charges would represent an unjustified windfall to investors. It was also argued that it would be impractical to implement and could impose a financial hardship on dealers. One commenter recommended that in the event of changes referred to in section 5.1 securityholders be given notice in a notice of meeting and information circular and that they be given the option to redeem out of the fund without any charges not previously agreed to if they do not approve of the change. Securityholders should be required to pay the redemption charge they agreed to pay when they obtained their securities on a deferred charge basis. A redemption charge should still be payable if the securityholder has been given an opportunity to vote on the change. The CSA have not changed the proposed National Instrument to impose any requirements on mutual fund managers to waive or refund sales charges for those securityholders who disagree with a proposed fundamental change.

Section 5.5(2)

Some commenters questioned the need for substantially similar valuation procedures and fee structure in respect of the "pre-approved merger" provisions of section 5.5 of the 1997 Draft NI. It was argued that the "substantially similar" requirement will give rise to uncertainty as to whether regulatory approval is required. One commenter suggested replacing the words "substantially similar" with the word "compatible". Alternatively the test could be dropped altogether on the principle that any changes to two of the matters (investment objectives and fees) are caught by the securityholder approval requirement and the other two (investment strategies and valuation procedures) are within a manager's prerogative to change subject to the statutory standard of the best interests of the fund. Some commenters questioned subparagraph 5.5(2)(a)(v), which would preclude mergers of larger funds

into small funds. Provided the other requirements in paragraph 5.5(2)(a) are met, the relative NAVs of the funds should not matter. One commenter remarked that, at a minimum, it was necessary to set a fixed point for determination (for example, immediately prior to mailing meeting materials). One commenter remarked that subparagraph 5.5(2)(d)(ii) should be dropped since it is redundant in light of subparagraph (d)(i) or implicitly imposes an obligation on the portfolio adviser to hold and maintain the transferred portfolio assets for an unspecified period of time. One commenter remarked that the words "other requirements prescribed by law" as used in subparagraph 5.5(2)(f)(i) do not provide a clear guideline as to what should be included in the circular. Another commenter recommended that the provision be amended to clarify that no separate mailing obligation is imposed if the material was delivered previously.

The CSA have made changes to section 5.6 of the proposed National Instrument in response to comments. Paragraph 5.1(g) of the proposed National Instrument, requiring meetings of continuing funds in certain circumstances, will address those mergers where regulatory issues arise for the continuing fund, and accordingly the CSA have deleted subparagraph 5.5(2)(a)(v) of the 1997 Draft NI.

Section 5.5(4)

One commenter recommended clarifying the approval requirements for a change in control of a manager of a mutual fund. Another commenter recommended exemptions for no-load funds (if 60 days notice provided) or where there is a change in direct control but no change in ultimate control (for example, where shares in a manager are transferred to a new subsidiary). Subsections 5.5(2) and 5.7(1) of the proposed National Instrument set out the requirements for regulatory approval with respect to the change in control of a manager. The CSA do not wish to "pre-approve" transactions involving a change in control of a manager. Instead, they wish to review each transaction pursuant to an approval process.

Section 5.8

A commenter stated that although this provision would address the technical problem created by the application of the terms "material change" and "material fact" used in securities legislation to mutual funds, it could also serve to broaden the related obligations of public mutual funds beyond those that are applicable to other reporting issuers. Another commenter recommended that the section be redrafted to ensure that all material changes (as defined in securities legislation) in the affairs of a fund would be "significant changes" for purposes of the proposed National Instrument. Another commenter stated that the section and the related definition of "significant change" come close to a reasonable and workable approach to establishing an appropriate continuous disclosure trigger for mutual funds. However, since the concept of "materiality" is very familiar to the Canadian securities market place, less confusion would be likely to result if both the definition of "significant change" and section 5.8 were amended to replace the words "significant" and "important" with the word "material". The CSA should re-examine the theory behind material change disclosure requirements in the context of mutual funds. The commenter stated that it is not clear that the same timely disclosure rules that apply to other reporting issuers should apply to mutual funds.

The CSA have amended the definition of "significant change" as described in the Notice of Changes and above. Section 7.5 of the proposed Companion Policy also discusses the application of this provision in some specific circumstances.

Section 6.1(3)

Some commenters questioned the requirement for written consent to the delegation of custodial authority to a sub-custodian. In most cases a global custodian maintains a network of sub-custodians throughout the world. The global custodian routinely places a mutual fund's assets with its network member in a given jurisdiction. It is not typical for a mutual fund to provide "written consent" for each use of a network member. It was argued that, as long as the global custody contract provides for the placement of assets in new jurisdictions as investments occur, separate country-by-country written consents would be a needless burden on funds and serve no investor protection purpose. It was suggested that the words "(which may be in the form of a general consent in the contract governing the relationship between the mutual fund and the custodian)" be inserted after the words "written consent" to clarify that separate, country-by-country consents are not required where the appointment of

a sub-custodian is consistent with the contract between the mutual fund and the global custodian. The CSA have amended subsections 6.1(4) and (5) of the proposed National Instrument in recognition of this comment.

Section 6.2 and 6.3

Some commenters argued that the "wholly owned" requirement in subsections 6.2(3) and 6.3(3) is unnecessary. It excludes sister affiliates or less than wholly-owned subsidiaries of eligible banks, which are common in international banking. In some countries wholly owned subsidiaries are precluded because legal requirements or custom dictate that a local resident must have an ownership interest in a domestic bank. The restrictions limit the ability of global custodians to place Canadian mutual fund assets with the best available sub-custodians. Canadian mutual fund investors would be sufficiently protected if the custodial arrangements are fully and unconditionally guaranteed by the parent. One commenter raised concerns that, by providing guarantees, reserve requirements or other regulatory restrictions might be triggered. It was recommended that the requirement to "fully and unconditionally guarantee" be replaced with the requirement that the parent "assume liability for" losses occurring as a result of the custody activities of the subsidiary to the same extent as if the parent had held the assets. There is little or no substantive difference from the standpoint of shareholder protection between an assumption of liability and an "unconditional guarantee". It was also recommended that the shareholders' equity requirement be reduced from $100 million to $50 million. In smaller or emerging markets the $100M requirement excludes most (sometimes all) of the eligible sub-custodians.

The CSA have amended subsections 6.2(3) and 6.3(3) of the proposed National Instrument to make the changes requested regarding "affiliates" and "guarantees". However, the CSA have not made the change to the shareholders' equity requirements. Although any dollar limit is by its very nature arbitrary, this limit retains the *status quo* that has been in place for some time. The CSA believe that the limit is appropriate.

Section 6.5(1) and (4)

Some commenters expressed concern that these provisions could be construed to cast doubt on the use of omnibus accounts to hold assets of Canadian mutual funds. Such accounts are extremely common in the global custody business. In an omnibus account arrangement the assets of all of a custodians' customers are held in a single account at a sub-custodian's bank or at a depository. In order to determine what part of the assets belong to any particular mutual fund one must look to the records of the global custodian. In cases where the sub-custodian in turn maintains an omnibus account at a depository, neither the records of the depository nor the records of the sub-custodian will be sufficient to determine which assets belong to a particular mutual fund for which the global custodian acts. It was recommended that the words "or sub-custodian or the applicable nominee" be deleted from subsection 6.5(1) and that the words "or sub-custodian of the mutual fund or the respective nominees" be deleted from subsection 6.5(4). Such changes would make clear that regardless of the form of the account at the sub-custodian and depositary level, the ownership of the assets is properly recorded as long as the global custodian's records identify the assets that belong to each particular mutual fund customer of that global custodian. These changes have been made by the CSA.

Section 6.6

A commenter questioned why the term "wrongful act" is used in subsection 6.6(2) whereas the term "willful misconduct" is used in section 4.3 and whether the intention was to impose a different standard for liability indemnification than for the standard of care for custodians. Section 6.6 of the proposed National Instrument has been amended to conform to the provisions of section 4.4 of the proposed National Instrument in order to ensure that all service providers to a mutual fund are held, to the extent possible, to similar standards of care.

Section 9.1

A commenter recommended allowing dealers to set cut-off times for the delivery of orders by representatives to either head office or principal distributors. This would correspond with the cut-off times for the delivery of orders that participating dealers are setting to ensure that it can get orders to the mutual funds before the usual 4 p.m. cut-off time at the fund. Subsection 9.1(4) of the proposed National Instrument makes the change requested.

Another commenter recommended defining "switches" and requiring that they be processed according to the same rules as for other purchases and redemptions. The CSA will be considering the regulatory issues raised in connection with transfers of money and mutual fund holdings between financial institutions and between mutual funds in 1999. Any rules in this regard deemed necessary will be published for comment after the conclusion of the CSA's review.

Section 9.4(1)

A number of commenters recommended clarifying paragraph (a) to simply state that regardless of when funds are received by the principal distributor or participating dealer, they must be forwarded to the order receipt office of the mutual fund so that they are received no later than T+3. Another commenter recommended that IDA members be exempt from the provisions of this section since settlement and delivery requirements are already addressed by IDA rules. The CSA have made changes to subsection 9.4(1) in response to the first comments in order to simplify the draft, but are not proposing to exempt IDA members from compliance with the simplified rules.

Section 9.4(6)

Commenters asked that the CSA reconsider whether or not they can make rules requiring principal distributors and participating dealers to make payments where settlements of purchase orders have not been made in a timely way. The commenters requested that the relevant provisions in this regard contained in NP39 be brought forward into the proposed National Instrument. Commenters recommended that, as a minimum, the proposed National Instrument set out the responsibilities of participating dealers to principal distributors for deficiencies. The CSA have made no changes to the proposed National Instrument. Certain of the CSA do not have the authority to include a provision relating to a participating dealer's ability to recover from its clients or other participating dealers amounts that they were required to pay to a mutual fund. Section 10.5 of the proposed Companion Policy provides further discussion.

Part 9 (new)

A commenter recommended adding rules for forced settlement procedures where cheques of investors are returned NSF. The rules should provide that forced settlement be done as soon as the insufficiency of funds is determined and should ensure that not only deficiencies to the fund on forced settlement but also any direct costs borne by the fund (such as bank charges) are recovered. Any excess amounts should be paid to the dealers if the dealer has the obligation to replace any loss to the fund. The CSA have made these changes in subsections 9.4(4), (5) and (6) of the proposed National Instrument except that the regime whereby the mutual fund retains the right to retain any excess amount has not been changed.

Section 10.1

Commenters recommended clarifying whether the term "securityholder" refers to the registered owner or the beneficial owner of securities. Section 10.2 of the proposed Companion Policy has been included for further clarity.

Section 10.5

One commenter recommended that the time period (10 days) be shortened to conform with T+3 settlement; that is, forced reversal of redemption orders should happen on T+4 to be consistent with the dates applicable to the forced settlement of purchases. Another commenter stated that 3 business days may not provide a securityholder with sufficient time to comply with any unfulfilled redemption requirements. However a fund could stipulate that a redemption order shall not be deemed complete and effective until all requirements are met, as permitted by paragraph 10.1(2)(a). Therefore the commenter was not opposed to reducing the time to 3 business days. The CSA consider that the 10 day period gives flexibility to fund companies and to investors to avoid forced reversal of redemption orders and have made no changes to section 10.5 of the proposed National Instrument.

Subsections 11.1(4) and 11.2(4)

A commenter recommended removing the requirement that all interest be paid to the applicable mutual funds. Instead, the commenter recommended giving the dealers the option of paying interest to mutual funds, investors or, if the cost of writing monthly cheques exceeds the aggregate interest to be remitted, to an approved contingency fund. A mandatory, reasonable formula for calculating and allocating interest should also be set. The CSA have amended these subsections in the proposed National Instrument. Subsection 11.1(5) of the proposed Companion Policy provides further clarification.

Section 13.1(3)

A commenter questioned restricting the calculation of NAV to Canadian and U.S. currency. The commenter stated that a fund manager may consider it advantageous to accept a foreign currency other than U.S. dollars in order for the fund to avoid currency conversion costs incurred to acquire the currency in which the fund normally invests. The CSA have not changed this provision as they consider that restricting the calculation of NAV to Canadian or U.S. currency is appropriate for Canadian mutual funds

Section 15.4(1)

A number of commenters expressed concern about the prohibition on the use of performance data for funds that have not completed at least one financial year. The prohibition precludes dealers from discussing the performance of such funds with clients who do not already own units of the fund but ask for the information. This leads to an anomalous result since the information is readily available from other sources, such as the media. The commenters suggested permitting disclosure within parameters (for example, not until 3 months old, text no more prominent than for other funds, control over distribution, no advertisements). Some commenters also argued that the prohibition created technical problems since many fund companies prepare combined quarterly and semi-annual reports for their funds that may include performance data for funds that are less than one year old. Therefore some securityholders could receive such performance data even though they do not own securities in such funds. The commenters argued that it would be impractical and expensive for funds in the same family to prepare and file separate financial statements in order to comply with the prohibition. The CSA have not changed this prohibition. However, the definition of "sales communication" has been amended to exclude financial statements, account statements and prospectuses (i.e. statutorily mandated disclosure).

Section 15.4(2)

Commenters recommended removing the prohibition on the use of performance data in radio and TV advertisements. This type of advertising is permitted in the United States. The CSA have deleted the general prohibition against including performance data in radio and television advertisements. Performance data in a radio or television advertisement is subject to the general requirements concerning performance data in sales communications.

Section 15 (new)

Some comments were received concerning so-called "clone funds". One commenter provided suggested guidelines for the use of performance data by clone funds. Another commenter recommended specifically prohibiting the use of performance data of foreign funds in the event that such foreign fund or "Canadian clones" of such funds were made available in Canada. The use of performance data of a foreign fund would be misleading since foreign funds are established and operate under different regulatory regimes. Section 15.6 of the proposed National Instrument prohibits advertising of performance data for funds that are less than 12 months old. Also, section 15.7 of the proposed National Instrument prohibits the comparison of mutual funds unless they are under common management or administration or they have fundamental investment objectives that a reasonable person would consider similar. The CSA consider these provisions sufficient to deal with the issues raised concerning "clone funds".

Section 20.3(4)

A number of commenters expressed serious concerns about this subsection because they felt it gives regulators a new opportunity to deny exemptive relief granted previously. The provision could create serious uncertainty for

funds. There is no explanation of what the CSA considers to be the "public interest". Also, it is possible that the interpretation of "public interest" could change over time. In order to avoid such a result it is necessary to provide an absolute grandfathering of relief already granted under NP 39. If relief is taken away, it could constitute a fundamental change for the fund since investors purchased the fund on the basis of previously granted relief. Such investors would not have a right to a hearing under the provision. This could expose funds and managers to claims by investors for liability. Therefore, at a minimum, actions against funds and managers should be precluded in such circumstances. One commenter recommended that if the provision is retained an exemption should only be eliminated after a long notice period. The CSA have deleted this provision from the proposed National Instrument. The CSA are of the view that mutual funds should be able to rely upon past exemptions or approvals. However, the CSA may have discretion under applicable securities legislation to revoke an exemption or waiver previously granted.

Section 21.1

Some commenters recommended setting out a transition period. One commenter recommended a transition period of at least 6 months. A commenter also recommended specific transitional rules for written sale communications (i.e. permit old ones to be used up). The commenter recommended transitional rules similar to those implemented when section 16 of NP 39 was adopted. A longer transition period was recommended for changes to material contracts to conform with section 4.3 of the 1997 Draft NI. The commenter recommended that section 4.3 should apply only to new contracts. Another commenter recommended that the proposed National Instrument permit changes to material contracts which are required to comply with section 4.3 to be made simply on notice to securityholders (i.e. without the need for securityholder meetings). The CSA have amended the proposed National Instrument to provide for transition periods. See sections 20.2 to 20.5 of the proposed National Instrument.

APPENDIX C

SUMMARY OF COMMENTS ON

PROPOSED NATIONAL INSTRUMENT 81-102 AND PROPOSED COMPANION POLICY 81-102CP

PUBLISHED FOR COMMENT JUNE 1997

Note: In this Table, "NI" means the proposed National Instrument NI 81-102 Mutual Funds and "CP" means Proposed Companion Policy 81-102CP Mutual Funds; "1997 Draft" means the version of the NI and CP published for comment in June 1997; "Revised Draft" means the proposed revised version of the NI and the CP being published for further comment, with the Notice of Changes; "NP39" means National Policy Statement No 39; and "CSA" means the Canadian Securities Administrators.

	1997 Draft Reference	***Revised Draft Reference***	***Comment***	***CSA Response***
1	Definition of "advertisement"	———	The definition of "advertisement" is too broad since it appears to capture all written sales communications. The 1997 Draft CP states that the term "public medium" will be interpreted to include all forms of print. The result is that all written sales communications (such as brochures and prospecting letters) are treated the same as advertisements and subject to the stricter rules on the disclosure of performance data. The CSA did not intend this result in section 16 of NP39.	No change made. The Revised Draft NI retains the distinctions between advertisements and sales communications as used in NP39. The definition of "sales communication" has been narrowed from that in NP39 to be a communication (both written and oral) by named parties associated with a mutual fund. An "advertisement" is a subset of "sales communication" and includes those sales communications published or designed for use on or through a "public medium"
2	Definition of "approved credit rating" and "approved credit rating organization"	———	Include Thomson BankWatch Inc. as an "approved credit rating organization". Use its ratings of B or better in the definition of "approved credit rating". This change would enlarge the universe of persons with whom Canadian mutual funds may deal without adding inappropriate credit risk. Thomson BankWatch Inc. ratings are accepted by SEC and other regulators.	Change made. Revised Draft NI recognizes as "approved credit ratings", one level higher than the lowest investment grade category of Thomson BankWatch Inc.
3	Definition of "asset allocation service"	———	Concern this definition would include services not provided by a registrant (eg. portfolio management services offered on an exempt basis). The definition should be amended to clarify that it only applies to a service offered by a registrant. Definition should be limited to situations where a fund manager or an affiliate chooses a combination	Changes made. The definition now recognizes that an "asset allocation service" may invest in other assets (GICs etc.) in addition to investing in mutual funds that are subject to the NI. Only specific administrative services in which an investment in mutual funds (which are subject to the NI) is an integral part are included. The definition does not include general investment

			of its own or affiliated funds in accordance with its strategy with a view to meeting the goals of an investor. Define the term "asset allocation strategy".	services such as discretionary portfolio management that may, but are not required to, invest in mutual funds subject to the NI. Clarification provided in section 2.1 of the Revised Draft CP.
4	Definition of "cash equivalent"	_____	Include fund receivables that may arise from the disposition of portfolio securities and the acceptance of purchase orders for mutual fund securities. When a fund disposes of portfolio securities it should be permitted to replace immediately the market exposure as it would on a subsequent purchase of portfolio securities. If not permitted to do so, a fund could be required to reduce its exposure in certain situations even though no leverage is being used, thereby leaving the fund potentially under-invested.	Changes made. Receivables, net of payables, arising from the disposition of portfolio assets can be used for cash cover by a mutual fund. Receivables related to purchase orders have not been included because the CSA are concerned about settlement risk. The word "cash" has been deleted from the definition and included in the definition of "cash cover".
5	Definition of "conventional convertible security"	_____	The definition does not cover certain preferred shares and other convertible securities that include a "soft retraction" feature allowing the issuer to settle the conversion with a cash payment. As a result, these instruments fall within the definition of "specified derivative". Delete the cash settlement exclusion in the definition so as not to restrict the ability of mutual funds to acquire such convertible securities.	Changes made. Similar change made to definition of "conventional warrant or right".
6	Definition of "debt-like security"	_____	Define the term "conventional floating rate debt instrument". Also, the definition seems to encompass certain types of derivatives that do not entail any leverage or other characteristics that should necessitate their use being subject to the restrictions applicable to debt-like securities. Include a method for determining the derivative component of the security.	Changes made. The term "conventional floating rate debt instrument" has been defined. Paragraph (b) of the definition has been amended to provide that the value of the component of the security that is not linked to the underlying interest must account for less than 80% of the purchase price in order for the security to be considered a "debt-like security". Paragraph (b) has also been amended to provide that the calculation is made at the date of acquisition of the security by the mutual fund, rather than at the date of issue. Section 2.4 of the Revised Draft CP provides further explanation.
7	Definition of "delta"	_____	Replace the word "measures" with the words "is a measure of".	Change made.
8	Definition of "hedging"	_____	The requirement to maintain a position is potentially problematic if a portion of the hedge is removed for tactical reasons or if part of the underlying exposure being hedged is reduced. Explain the rationale for this requirement.	Changes made. The requirement that a transaction be considered a hedge under Canadian GAAP has been deleted. Subparagraph (a)(i) of the 1997 Draft NI has been deleted. Subsection 2.7 of the Revised Draft CP clarifies that the component of the definition that requires the "maintaining" of a hedge position does not mean that a mutual fund is locked into a specified derivatives position. Instead, it means that the specified derivatives position must continue to satisfy the definition of "hedging" in order to receive hedging treatment under the Revised Draft NI.
9	Definition of "illiquid asset"	_____	Over-the-counter ("OTC") options and forwards could be considered illiquid because they are not disposed of through market facilities on which public quotations in common use are available, which may be an undesirable result if the positions have other features that "effectively" make them liquid (eg. the terms of the option or forward and the required credit rating of the counterparty). The requirement for disposal through market facilities on which public quotations in common use are widely available should not be imposed in all cases. Some assets such as convertible debentures and special and purchase warrants do not trade through market facilities but can be disposed of readily at an amount at least equal to the amount at which the asset is valued for net asset value purposes. Such assets should not be classified as illiquid. The definition should contemplate that the sale price of a security can be reduced by transaction costs. Why does the illiquid assets test apply to derivatives used for non-hedging purposes but not to derivatives used for hedging purposes.	One change made. NP39 deemed all options to be illiquid. The Revised Draft NI considers options to be liquid if they satisfy the specified test. The CSA recognize that OTC options probably do not have a market facility with public quotation in common use and that the effect of the section is that such options are illiquid assets. The CSA believe that this objective test is necessary (i.e. a fund must be able to sell at any time via an auction market at a quoted price). The words "at least equal to" have been deleted and replaced with the words "that at least approximates". The change was made to recognize that the sale price of securities will be reduced by transaction costs. Derivative instruments used for hedging purposes have been taken out of the investment restrictions and practices due to the need for flexibility for hedging by mutual funds. The CSA consider that the nature of hedging is such that no further restrictions are necessary.
10	Definition of "index participation units"	_____	Revise definition to include non-Canadian stock exchange listed index participation units. The definition should not require that such units be sponsored by an exchange.	Changes made.
11	Definition of "listed"	DELETED	Definition should include securities listed on the Canadian Dealer Network as well as securities quoted on the inter-dealer bond market since quotations on that market are deemed to be "public".	Definition deleted since the word "listed" only used in connection with the term "listed warrant " and "listed equity dividend shares". The CSA propose to not distinguish between "listed" and "unlisted" securities in these contexts.
12	Definition of "manager"	_____	Definition inadvertently captures third party advisors who may have certain powers and responsibilities with respect to a mutual fund.	Change made. Section 2.10 of the Revised Draft CP also discusses this defined term.
13	Meaning of "office"	N/A	Define the word "office" used in Parts 9 and 10 so that it includes remote or "virtual" offices (such as home offices or client homes).	No definition provided. However, Parts 9 and 10 of the Revised Draft NI have been amended by replacing the word "office" with word "location" to recognize both the possibility of the receipt of orders electronically or at a location other than an office.
14	Definition of "order receipt office"	_____	Ensure definition permits the use of technology to timestamp and verify orders that are placed electronically (i.e. no physical office or premises is involved in the process).	Change made. The definition has been amended by replacing the reference to "office" with a reference to "location".
15	Definition of "permitted derivatives"	DELETED	Include "swaps" in the definition.	Changes made. The term "permitted derivative" has been deleted from the Revised Draft NI in order to improve clarity. Mutual funds can invest in "specified derivatives" subject to the investment restrictions and conditions set out in Part 2 of the Revised Draft NI. The Revised Draft NI has also been amended to permit the use of swaps by mutual funds.
16	Definition of "permitted	DELETED	Why does the definition of permitted derivatives include listed warrants but not unlisted warrants? Add unlisted warrants to the definition of "permitted derivatives" and make them subject to s. 2.3(2)(a)	Changes made. The term "permitted derivative" has been deleted from the Revised Draft NI in order to improve clarity. Both listed and unlisted warrants can be acquired by mutual

	derivatives"		restrictions.	funds as specified derivatives, since they fall within the term "options".
17	Definition of "permitted derivatives"	DELETED	Allow mutual funds to use derivatives (for hedging and non-hedging purposes) that have underlying interests in commodities other than gold.	No change made. The Revised Draft NI prohibits mutual funds from investing in physical commodities other than gold. Therefore mutual funds should be prohibited from investing in physical commodities other than gold through derivatives.
18	Definition of "permitted gold certificates"	_____	Remove the insurance requirement from the definition since it "effectively excludes gold certificates issued by banks". Allow mutual funds to purchase certificates representing silver, platinum, palladium, rhodium and iridium.	One change made. The definition has been amended to specifically permit the acquisition of gold certificates from a bank listed in Schedule I or II of the *Bank Act* (Canada) without the need for specified insurance. The Revised Draft NI has not been changed to permit investments in other precious metals. The restriction on investing in physical commodities other than gold is continued from NP39.
19	Definition of "pricing date"	_____	Include in definition redemptions as well as sales.	No change made. The definition is used only for the delivery of money and settlement related to the sale of mutual fund securities.
20	Definition of "sales communication"	_____	Delete the words "to the mutual fund or asset allocation service" and replace them with the words "any of the above". The qualification in clause (a)(ii) that the communication be made to induce a purchase of mutual fund securities should apply also to existing securityholders. Why was the definition made more narrow than the NP39 definition which covered communications made by any person or company? Paragraph (b) of the definition should exclude communications contained in financial statements. The definition would include statements of account and information notices that do not include financial statements of the relevant fund, which should not be intended.	Changes made, except that the CSA have not changed paragraph (a)(i) of the definition. The CSA have added subsection 2.16(4) to the Revised Draft CP to explain the changes made to this definition in paragraph (b).
21	Definition of "significant change"	_____	The definition differs from the definition of "material change" relating to investment funds that was published in Request for Comment 51-901 - "Report of the Toronto Stock Exchange Committee on Corporate Disclosure and Proposed Changes to the Definitions of "Material Fact" and "Material Change"". Rename the term as "material change". Paragraph (b) of the definition and the requirement in section 5.8 to file an amended prospectus disclosing the "significant change" could cause a mutual fund to amend its prospectus to disclose a "significant change" prior to board approval.	Changes made. The definition has been amended to clarify its meaning without substantive change. The CSA are satisfied that paragraph (b) of the definition is consistent with current securities legislation.
22	Definition of "specified derivative"	_____	Definition should exclude index participation units of a stock exchange or customized indices listed and traded on a stock exchange (TIPS, HIPS, WEBS, etc). Exclude unlisted equity dividend shares, listed capital shares and listed warrants.	Changes made. See also revised definition of "index participation unit" . References to "listed" subdivided shares and "listed warrants" have been deleted. All warrants may be acquired as specified derivatives (by virtue of definition of "option") except for "conventional warrants or rights" which are excluded from the definition of "specified derivative".
23	Definition of "synthetic cash"	_____	Delete paragraphs (a) and (b); they unnecessarily limit the means by which such a position is achieved. Definition should be flexible enough to include other structures that may be identified in the future to create synthetic cash.	No changes made. The technique for achieving "synthetic cash" described in the definition is a conservative technique that is in keeping with the objective for cash cover and its need where mutual funds are using derivatives.
24	S. 1.2	_____	Extend the application of the NI to all investment products similar to mutual funds, including wrap accounts offered through brokerages, segregated funds offered by insurance companies, labour sponsored investment funds as well as asset allocation services.	No changes made. This recommendation is beyond the scope of the Revised Draft NI, although the Revised Draft NI (as did NP39 and the 1997 Draft NI) applies to labour sponsored investment funds.
25	Sections 2.1 and 2.2 (general)	Sections 2.1 to 2.7	Delete sections and amend the NI to adopt a "prudent person" regime.	No change made.
26	S. 2.1(1)(a)	S. 2.1 (1), (2)	Include the regime described in Part 3 of the 1997 Draft CP as an exception to the rules setting out the investment restrictions and practices.	No change made. The CSA wish to review all applications for relief, rather than providing blanket approval in the NI. The conditions to the relief may change depending on circumstances.
27	S. 2.1(1)(a)	S. 2.1(1), (2)	Allow the use of supranational and country debt as cash cover without being subject to the 10% restriction in s. 2.1(1)(a) .	No change made. The CSA are of the view that there is no compelling reason to exempt securities used for cash cover purposes, other than a "government security", from the 10% restriction.
28	S. 2.1(1)(b)	S. 2.2(1)(a)	Delete the 10% restriction on holdings of a series of a class of securities. Expand s. 2.1(4) of the 1997 Draft NI to include listed permitted derivatives, conventional rights and warrants, and conventional convertible securities so that a fund is not in violation of the 10% limit if, upon conversion, the fund would continue to hold less than 10% of any class of an issuer's securities. Explain what constitutes a "class or series of a class" of debt securities. Permit aggregation of "like-debt" (i.e. debt that has the same essential elements -- same covenants of the issuer, same security (or lack thereof), same priority *inter se*). Section creates problems in the context of share purchase warrants acquired in the context of special warrant offerings.	Changes made. This provision has been substantively changed to reflect its original regulatory purpose. The restriction contained in the Revised Draft NI applies only to the acquisition of securities carrying more than 10 percent of the votes of an issuer, or to the acquisition of more than 10 percent of the equity securities of an issuer. The purpose of the restriction is to prevent a mutual fund from acquiring securities of an issuer that would enable the mutual fund to exert control over the issuer. The additional definition of "purchase" and the discussion in section 2.14 of the Revised CP is relevant to an understanding of the changes made in response to this comment.
29	S. 2.1(1)(f)	S. 2.4	Under NP39 "restricted securities" were not deemed to be illiquid assets; they are treated as such in the 1997 Draft NI. The NI should distinguish between assets that are inherently illiquid and those that are temporarily restricted from being sold in the open market (eg. restricted securities that cannot be sold for a period of 6 months or less).	No change made. The 1997 Draft NI continues to regulate restricted securities as did NP39; the intent of NP39 was that certain types of restricted securities should be included in the definition of illiquid investments.
30	S. 2.1(1)(g)	S. 2.4	Delete requirement or change it to require that excess illiquid assets be disposed as quickly as is commercially practicable and reasonable. The requirement of the 1997 Draft NI could force a manager to dispose of assets on unfavourable terms. If a prescribed time period is to be retained, increase the time to at least 90 days. In lieu of this	Changes made. The percentage limit has been increased to 15 percent and mutual funds that find themselves over that limit at any point in time must dispose of them as soon as commercially reasonable and in any event within 90 days of triggering the

			requirement, require mutual funds to immediately file a notice with their principal jurisdiction whenever their holdings of illiquid assets exceed 15% of their net assets for a continuous period of 30 days.	limit.
31	S. 2.1(1)(l)	S. 2.3(h)	Eliminate the restriction on the purchase or sale of physical commodities other than gold and permitted gold certificates.	No change made. The CSA believe that it is not appropriate to eliminate the prohibition on the investment by mutual funds in physical commodities other than gold. A mutual fund can apply for discretionary relief if it believes that such investments are appropriate in light of its fundamental investment objectives.
32	S. 2.1(1)(m)	S. 2.5	The 10% restriction on investments in other mutual funds is a significant change from the *status quo* that could affect the management of existing funds. The CSA must address the issue of fund of fund arrangements and amend the NI to establish criteria for actively managed fund of fund arrangements and thereby eliminate the need for *ad hoc* relief. At a minimum, the NI should set criteria for passively managed fund of fund arrangements to recognize the *ad hoc* relief currently being granted. Clarify the section to ensure that listed investment funds and index participation units (including those listed on non-Canadian stock exchanges) are not considered mutual funds and therefore not be captured by the fund of fund provisions.	No changes made, other than in respect of the definition of "index participation unit" and to clarify the status of listed investment funds. The CSA agree that they must address the regulatory issues raised by fund of funds arrangements. In the interests of completing the NI, the CSA have decided to address this issue later during 1999 and will publish for comment a parallel amending instrument once their review is completed. The CSA are of the view that the 10% restriction on investments in other mutual funds is not a substantial change to the status quo.
33	S. 2.2 (a)(ii)	S. 2.6(a)(ii) and (iv)	Provision is too restrictive; mutual funds should be permitted to encumber portfolio assets to effect derivative transactions instead of posting margin. Also, the provision does not fit with subsection 6.8(3), which permits a mutual fund to deposit portfolio assets with a counterparty as collateral in OTC options and forwards (posting assets as collateral creates an encumbrance on the assets).	Changes made. The provision has been amended to permit the encumbrance of portfolio assets to enable a mutual fund to post margin to effect a specified derivative transaction under the NI and to permit encumbrances as contemplated by s. 6.8(3).
34	S. 2.2(b)	S. 2.6(b)	Section, along with subsections 6.8(1) and (2), effectively prohibits the purchase for non-hedging purposes of listed warrants and debt-like securities on margin under any circumstances.	No change made. The CSA are of the view that a mutual fund cannot acquire securities on margin, except where the only way a mutual fund can acquire a specified derivative is through the use of margin.
35	S. 2.2(f)	S. 2.6(f)	Allow mutual funds to enter into repurchase agreements and engage in securities lending. Suggestions were made concerning how to regulate this activity by mutual funds.	No change made. The CSA agree that they must address the regulatory issues raised by mutual funds engaging in these activities. In the interests of completing the NI, the CSA have decided to address this issue later during 1999 and will publish for comment a parallel amending instrument once their review is completed.
36	S. 2.2(g)	s. 2.3(i)	Do not prohibit mutual funds from acquiring interests in loan participations. Other provisions relating to liquidity, concentration of investments and obligations to make additional contributions adequately address concerns about loan participations. Provided that a loan syndication or participation is structured such that the mutual fund has no obligation to make an additional contribution there is no reason to prohibit such transactions which are, in essence, substantially similar to other forms of debt.	Change made. A mutual fund cannot purchase an interest in a loan syndication or loan participation if the purchase would require the mutual fund to assume any responsibilities in administering the loan.
37	S.2.3	Sections 2.7, 2.8, 2.9, 2.10, 2.11	Approach to derivatives use in the 1997 Draft NI is inappropriate. Move to a "prudent person" standard and move away from "legal list" regulation. Regime should not restrict derivatives use to list of "permitted derivatives".	No change made, other than to delete the definition of "permitted derivatives". Mutual funds may use "specified derivatives" provided they follow the rules set out in Part 2 governing such use. The CSA do not consider a move to a "prudent person" regime for the use of derivative instruments, in place of the regime proposed in the Revised Draft NI, to be appropriate at this time. Mutual funds can apply for relief from the applicable rules, in appropriate circumstances, and relief may be granted if warranted.
38	S. 2.3 (1)	S. 2.9	Clarify why the application of investment restrictions and practices should depend on whether a derivative is used for hedging or non-hedging purposes.	No changes made. See the Notice for the 1997 Draft wherein the derivatives regime was described.
39	S. 2.3 (2)	S. 2.8(1)	Extend the cash cover concept for other derivatives such as futures and forwards to options.	No change made. Appropriate cash cover is required for all applicable uses of specified derivatives.
40	S. 2.3 (2)(b)	S. 2.8(1)	Change the wording of paragraph 2.3(2)(b) (ii) to specify that the right or obligation to acquire a quantity of the underlying interest of the option equivalent to the amount specified in the option must be a right or obligation which may be exercised at any time before the expiry date and not only on that date (ie. an American style option). Also, paragraph (ii) should be changed so that the amount of cash cover is not required to be determined by reference to a "strike price" (since strike price refers to the per unit price at which an option may be exercised) but to the aggregate cost of exercising the obligation and the aggregate proceeds to the mutual fund upon exercise of the option by the option purchaser. Change wording of paragraph (iii) to permit a mutual fund to partially satisfy the requirements through a combination of paragraphs (i) and (ii).	Changes made, except that the CSA consider that the change requested to paragraph (ii) relating to "strike price" is unnecessary.
41	S.2.3(3)	S. 2.7(1)	Delete the maximum term requirements. The term restrictions prevents a mutual fund from hedging longer term risks and may force a fund to accept market risk it could otherwise avoid.	No change made. The CSA are of the view that the five year limit is appropriate and disagree with the comments received concerning the relationship of the term of a specified derivative to risk.
42	S. 2.3(7) and Appendix A	S. 2.7(4) and Appendix A	Expand list of clearing corporations in Appendix A to include certain specified European, Asian and African exchanges and ensure flexibility to permit future additions.	Changes made. Clearing corporations have been deleted from Appendix A and the concept of "acceptable clearing corporation" (defined in section 1.1) has been introduced. Section 2.7(4) now exempts from its application any futures contracts traded through an acceptable clearing corporation or a clearing corporation that settles transactions effected on a futures exchange listed in Appendix A. The CSA see no alternative to a list of acceptable futures exchanges given the lack of a common definition of acceptable futures exchanges.

43	S. 2.3(7)	S. 2.7(4) and (5)	Test should apply to "net" not "gross" exposure to a counterparty provided that there is a netting agreement or a right of set off in place.	Change made.
44	S. 2.3(7)	S. 2.7(4) and (5)	Increase time to "cure" a breach of restriction from 30 to 90 days or delete time period and substitute a requirement to dispose of such excess positions as quickly as possible. Amend provision to restrict a mutual fund from entering into additional positions with the same counterparty once its aggregate exposure to that counterparty exceeds 10% of assets. Delete restrictions since the requirement that counterparties maintain an appropriate credit rating addresses any risks this provision is intended to address.	No changes made, other than to clarify acceptable counterparties to which this restriction does not apply.
45	S. 2.3(8)	S. 2.10	1997 Draft NI does not carry forward s.2.07(5)(c)(ii) of NP39; existing arrangements based on approvals previously obtained under s. 2.07(5)(c)(ii) should be "grandfathered".	No changes made. As stated in the Notice to the 1997 Draft, the CSA are of the view that this provision of NP39 is inappropriate and encourage entities relying on previously granted relief, if they are uncertain as to their status, to seek clarification from staff.
46	S.3.1(1)(b)	_____	Provision is unworkable. If a mutual fund has 48 hours to accept or reject a subscription, how is it possible with any certainty to accumulate $500,000 in subscriptions in any 48 hour period such that subscriptions can be accepted and securities of the fund can be issued in a manner which complies with the provision? The purpose of the provision is unclear.	No change made. This provision establishes the minimum proceeds that a mutual fund must raise before issuing securities to investors. The time period within which a mutual fund can reject a purchase order has been reduced from 2 days to 24 hours. See section 9.2 of the Revised Draft NI. The CSA do not understand that this section has created, or will create, any compliance difficulties.
47	Part 4 (general)	_____	CSA should articulate a clear policy regarding their regulation of related party transactions and the associated technical provisions of the NI. The 1997 Draft NI is not clear as to whether the trend in regulation is toward liberalization or a "corporate governance" model. A comprehensive review of all conflict of interest provisions in connection with mutual funds is required. The CSA should deal with this matter expeditiously since the current regulatory regime is too restrictive and does not advance the best interests of investors.	No changes made. The CSA agree that they must address the regulatory issues raised by related party transactions by mutual funds and their operators. In the interests of completing the NI, the CSA have decided to address these issues later during 1999 and will publish for comment a parallel amending instrument once their review is completed.
48	S. 4.1	_____	Section is unduly harsh especially since it may affect the ability of mutual funds to make investments that would benefit securityholders of the fund. The prohibition creates significant, systemic disadvantages to one group of investors (i.e. those investing in mutual funds sponsored by financial institutions with affiliated investment dealers). Exceptions to the prohibition should be permitted in cases where potential conflicts of interest have been minimized (for example, where a fund has an independent board of trustees that has passed conflict of interest procedures providing for regular review of applicable transactions). The rule should be relaxed and, at a minimum, the CP should include a discussion about the possibility of obtaining exemptive relief. Conditions for exemptive relief should be considered by CSA staff (eg. review by an independent board) and articulated in the CP.	No changes made. See above explanation concerning the CSA's further work in this area.
49	S. 4.2	_____	Amend section to permit inter-fund trading of portfolio securities.	No change made. The CSA agree that they must address the regulatory issues raised by inter-fund trading of portfolio securities. In the interests of completing the NI, the CSA have decided to address these issues later during 1999 and will publish for comment a parallel amending instrument once their review is completed.
50	S. 4.2	s. 4.2 and 4.3	Permit principal trading between mutual funds and related parties on the conditions prescribed by section 4.03 of NP39. This exemption is necessary to preserve the status quo, pending the more complete review of the conflicts of interest provisions.	Change made. The CSA will address principal trading at a later date, as described above, but pending completion of that review, have decided to bring forward section 4.03 of NP 39 into the Revised Draft NI. See section 4.3 of the Revised Draft NI.
51	S. 4.3	S. 4.4	Revise to ensure that service providers have to meet a standard of care similar to section 116 of the *Securities Act* (Ontario). Revise to mandate a gross negligence standard which is often articulated in constating documents or material agreements for mutual funds. Significant evidentiary burden on a service provider to prove its action or inaction meets the articulated tests. Conform words used in this section to those used in section 6.6. Conditions in (a) and (b) should be mutually exclusive (separated with an "or"); the tests should stand alone and allow a mutual fund to provide relief from and indemnify against actions or inactions which are either not negligent or in good faith determined to be in the best interests of the mutual fund. Transitional relief needed to ensure time to make changes to material contracts necessary to comply with this section.	Changes made. Subsections (1) and (2) amended to ensure that they correspond to the statutory standard of care imposed on managers under Canadian securities legislation. The subsections are designed to ensure that a manager remains responsible to the mutual fund for any breach of the statutory standard of care committed by it or anyone providing services to it or the mutual fund in connection with the mutual fund. A gross negligence standard is not acceptable to the CSA. A transitional period is provided by subsection 20.5(2) of the Revised Draft NI. Part 5 has been added to the Revised Draft CP to further clarify this section.
52	S. 4.3	S.4.4	Not appropriate for custodians to make a "good faith" determination that an action or inaction was in the best interests of the fund. Custodians are obligated by contract to follow instructions that are received from their clients and not empowered to exercise discretion such as contemplated by making a "best interests" determination. Also, a custodian is not in a position to determine what is in the best interests of the fund since few of the relevant variables are within its control (or even its knowledge).	Changes made. A new subsection (5) has been added to clarify that section 6.6 of the Revised Draft NI governs the custodial relationships. Part 5 has been added to the Revised Draft CP to further clarify this section.
53	S. 5.1 (general)	_____	Securityholder approval is expensive and in many situations impractical. Permit the changes enumerated in section 5.1 to be made by either securityholder approval or independent board approval or "other acceptable approval process".	No change made. Part 5 is now entitled "Fundamental Changes". Section 5.1 is essentially unchanged. The CSA will consider applications for *ad hoc* relief to permit different procedures in appropriate circumstances, but continue to be of the view that securityholder approval requirements place a necessary discipline on operators of mutual funds proposing fundamental changes to mutual funds and that securityholders should retain their rights to approve these fundamental changes.

54	S. 5.1(1)(a)	5.1(a)	Set a "*de minimus* level of increases" below which securityholder approval would not be required. Securityholder approval should be required only when investors would be faced with a material increase in costs based on its current asset level or where the increase would result in a "significant change" (as defined) to the mutual fund. It was recommended that a *de minimus* threshold be established for fees paid to arm's length service providers. Securityholder approval should be required for any changes resulting in an increase in fees paid to a fund's manager or other non-arm's length parties.	No change made. The CSA are of the view that a *de minimus* exception would raise more problems that the current provisions. In appropriate circumstances, mutual funds can apply for *ad hoc* relief from this requirement.
55	S. 5.1(1)(d)	s.5.1(d)	Securityholder approval should not be required for a change of auditors, especially where there has not been a reportable event, given the costs and time associated with holding a securityholder meeting. The board of directors of the manager of a mutual fund should have the ability to change auditors subject to reporting requirements of the CSA. Alternatively, such discretion could be given to a mutual fund's independent advisory committee (where a fund has one). Alternatives to requirement include meetings only required where new auditors are not on an approved CSA list of auditors (which should contain the names of all major auditing firms) or where there is an auditing disagreement.	No change made. As described above, the CSA are of the view that securityholder meeting requirements impose a discipline on mutual fund operators and ensure that investors continue to have voting rights in respect of fundamental changes to their funds. The CSA are of the view that a change of auditors of a mutual fund constitutes a fundamental change to that mutual fund.
56	S. 5.1(1)(f)	s.5.1(f) and (g)	Do not require securityholder approval of terminating fund holders in the case of no-load funds. Instead, investors should be given 60 days notice in order to permit them to redeem their investments should they wish to do so. Securityholders of a continuing mutual fund should not be required to approve a merger unless it results in a "significant change" to the affairs of the continuing mutual fund.	Changes made in respect of approvals of securityholders of continuing funds. Otherwise no change made, consistent with the approach of the CSA to fundamental changes to mutual funds. Paragraph 5.1 (g) has been added to require securityholder approval for a continuing fund where the transaction would constitute a significant change to the mutual fund.
57	S. 5.1(2)	S. 5.8	Delete requirement for securityholder approval in context of changes of control of managers. The 1997 Draft NI has no definition of "control" or "change of control"; the provision could compromise private property rights of shareholders of managers that are public companies (i.e. mutual fund securityholders could potentially control what happens to the public company at the expense of the shareholders of the public company who have a private property interest in the company). Prior approval mechanism set out in subsection 5.5(4) of the 1997 Draft NI gives the CSA the ability to consider transactions and to impose securityholder approval requirements in appropriate circumstances.	Changes made. Subsection 5.1(2) has been replaced by new section 5.8 that requires 60 days notice containing proxy level disclosure of a direct or indirect change of control of a manager. Securityholder approval is no longer required, although the CSA note their continued concern about the regulatory issues raised with changes in control of managers that can cause as fundamental a change to the affected mutual funds as changes in managers (where securityholder approval is required).
58	S. 5.2	_____	Do not impose requirements that securityholders involved in a merger be entitled to a refund of sales charges paid (for a limited period of time). Allowing redemptions with refunds or waivers of sales charges would represent an unjustified windfall to investors. Securityholders should not be required to pay any fees on redemption that they have not already agreed to pay.	No changes made. The CSA will maintain the requirements for securityholder approval at this time, but will not impose any requirements on mutual fund managers to refund or waive sales charges for those securityholders who disagree with a proposed fundamental change.
59	S. 5.5 (2)(a)	S. 5.6(1)(a)	Delete need for substantially similar valuation procedures and fee structure or replace words "substantially similar" with the word "compatible". Test should be dropped altogether on the principle that any changes to two of the matters (investment objectives and fees) are caught by the securityholder approval requirement and the other two (investment strategies and valuation procedures) are within a manager's prerogative to change subject to the statutory standard of acting in the best interests of the fund.	Changes made to impose a reasonable person test, but not to delete the references to valuation procedures and fee structure. The reference to "investment objective" has been changed to "fundamental investment objective" and the reference to "investment strategies" has been deleted.
60	S. 5.5 (2)(a)(v)	Deleted	Delete requirement which would preclude mergers of larger funds into small funds. Provided the other requirements in paragraph 5.5(2)(a) are met the relative size of the mutual funds should not matter. At a minimum, a fixed point for determination (for example, immediately prior to mailing meeting materials) was necessary.	Change made in conjunction with the addition of paragraph 5.1 (g), which the CSA consider a better approach to the regulatory concern on the effect of a proposed merger on securityholders of a continuing fund. Subsection 7.4(2) of the Revised Draft CP contains the CSA's views in this regard.
61	S. 5.5 (2)(d)(ii)	S. 5.6(1)(d)(ii)	Delete requirement; redundant in light of (d)(i) or implicitly imposes an obligation on the portfolio adviser to hold and maintain the transferred portfolio assets for an unspecified period of time.	No change made. A determination must be made based on the particular circumstances and objectives of a mutual fund.
62	S. 5.5(2)(f)(i)	S.5.6(1)(f)(i)	Words "other requirements prescribed by law" do not provide a clear guideline as to what should be included in a circular.	No change made. The CSA are of the view that the meaning of the requirement is clear. The words referred to require compliance with applicable proxy solicitation requirements.
63	S. 5.5(2)(f)(ii)	S.5.6(1)(f)(ii)	Clarify that no separate mailing obligation is imposed if the material was delivered previously.	Change made.
64	S. 5.5(4)	S. 5.5(2)	Clarify the securities regulatory approval requirements for a change in control of a manager of a mutual fund. Alternatively, provide exemptions for no-load funds (if 60 days notice provided) or where there is a change in direct control but no change in ultimate control (for example, where shares in a manager are transferred to a new subsidiary).	No changes made. Subsections 5.5(2) and 5.7(1) set out the requirements for regulatory approval with respect to the change in control of a manager. The CSA do not wish to "pre-approve" transactions involving a change in control of a manager. Instead, they wish to review each transaction pursuant to an approval process.
65	S. 5.6(b)(iv)	S. 5.7(1)(b)(iv)	Amend requirement to request a list of those clauses of section 5.5(2) with which the applicant has not complied. A request for an "explanation for the differences" between the elements of the proposed transaction and s.5.5(2) implies that there is an obligation to comply with section 5.5(2) and unduly increases the cost and expense of making the application.	Changes made. The required application must include a description of the elements of the proposed transaction that make section 5.6 inapplicable. See also section 7.4 of the Revised Draft CP.
66	S. 5.6(d)	S. 5.7(1)(d)	Delete the reference to "material change" because it is ambiguous and confusing given the reference to "significant change".	Change made.
67	S. 5.7	S. 5.9	Clarify whether the Quebec Securities Commission will continue to require a separate application in relation to mutual fund conflict of interest investment restrictions contained in Quebec securities legislation.	No change made. The section provides relief from the provisions of Quebec securities legislation as other provincial securities legislation.

68	S. 5.8	S. 5.10	Ensure that all material changes (as defined in securities legislation) in the affairs of a mutual fund would be a "significant change" for purposes of the NI. Definition of "significant change" in the 1997 Draft NI comes close to a reasonable and workable approach to establishing an appropriate continuous disclosure trigger for mutual funds. However, since the concept of "materiality" is very familiar to the Canadian securities market place, less confusion would be likely to result if both the definition of "significant change" and s.5.8 are amended to replace the words "significant" and "important" with the word "material". Articulate why the same timely disclosure rules that apply to other reporting issuers should apply to mutual funds.	Changes made to the definition of "significant change" to accommodate comments raised. Section 7.5 of the Revised Draft CP has also been drafted to clarify this provision.
69	S. 6.1	_____	Clarify section to ensure that where a custodian is not involved in the selection of a sub-custodian, but consents to the appointment, the custodian will nevertheless have responsibility for the sub-custodian.	No change made. Section 6.6 establishes the relationship between custodians and sub-custodians.
70	S. 6.1(1)	_____	Amend section to permit a mutual fund to have more than one Canadian custodian. A specific example of how section 6.1 would create a practical problem was given.	No change made. The CSA consider that the practical concern raised should be addressed in an application for *ad hoc* relief.
71	S. 6.1(3)	_____	Do not require written consent to the delegation of custodial authority to a sub-custodian. In most cases a global custodian maintains a network of sub-custodians throughout the world. The global custodian routinely places a mutual fund's assets with its network member in a given jurisdiction. It is not typical for a mutual fund to provide "written consent" for each use of a network member. As long as the global custody contract provides for the placement of assets in new jurisdictions as investments occur, separate country-by-country written consents would be a needless burden on funds and serve no investor protection purpose.	Changes made. Subsections 6.1(4) and (5) of the Revised Draft NI have been added to permit general consent to be given in the agreement between a mutual fund and custodian or the custodian and sub-custodian and to require that the mutual fund be provided with a list of those persons or companies that are appointed sub-custodian under the general consent.
72	S. 6.2 and S. 6.3	_____	Delete "wholly owned" requirements in subsections 6.2(3) and 6.3(3). Sister affiliates or less than wholly-owned subsidiaries of eligible banks are not eligible custodians or sub-custodians; both such entities are common in international banking. The restrictions limit the ability of global custodians to place Canadian mutual fund assets with the best available sub-custodians.	Changes made. The words "a wholly owned subsidiary" have been replaced by the words "an affiliate".
73	S. 6.2 and 6.3	_____	Replace the requirement to "fully and unconditionally guarantee" with the requirement that the parent "assume liability for" losses occurring as a result of the custody activities of the subsidiary to the same extent as if the parent had held the assets."	Change made.
74	S. 6.2 and 6.3	_____	Reduce the shareholders' equity requirement from $100 million to $50 million. In smaller or emerging markets the $100M requirement excludes most (sometimes all) of the eligible sub-custodians.	No change made. Although any dollar limit is arbitrary, this limit retains the status quo which has been in place for some time. The CSA are of the view that this limit is appropriate.
75	S. 6.5(1) and (4)	_____	Amend provisions to permit the use of omnibus accounts to hold assets of Canadian mutual funds. Such accounts are extremely common in the global custody business. In an omnibus account arrangement the assets of all of a custodians' customers are held in a single account at a sub-custodian or at a depository. In order to determine what part of the assets belong to any particular mutual fund one must look to the records of the global custodian. In cases where the sub-custodian in turn maintains an omnibus account at a depository, neither the records of the depository nor the records of the sub-custodian will be sufficient to determine which assets belong to a particular mutual fund for which the global custodian acts.	Change made.
76	S. 6.5(4)	_____	Add the words "are sufficient to" after "their respective nominees" to conform with subsection 6.5(1).	Change made.
77	S. 6.6	_____	Add the words "or agents" to end of subsection (2). Extend the standard of care to contractors of custodians and sub-custodians. Conform use of term "wrongful act" as used in subsection 6.6(2) with the term ""willful misconduct" as used in section 4.3.	Changes made to this section to conform to section 4.4 of the Revised Draft NI to ensure that all service providers to a mutual fund are held, to the extent possible, to similar standards of care.
78	S. 6.7(1)(c)(ii)	_____	Provision, which would require a mutual fund to change a sub-custodian if, at some point, it fails to meet the requirements of section 6.2 and 6.3, could require a mutual fund to divest of assets in a market. Such a divestment might not be in the best interests of the mutual fund or the unitholders.	No change made. Section 8.3 has been added to the Revised Draft CP to clarify the CSA views in this regard.
79	S. 6.8	_____	Too stringent as some U.S. dealers may not be able to hold securities in segregated safekeeping. Also subsection (4) may be problematic since brokers normally hold margin in derivative transactions and may not be in a position to have records evidencing a fund's beneficial ownership of segregated assets.	Changes made. Paragraph 6.8(2)(b) has been deleted. Subsection 6.8(4) has been amended so that the agreement by which portfolio assets are deposited must require that the person or company holding the assets ensure that its records show that the beneficial ownership of the portfolio assets is vested in the mutual fund.
80	S.7.1	_____	Clarify that paragraph 7.1(b) means the calculation of an incentive fee is only based on the period since a performance fee was previously paid. Thus, no fee will be paid until it is due based on performance in a period which includes that period for which no fee was payable.	No changes made. Paragraph 7.1(b) is clear and consistent with comment.
81	Part 9 (general)	_____	Clarify the meaning of the phrase "principal office". Is the "principal office" of a national dealer the head office of a dealer or the main office in a province? Does the transmission to a "principal office" have to take place before transmission to the mutual fund or can transmission to both be concurrent? Can the branch office of a dealer directly place a trade with a fund company after transmitting the purchase order to the principal office of the dealer?	Changes made. The Revised Draft NI has been amended to clarify that the order is either sent to the "principal office" in a jurisdiction for transmission to the mutual fund or is sent to the "principal office" (national) for transmission to the mutual fund, provided that a copy of each purchase order received in a jurisdiction is also sent to the person responsible for approving the opening of new accounts and supervising client trades for the principal distributor or participating dealer in the jurisdiction.

82	S. 9.1	_____	Reverse the order of subsections (1) and (2) so that orders forwarded by representatives to dealers are addressed first followed by orders forwarded by participating dealers or principal distributors to mutual funds.	Change made.
83	S. 9.1	_____	Replace words "without charge to the person or company placing the order" in subsection 9.1(2) with the words "without charge to the client". Add the word "only" to subsection 9.1(2) to make it clear that orders are to be routed only through the principal office of the participating dealer.	No changes made. The CSA consider the drafting clear in this regard.
84	S. 9.1	_____	Amend section to clarify that representatives of participating dealers must forward orders to dealers on the day they receive the orders, regardless of how the order is received by the representative.	No change made. The CSA consider the section is clear in this regard and requires representatives to so deliver orders.
85	S. 9.1	_____	Define the word "order". Suggested wording was given. The existence of an "order" should depend on all required documentation being properly completed and submitted and "sufficient funds" to settle the order received.	No change made. See section 10.3 of the Revised Draft CP.
86	S. 9.1	_____	Allow dealers to set cut-off times for the delivery of orders by representatives to either head office or principal distributors. Participating dealers are setting cut-off times for receipt of orders at their head office, to ensure that they can send orders to mutual funds the same day they are received via electronic order processing.	Change made. See subsection 9.1(4) of the Revised Draft NI.
87	S. 9.1	_____	Define "switches" and require that they be processed according to the same rules as for other purchases and redemptions.	No changes made. The CSA will be considering the regulatory issues raised in connection with transfers of money and mutual fund holdings between financial institutions and between mutual funds during 1999. Any rules in this regard deemed necessary will be published for comment after the conclusion of the CSA's review.
88	S. 9.1(2)	S. 9.1(1)	Is the one-day delay inherent in the requirement to forward an order to the principal office of the participating dealer justified by the need for dealers to monitor compliance of representatives with securities requirements?	No change made. The Revised Draft NI is permissive; it permits the delivery timing to accommodate participating dealers not submitting orders via electronic order processing, but instead relying on delivery of paper orders.
89	S. 9.2	_____	Reduce the time within which a mutual fund can reject a purchase order from 2 days to 24 hours.	Change made.
90	S. 9.3	_____	Section 9.3 constitutes a definition and therefore should be moved to Part 1. Define "backward pricing" and explicitly prohibit backward pricing.	Changes made in section, but not to respond to this comment. Section 9.3 is a substantive requirement. Backward pricing is explicitly prohibited, in that only "forward pricing" is permitted. Section 10.4 of the Revised Draft CP contains a discussion of the prohibition against "backward pricing".
91	S. 9.4(1)	_____	Clarify paragraph (a) to simply state that regardless of when funds are received by the principal distributor or participating dealer, they must be forwarded to the order receipt office of the mutual fund so that they are received no later than T + 3. Exempt IDA members from the provisions of this section since settlement and delivery requirements are already addressed by IDA rules.	Changes made to simplify the drafting and hence the requirements. IDA members not exempted from the requirements.
92	S. 9.4(2)	_____	Provision seems to prohibit a participating dealer from settling net of commissions. It is common practice for dealers to settle net of commissions.	No change made. The CSA consider no change to the drafting is necessary.
93	S. 9.4(6)(b)	_____	Add the words "upon notification by the mutual fund" after the word "immediately".	Change made.
94	S. 9.4(6)	_____	CSA should re-consider whether or not they can make rules requiring principal distributors and participating dealers to make payments where settlements of purchase orders have not been made in a timely way. The provisions in NP39 should be brought forward into the NI. At a minimum the NI should set out the responsibilities of participating dealers to principal distributors for deficiencies.	No changes made. Certain of the CSA do not have the authority to make rules relating to a participating dealer's ability to recover from its clients or other participating dealers amounts that they were required to pay to a mutual fund. See section 10.5 of the Revised Draft CP.
95	Part 9 (new)	S. 9.4 (4), (5) and (6)	Add rules for forced settlement procedures where cheques of investors are returned NSF. The rules should provide that forced settlement be done as soon as the insufficiency of funds is determined and should ensure that not only deficiencies to the fund on forced settlement but also any direct costs borne by the fund (eg. bank charges) are recovered. Any excess amounts should be paid to dealers if the dealer has the obligation to replace any loss to the fund.	Changes made; however, the regime whereby the mutual fund retains the right to retain any excess amount has not been changed.
96	S. 10.1	_____	Clarify whether the term "securityholder" refers to the registered owner or the beneficial owner of securities.	Changes made . Section 10.2 of the Revised Draft CP has been added for further clarity.
97	S. 10.1(1)	_____	Move reference to certificated units to the end of the section since certificates are not commonly used. The initial focus of the redemption section should be on other forms of redemption.	No change made. The CSA consider that the drafting is clear.
98	S. 10.1(1)	_____	Provision does not reflect industry practice. IDA members may, if properly authorized, make redemption requests on behalf of clients without "specific instructions" and without a request in writing regardless of whether the account is held in nominee or investor name. Alternative arrangements regarding the making of redemption requests (i.e by phone or electronic means) are normally made between the dealer and the fund manager and not between the investor and the fund manager.	No changes made. The CSA consider that these comments are addressed through the clarification of their views contained in section 10.2 of the Revised Draft CP.
99	S. 10.1 (3)	_____	Clarify the expected detail of disclosure, as well as the meaning and intent of clause (d). The provision should only apply to redemption procedures for standard accounts held in client name. For other types of accounts or unique situations the investor should contact the fund company or the dealer for further details. The provision should make	Changes made .

			clear that the fund manager is responsible for providing this disclosure.	
100	S.10.2	_____	Is the one-day delay inherent in the requirement to forward an order to the principal office of the participating dealer justified by the need for dealers to monitor compliance of their representatives with securities law requirements?	No change made. The Revised Draft NI is permissive, it permits the delivery timing to accommodate participating dealers not submitting orders via electronic order processing, but instead relying on delivery of paper orders.
101	S. 10.2(1) and (2)	_____	Reverse the order of subsections 10.2(1) and (2).	Change made
102	S.10.2(5)	S. 10.2(6)	Amend section to require notice be given to the securityholder, principal distributor, participating dealer or their agents.	No change made. Section 10.2 of the Revised Draft CP is intended to provide clarification in this regard.
103	S. 10.3	_____	Section constitutes a definition and therefore should be moved to Part 1.	No change made. As with section 9.3, this section has been simplified and the discussion of backward pricing has been moved to section 10.4 of the Revised Draft CP.
104	S. 10.4(2)	_____	Terminology in this section is inconsistent since subsection (2) refers to "registered holder" rather than "securityholder".	Change made.
105	S. 10.4(2)	_____	Amend provision to permit the deduction of applicable withholding taxes.	No change made. The definition of "investor fees" is broad enough to cover withholding taxes.
106	S. 10.4(5)	_____	Why does the deeming section not also apply to the mailing of a cheque or the transmittal of money by a participating dealer?	No change made. The section is only intended to address the payment by the mutual fund.
107	S. 10.5	_____	Shorten the time period (10 days) to conform with T + 3 settlement i.e. forced reversal of order should happen on T+4 to be consistent with the dates applicable to the forced settlement of purchases. Conversely, three business days may not provide a securityholder with sufficient time to comply with any unfulfilled redemption requirements. However a fund could stipulate that a redemption order shall not be deemed complete and effective until all requirements are met, as permitted by clause 10.1 (2)(a).	No change made. The CSA consider the 10 day period necessary since it gives flexibility to fund companies and to investors to avoid forced reversals of redemption orders.
108	S. 10.5(1)(a)	_____	Replace the word "equal" with the word "equivalent" to reflect changes during the ten day period such as the declaration of a dividend.	No change made. The CSA consider that the forced reversal of a redemption should treat the investor and the mutual fund as if no redemption order had ever been made.
109	S. 11.1(1)(b) and S. 11.2(1)(b)	_____	Delete these clauses since they do not add anything to clause (a).	Changes made to improve clarity.
110	S. 11.1(4) and 11.2 (4)	_____	Remove the requirement that all interest be paid to the applicable mutual funds. Instead, give dealers the option of paying interest to mutual funds, investors or, if the cost of writing monthly cheques exceeds the aggregate interest to be remitted, to an approved contingency fund. A mandatory, reasonable formula for calculating and allocating interest should also be set out.	Changes made. See also subsection 11.1(5) of the Revised Draft CP.
111	S. 11.2(3)	_____	Remove the last two lines of (a) and replace them with the words "net settlement (or payable) amount". Add to the list of items that can be withdrawn from a trust account: dealer compensation, bank charges, and any excess amounts owed to investors after a purchase of mutual funds from proceeds of deposit.	Changes made. A cross-reference to subsection 11.2(5) has been added to permit an offset of the proceeds of redemption against amounts held in the trust account for investment in the mutual fund. Paragraph 11.3(1)(c) prohibits charges in respect of a trust account from being paid with trust money. The definition of "investor fees" covers dealer compensation.
112	S. 11.2(6)	_____	Amend subsection to require a participating dealer's auditor to give comfort on the compliance of the participating dealer rather than implying an onus on the fund manager or the principal distributor to do its own inspection and audit.	No change made. This provision continues the requirement in subsection 12.03(6) of NP39.
113	S.11.4	DELETED	Add a reference to section 11.2 so that money received by third party service providers from participating dealers is handled in the same way.	Changes made. Section 11.4 has been deleted but references to third party service providers have been added to sections 11.1 and 11.2 to ensure that money handled by service providers are subject to the rules applicable to dealers handling money.
114	S. 12.1	_____	Timing for filing compliance reports should be 140 days in order to coincide with the timing of filing annual financial statements. Amend section to clarify that the auditor reports should only relate to compliance with the sections of the NI on which the mutual fund, principal distributor or participating dealer is required to report. Compliance reports should make allowances for non-material deficiencies.	Changes made, except that no change made in respect of "non-material deficiencies". The reference to a specific section of the Handbook has been deleted. Instead, the audit report must be in the form contained in the Appendices to the NI.
115	S. 12.1(3)	_____	Exempt IDA members from the requirement to file compliance reports.	Change made.
116	S. 12.1(3)(a)	_____	Participating dealers should be required to report on compliance with section 10.2 concerning the transmission and receipt of redemption orders.	Changes made. Reports on compliance with the applicable requirements of Parts 9, 10 and 11 are required.
117	S. 13.1	_____	Requirement to calculate net asset value weekly or daily presents a problem for non-conventional mutual funds which currently calculate net asset value once a month. Amend the NI to permit the calculation of NAV monthly if the mutual fund securities are listed on a stock exchange.	No change made. The CSA consider that non-conventional mutual funds should request *ad hoc* relief, if necessary.
118	S. 13.1(3)	_____	Do not restrict the calculation of NAV to Canadian and U.S. currency. A fund manager may consider it advantageous to accept a foreign currency other than U.S. dollars in order for the fund to avoid currency conversion costs incurred to acquire the currency in which the fund normally invests.	No change made. The CSA consider that restricting the calculation of NAV to Canadian or U.S. currency is appropriate for Canadian mutual funds.
119	S. 13.5	_____	Once GAAP clarifies the requirements for the valuation of derivatives, the rules set out in section 13.5 of the 1997 Draft NI should be replaced.	No change made. The CSA will monitor the developments in Canadian GAAP.
120	S. 14.1	_____	Clause (b) does not work technically. Amend to permit a record date to be fixed as the business day before the date the NAV is calculated for the distribution or the date the right is issued, if the NAVPS would not ordinarily be calculated on the distribution date or the date the right is issued.	Changes made.

121	S. 15.2	_____	Add a preamble to Part 15 concerning what is considered a "sales communication" (along the lines of the discussion contained in section 2.11 of 1997 Draft CP) which would give the rule the requisite weight and authority as well as clarify the sales communication provisions.	No change made. The CSA consider that the Revised Draft NI is clear and Part 12 of the Revised Draft CP adds additional perspective and context for clarity.
122	S. 15.2(3)	S. 15.4(1)	Amend the wording to provide that "a written sales communication shall bear the name of the person or company that distributed the sales communication and if the sales communication was distributed by a registered representative of a participating dealer, the name of the participating dealer...."	Change made.
123	S. 15.2(4)	S. 15.2(2)	Limiting the requirement for 8 point type to all "material" text. Non-material text (such as trademark identification) could be in whatever size type deemed appropriate.	No change made. The CSA have amended this requirement to require at least 10 point type.
124	S. 15.2(6)	S. 15.3(5)	Clarify to acknowledge that some mutual funds that were considered money market funds under NP39 will not be considered money market funds under the NI. Amend the provision to permit such funds to disclose performance data for those periods during which they fitted within the definition in NP 39.	Change made.
125	S. 15.3(3)	S. 15.5(3)	The concept of "undue prominence" is unclear and open to interpretation. Delete the words "and shall not give undue prominence to the existence or absence of any particular fee or charge" and replace them with the words "to be included in the body of the sales communication".	Changes made to delete the reference to "undue prominence". Subsection 15.5(2) of the Revised Draft NI has been amended to require a sales communication that describes a mutual fund as "no load" to include a summary of the fees and charges paid by the mutual fund and disclose the existence of any trailing commissions paid by a member of the organization of the mutual fund.
126	S. 15.4(1)	Sections 15.6, 15.7, 15.8 and 15.9	Permit "young funds" to use performance data. The prohibition precludes dealers from discussing the performance of such funds with clients who do not already own units of the fund but ask for the information. This leads to an anomalous result since the information is readily available from other sources (for example, press, SEDAR). Disclosure should be permitted within parameters (for example, not until 3 months old, text no more prominent than for other funds, control over distribution, no advertisements). Technical problems created by the prohibition since many fund companies prepare combined quarterly and semi-annual reports for their funds that may include performance data for funds that are less than one year old. Therefore some securityholders could receive such performance data even though they do not own securities in such funds. It would be impractical and expensive for funds in the same family to prepare and file separate financial statements in order to comply with the restriction.	No change made. The definition of "sales communication" has been amended to remove financial statements, account statements and prospectuses and other statutorily mandated disclosure from the ambit of the definition.
127	S. 15.4(1)(a)	S. 15.6(a)	Section prohibits asset allocation services from communicating performance data where it has non mutual fund components eg. where investors invest in mutual funds and GICs. Amend the provision to permit the general distribution of sales communication related to such services.	Change made to the definition of "asset allocation service".
128	S. 15.4 (1)(f)	S. 15.4(7)	The words "close proximity" could pose problems for certain types of advertisements (i.e. where the format is not conducive to including the assumptions in "close proximity").	Change made. Disclosure relating to annualized returns for money market funds to be located immediately following the performance data in the sales communication.
129	S. 15.4(1)(l)	S. 15.8(3)	Require performance data calculation from inception in addition to the other requirements.	Change made. Where a mutual fund is less than ten years old, it must give performance information from inception in addition to disclosure of performance for 1, 3, 5 and 10 year periods.
130	S. 15.4(1)(f),(g) and (h)	S. 15.4(6), (7) and (8)	The references to "income taxes payable" and the possible reduction in overall returns due to income taxes imply that taxes are payable at the fund level even though funds typically operate so that no tax is payable at the fund level. Also, investors in registered plans (eg. RRSP) could be confused notwithstanding the tax exempt status of the plan. Furthermore, other financial products are not required to make similar disclosure.	No changes made. The CSA consider that the provisions are necessary.
131	S. 15.4(1)(i)	S. 15.9(1)	Expand the CP to provide guidance as to what is considered to be a material change in the performance of a fund. A *de minimus* threshold should be prescribed to ensure uniform and consistent compliance with this provision (eg. if a change in fees increases the management expense ratio by one basis point, would this be deemed to be sufficient to "materially" affect the performance of the fund, thereby invoking the disclaimer required by this provision?).	Changes made. A *de minimus* threshold has not been added. See subsection 12.2(1) of the Revised Draft CP.
132	S. 15.4(2)	DELETED	Remove the prohibition on performance data in radio and TV advertisements.	Changes made. Performance data in a radio or television advertisement is subject to the general requirements concerning performance data in sales communications.
133	S. 15.5 (1)1(b)	S.15.11(1)1 (b)	It is impossible to generate performance information that will be relevant to the experience of individual securityholders if this assumption is made. It would be preferable to account for recurring fees and charges at the fund level so that the data generated will be representative of the performance of the fund, as opposed to a particular investor. This manner of accounting for recurring fees and charges would also be more consistent with the performance rating calculations of fund tracking companies which distribute their findings to the public. Such consistency will reduce the possibility of confusion amongst investors or potential investors.	No change made. The assumptions in section 15.11 of the Revised Draft NI are prescribed for the purpose of calculating *standard* performance data. The assumptions provide for a recognized standard which permits comparison between mutual funds.
134	S. 15.5(4) -- definition of effective yield for	S. 15.10(2)	Calculating "effective yield" by compounding income over a 7 day period misleads investors by reducing the comparability between funds. In money market funds income only compounds upon maturity of individual securities and the reinvestment of the proceeds of such maturities. In a fund with numerous discounted securities purchased at	No changes made. The use of a "seven day return" is consistent with NP 39. The definition of "money market fund" provides for a dollar-weighted average term to maturity of up to 90 days. The use of a common period for calculating "effective yield" permits comparability between mutual funds. This requirement

	money market fund		different times, the compounding period is best estimated by the fund's average term to maturity. Amend the subsection to provide for more meaningful comparisons between funds with different average terms to maturity.	is for the purpose of calculating standard performance data. The Revised Draft NI does not preclude the use of other performance data so long as standard performance data is also disclosed. See section 15.6 of the Revised Draft NI.
135	S. 15.5(7)	S. 15.10(6)	Amend subsection to clarify that all numerical performance data must be calculated on the same basis as set out in this provision.	Change made.
136	S. 15.6	S. 15.4	The mandated words "mutual funds are not guaranteed" could be confusing, particularly with the advent of "guaranteed" mutual funds. Instead require a statement that mutual funds are not CDIC insured. Furthermore, the statement that "values change frequently" may be inaccurate. Instead mandate a statement that "values may change".	Changes made. The disclosure required by section 15.4 of the 1997 Draft NI and the warnings required by section 15.6 of the 1997 Draft NI have been combined, where possible, in section 15.4 to reduce duplication. The statement that "values change frequently" has been retained. In addition, special warnings are now mandated for "guaranteed" or "insured" mutual funds.
137	S.15.6(8)	S. 15.4(12)	The provision should only require warnings to be communicated at the same time as the related sales communication. The requirement to communicate the warning through the same medium is not necessary to give effect to the purpose of the section and it may be confusing in some circumstances (eg. sales conferences - written vs. oral communications).	No change made to "same medium" requirement. The subsection has been amended to establish a "reasonable person" test.
138	S. 15 (new)	_____	Provide guidance for the use of performance data by so-called "clone" funds. Specifically prohibit the use of performance data of foreign funds in the event that such foreign fund or "Canadian clones" of such funds were made available in Canada. The use of performance data of a foreign fund would be misleading since foreign funds are established and operate under different regulatory regimes.	Changes made. Section 15.6 of the Revised Draft NI prohibits advertising of performance data for funds that are less than 12 months old. Also, section 15.7 of the Revised Draft NI prohibits the comparison of mutual funds unless they are under common management or administration or they have fundamental investment objectives that a reasonable person would consider similar.
139	S. 16.4	DELETED	Do not require certificates (for prospectuses). Instead, the Act should be amended so that a person's liability is determined by his or her relationship with the issuer rather than by the presence or absence of the certificate.	Section 16 of the 1997 Draft NI has been deleted since it related to aspects of prospectus disclosure, but it will be moved to proposed National Instrument 81-101. No change to this requirement will likely be made.
140	S. 16.7	DELETED	The warning on the front page of a money market fund prospectus should simply state that it is not CDIC insured and the statement that such funds are not "guaranteed" should be removed.	Section 16 of the 1997 Draft NI has been deleted since it related to aspects of prospectus disclosure now dealt with in NI 81-101.
141	S. 16.8	DELETED	Disclosure of exemptions and approvals should be required only in the annual information form (the "AIF") and not in the simplified prospectus (the "SP"). Why is it necessary to disclose exemptions and approvals obtained under securities legislation? Not meaningful disclosure to investors and could be confusing to investors. As an alternative, publish all exemptions or approvals .	Section 16 of the 1997 Draft NI has been deleted since it related to aspects of prospectus disclosure now dealt with in NI 81-101.
142	S. 17.1(3)	DELETED	Do not require incorporation by reference of the separate document referred to, into the prospectus. Officers and directors signing a SP/AIF cannot certify documents sent in the future and will not be in a position to approve every separate arrangement.	Section 17 of the 1997 Draft NI has been deleted since it related to aspects of prospectus disclosure now dealt with in NI 81-101.
143	S. 17.1 and 17.2	DELETED	Section 17.1 should require disclosure of any tax issues. Structures whereby management fees are paid directly by securityholders raise a number of tax issues relating to the deductibility of such fees.	Section 17 of the 1997 Draft NI has been deleted since it related to aspects of prospectus disclosure now dealt with in NI 81-101.
144	S. 17.2(2) and (3)	DELETED	The provisions should refer to "material" tax consequences since it is not possible for a SP to disclose all income tax consequences pertaining to each securityholder. It is also not possible to ensure that a change in management fee structure does not result in any adverse tax consequences to securityholders. Subsection 17.2(3) should be amended to permit a fund to adopt a management fee structure that may have certain adverse tax consequences if it is approved by securityholders pursuant to section 5.1. Subsection 17.2(3) would prohibit a reduction of management fees if the ancillary result of that reduction would be increased taxes payable by securityholders. Therefore, the subsection should be deleted or, if retained, amended to prohibit only changes to the management fee structure that result in adverse tax consequence without a corresponding benefit. The subsection should also clarify that the negative tax consequences must be material and felt by a majority of securityholders.	Section 17 of the 1997 Draft NI has been deleted since it related to aspects of prospectus disclosure now dealt with in NI 81-101.
145	S. 18.1	S. 17.1	Amend these provisions to require compliance with Canadian GAAP.	No change made. When appropriate, the CSA will amend this section through an amendment to the NI.
146	S. 19.1(c)	S. 18.1(c)	Delete the requirement to maintain "trading" records. It is unnecessary and impractical to require a separate record of historical trading information for the benefit of other securityholders. Such information is already maintained elsewhere. Time restrictions on the maintenance of records should be established so that fund managers are not required to expend significant time and money inputting old securityholder data into their systems.	Changes made.
147	S.19.2	S. 18.2	Quebec privacy laws would prohibit the release of information concerning a securityholder to another person without the prior consent of the securityholder. Therefore, funds offered in Quebec would have to have a different application form containing consent language and consent would have to be obtained for the release of information concerning existing securityholders. Concern that access be given only in *bona fide* cases of voting/proxy solicitation. In order to address concerns about the use of such information for improper purposes a standard form of request or securityholder agreement could be adopted and appended to the NI. The CP should prescribe a procedure to be followed by securityholders for proxy solicitation along the lines of that prescribed for issuers under NP41. The requirement to obtain a securityholder's agreement to use the information for a specified	No changes made. The CSA consider it unnecessary to include a standard form or prescribe proxy solicitation procedures in the NI. Subsection 18.2(1) has been amended to ensure that securityholder records need only be made available for appropriate purposes. Compliance with Quebec privacy laws is necessary and cannot be dealt with by the CSA in the Revised Draft NI.

			purpose should apply equally with respect to the inspection of the register. Therefore, a provision similar to s.19.2(2)(a) should be inserted in s.19.2(1).	
148	S. 20.2	DELETED	Amend the section to allow a memorandum to be filed requesting relief to deal with matters arising during the course of the review process, as is current practice. Amend the section to permit the SP to refer to the AIF for details of the exemptions obtained. Eliminate the need for separate applications for relief from Quebec securities legislation in Quebec. The Quebec Securities Commission should not require mutual funds to re-apply annually to renew relief previously granted under Quebec securities legislation and NP39. Such a policy imposes unnecessary costs and uncertainty on issuers.	Section 20.2 of the 1997 Draft NI has been deleted since the CSA considers that it is appropriate that a separate approval document be issued by the CSA to evidence exemptions from, or orders given under, the NI. The Quebec Securities Commission has noted the comments made and will be addressing them once it has obtained rulemaking powers. In the interim, the Quebec Securities Commission has requested that the Revised Draft CP remain the same as the 1997 Draft CP.
149	S. 20.3(4)	DELETED	This subsection gives regulators a new opportunity to deny exemptive relief granted previously and, accordingly, could create serious uncertainty for mutual funds. There is no explanation of what the CSA considers to be the "public interest". Also, it is possible that the interpretation of "public interest" could change over time. In order to avoid such a result it is necessary to provide an absolute grandfathering of relief already granted under NP 39. If relief is taken away, it could constitute a fundamental change for the mutual fund since investors purchased the fund on the basis of previously granted relief. Such investors would not have a right to a hearing under the provision. This could expose funds and managers to claims by investors for liability.	Change made. The CSA are of the view that mutual funds should be able to rely upon past exemptions or approvals. However, the CSA may have discretion under applicable securities legislation to revoke an exemption or waiver previously granted. Therefore, subsection 19.2(1) of the Revised Draft NI is designed to clarify this point.
150	S. 20.3(1)	S. 19.2(1)	Grant "blanket" grandfathering whether or not provisions are "substantially similar" or clarify what is considered "substantially similar".	No change made. The CSA consider that the "substantially similar" test and the disclosure required by subsection (3) provides certainty for mutual funds, investors and regulators about the rules that apply to a particular fund. Section 13.2 of the Revised Draft CP is intended to provide further clarification.
151	S. 21.1	S. 20.1	Establish a transition period for new rules, of at least 6 months. Specific transitional rules for written sale communications needed. A longer transition period is recommended for changes to material contracts to conform with section 4.3 of the 1997 Draft NI or clarify that section 4.3 applies only to new contracts. The NI should permit changes to material contracts which are required to comply with section 4.3 of the 1997 Draft NI to be made simply on notice to securityholders (i.e. without the need for securityholder meetings).	Changes made. Sections 20.2 to 20.5 of the Revised Draft NI provide for transition.
152	S. 21.2	DELETED	If prospectuses need to be amended to ensure full, true and plain disclosure as a result of the enactment of the NI, mutual funds should not be required to pay the potentially substantial amendment filing fees and SEDAR fees. The NI should provide a waiver of fees in these circumstances.	No change made to deal with comment. This section was deleted since it related to aspects of prospectus disclosure now dealt with in proposed NI 81-101.
153	(new)	_____	The NI should establish rules for processing transfers of mutual fund securities in registered plans.	No change made. The CSA agree that they must address the regulatory issues raised by transfers between financial institutions and between mutual funds and the processing of orders by trustees of registered tax plans. In the interests of completing the NI, the CSA have decided to address these issues later during 1999 and will publish for comment a parallel amending instrument once their review is completed.
154	(new)	_____	The NI should address the "highly unsatisfactory regulatory regime regarding rights of rescission and rights of withdrawal with respect to mutual funds". The general withdrawal rights in subsection 71(2) of the *Securities Act* (Ontario) (the "OSA") should not apply to mutual fund investors given the rescission right provided by s. 137 of the OSA. In order to prevent abuse, the NI should specifically remove withdrawal rights in the context of mutual fund purchases.	No change made. The CSA agree that they should address the regulatory issues raised by withdrawal and rescission rights and delivery requirements. In the interests of completing the NI, the CSA have decided to address these issues later during 1999 and 2000. The CSA note that legislative changes will likely be required.
155	(new)	_____	The NI should mandate the use by dealers of a specified point of sale mutual fund checklist.	No change made. This comment relates to NI 81-101 and has been considered in conjunction with this instrument.
156	(new)	_____	Amend the NI to accommodate the purchase of securities of mutual funds using charge or credit cards.	No change made.
157	S. 2.12 1997 Draft CP	S. 2.17 Revised Draft CP	Add linked notes (where there is no leverage) to the list of those securities which will not be treated as "specified derivatives".	No change made. "Linked notes" are part of the definition of "debt-like securities" which are "specified derivatives" under the Revised Draft NI.
158	S. 2.10 1997 Draft CP	S. 2.15 Revised Draft CP	Include a discussion of the valuation of special warrants and other securities for which valuations can be difficult. General descriptive language would be useful in addressing securities that are currently issued and others that may be issued in the future.	No change made. The CSA understand the concerns raised about the valuation of portfolio assets. The CSA will monitor this issue with a view to articulating principles in a future revision to either the NI or the CP.
159	Part 2 1997 Draft CP	_____	Add a definition of "electronic means" (used in Part 9 and 10 of NI).	No change made.
160	S. 6.1(4)(b)(I) 1997 Draft CP	S. 7.1(4)(b)(I) Revised Draft CP	Delete reference to birthrates since they seem to be unnecessary.	No change made. Birthdates are required so that CSA staff can conduct the necessary police checks.
161	S. 6.3 1997 Draft CP	S. 7.4 Revised Draft CP	Clarify the reference to "without charge"; the CSA should not include redemption or transfer fees that a securityholder has previously agreed to pay.	Change made. The CSA have deleted this statement in light of the revisions made to the merger provision in the Revised Draft NI.
162	S. 11.1 1997 Draft CP	DELETED	The detailed disclosure about derivatives required is inconsistent with a move to providing investors with simpler documents.	Change made. This section of the 1997 Draft CP is deleted from the Revised Draft CP since mutual fund prospectus requirements will be addressed in NI 81-101.
			Add a section to the CP clarifying Part 11 of the NI. Dealers who offer self-directed registered plan products maintain separate trust accounts	No change made. Part 11 of the Revised Draft NI has been

163	(new)	_____	for them and it may be helpful to clarify that Part 11 does not preclude interest on those types of trust accounts from being remitted directly to investors.	amended to permit the payment of interest to securityholders.

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NATIONAL INSTRUMENT 81-102

MUTUAL FUNDS[(5)]

PART 1 DEFINITIONS AND APPLICATION

1.1 Definitions[(6)] - In this Instrument[(7)]

"acceptable clearing corporation" means a clearing corporation that is an acceptable clearing corporation under the Joint Regulatory Financial Questionnaire and Report;[(8)]

"advertisement" means a sales communication that is published or designed for use on or through a public medium;

"approved credit rating" means, for a security or instrument, a rating at or above one of the following rating categories issued by an approved credit rating organization for that security or instrument or a category that replaces one of the following rating categories if

(a) there has been no announcement by the approved credit rating organization of which the mutual fund or its manager is or ought to be aware that the rating of the security or instrument to which the approved credit rating

was given may be down-graded to a rating category that would not be an approved credit rating, and

(b) no approved credit rating organization has rated the security or instrument in a rating category that is not an approved credit rating:

Approved Credit Rating Organization	Commercial Paper/ Short Term Debt	Long Term Debt
CBRS Inc.	A-1	A
Dominion Bond Rating Service Limited	R-1-L	A
Fitch IBCA, Inc.	A-1	A
Moody's Investors Service, Inc.	P-1	A2
Standard & Poor's Corporation	A-1	A
Thomson BankWatch, Inc.[(9)]	TBW-2	A

"approved credit rating organization" means each of CBRS Inc., Dominion Bond Rating Service Limited, Fitch IBCA, Inc., Moody's Investors Service, Inc., Standard & Poor's Corporation, and Thomson BankWatch, Inc. and any of their respective successors;

"asset allocation service" means an administrative service under which the investment of a person or company is allocated, in whole or in part, among mutual funds to which this Instrument applies and reallocated among those mutual funds and, if applicable, other assets according to an asset allocation strategy;[(10)]

"book-based system" means a system for the central handling of securities or equivalent book-based entries under which all securities of a class or series deposited within the system are treated as fungible and may be transferred or pledged by bookkeeping entry without physical delivery;

"cash cover" means any of the following portfolio assets of a mutual fund that are held by the mutual fund, have not been allocated for specific purposes and are available to satisfy all or part of the obligations arising from a position in specified derivatives held by the mutual fund:

1. Cash.

2. Cash equivalents.

3. Synthetic cash.

4. Receivables of the mutual fund that arise from the disposition of portfolio assets, net of payables that arise from the acquisition of portfolio assets;[(11)]

"cash equivalent" means an evidence of indebtedness that has a remaining term to maturity of 365 days or less and that is issued, or fully and unconditionally guaranteed as to principal and interest, by

(a) the government of Canada or the government of a jurisdiction[(12)],

(b) the government of the United States of America, the government of one of the states of the United States of America, the government of another sovereign state or a permitted supranational agency, if, in each case, the evidence of indebtedness has an approved credit rating, or

(c) a Canadian financial institution[(13)], or a financial institution that is not incorporated or organized under the laws of Canada or of a jurisdiction if, in either case, evidences of indebtedness of that issuer or guarantor that are rated as short term debt by an approved credit rating organization have an approved credit rating;

"clearing corporation" means an organization through which trades in options or standardized futures are cleared and settled;

"clearing corporation option" means an option, other than an option on futures, issued by a clearing corporation;

"conventional convertible security" means a security of an issuer that is convertible into, or exchangeable for, other securities of the issuer, or of an affiliate of the issuer;(14)

"conventional floating rate debt instrument" means an evidence of indebtedness of which the interest obligations are based upon a benchmark commonly used in commercial lending arrangements;(15)

"conventional warrant or right" means a security of an issuer, other than a clearing corporation, that gives the holder the right to purchase securities of the issuer or of an affiliate of the issuer;(16)

"currency cross hedge" means the substitution by a mutual fund of a risk to one currency for a risk to another currency, if neither currency is a currency in which the mutual fund determines its net asset value and the aggregate amount of currency risk to which the mutual fund is exposed is not increased by the substitution;

"custodian" means the institution appointed by a mutual fund to act as custodian of the portfolio assets of the mutual fund;

"dealer managed mutual fund" means a mutual fund the portfolio adviser of which is a dealer manager;

"dealer manager" means

(a) a specified dealer that acts as a portfolio adviser,

(b) a portfolio adviser in which a specified dealer, or a partner, director, officer, salesperson or principal shareholder of a specified dealer, directly or indirectly owns of record or beneficially, or exercises control or direction over, securities carrying more than 10 percent of the total votes attaching to securities of the portfolio adviser, or

(c) a partner, director or officer of a portfolio adviser referred to in paragraph (b);

"debt-like security" means a security purchased by a mutual fund, other than a conventional convertible security or a conventional floating rate debt instrument, that evidences an indebtedness of the issuer if

(a) either

(i) the amount of principal, interest or principal and interest to be paid to the holder is linked in whole or in part by a formula to the appreciation or depreciation in the market price, value or level of one or more underlying interests on a predetermined date or dates, or

(ii) the security provides the holder with a right to convert or exchange the security into or for the underlying interest or to purchase the underlying interest, and

(b) on the date of acquisition by the mutual fund, the percentage of the purchase price attributable to the component of the security that is not linked to an underlying interest is less than 80 percent of the purchase price paid by the mutual fund;(17)

"delta" means the positive or negative number that is a measure of the change in market value of an option relative to changes in the value of the underlying interest of the option;

"equivalent debt" means, in relation to an option, swap, forward contract or debt-like security, an evidence of

indebtedness of approximately the same term as, or a longer term than, the remaining term to maturity of the option, swap, contract or debt-like security and that ranks equally with, or subordinate to, the claim for payment that may arise under the option, swap, contract or debt-like security;[(18)]

"forward contract" means an agreement, not entered into with, or traded on, a stock exchange or futures exchange or cleared by a clearing corporation, to do one or more of the following on terms or at a price established by or determinable by reference to the agreement and at or by a time in the future established by or determinable by reference to the agreement:

1. Make or take delivery of the underlying interest of the agreement.

2. Settle in cash instead of delivery;

"fundamental investment objectives" means the investment objectives of a mutual fund that define both the fundamental nature of the mutual fund and the fundamental investment features of the mutual fund that distinguish it from other mutual funds and whether the mutual fund is managed to constitute foreign property under the ITA[(19)];

"futures exchange" means an association or organization operated to provide the facilities necessary for the trading of standardized futures;

"government security" means an evidence of indebtedness issued, or fully and unconditionally guaranteed as to principal and interest, by any of the government of Canada, the government of a jurisdiction or the government of the United States of America;

"guaranteed mortgage" means a mortgage fully and unconditionally guaranteed, or insured, by the government of Canada, by the government of a jurisdiction or by an agency of any of those governments;

"hedging" means the entering into of a transaction, or a series of transactions, and the maintaining of the position or positions resulting from the transaction or series of transactions

(a) if

(i) the intended effect of the transaction, or the intended cumulative effect of the series of transactions, is to offset or reduce a specific risk associated with all or a portion of an existing investment or position or group of investments or positions,

(ii) the transaction or series of transactions results in a high degree of negative correlation between changes in the value of the investment or position, or group of investments or positions, being hedged and changes in the value of the instrument or instruments with which the investment or position is hedged, and

(iii) there are reasonable grounds to believe that the transaction or series of transactions no more than offset the effect of price changes in the investment or position, or group of investments or positions, being hedged, or

(b) if the transaction, or series of transactions, is a currency cross hedge;[(20)]

"illiquid asset" means

(a) a portfolio asset that cannot be readily disposed of through market facilities on which public quotations in common use are widely available at an amount that at least approximates[(21)] the amount at which the portfolio asset is valued in calculating the net asset value of the mutual fund, or

(b) a restricted security held by a mutual fund, the resale of which is prohibited by a representation, undertaking or agreement by the mutual fund or by the predecessor in title of the mutual fund;

"index participation unit" means a security traded on a stock exchange in Canada or the United States and issued by an issuer the only purpose of which is to hold the securities that are included in a specified widely quoted market index in substantially the same proportion as those securities are reflected in that index;(22)

"investor fees" means all fees, charges and expenses that are or may become payable by a securityholder of a mutual fund in connection with the purchase, conversion, holding, transfer or redemption of securities of the mutual fund;

"Joint Regulatory Financial Questionnaire and Report" means the Joint Regulatory Financial Questionnaire and Report of various Canadian SROs(23) on the date that this Instrument comes into force and every successor to the form that does not materially lessen the criteria for an entity to be recognized as an "acceptable clearing corporation";(24)

"long position" means a position held by a mutual fund, that for

(a) an option, entitles the mutual fund to elect to purchase, sell, receive or deliver the underlying interest or, instead, pay or receive cash,

(b) a standardized future or forward contract, obliges the mutual fund to accept delivery of the underlying interest or, instead, pay or receive cash,

(c) a call option on futures, entitles the mutual fund to elect to assume a long position in standardized futures,

(d) a put option on futures, entitles the mutual fund to elect to assume a short position in standardized futures, and

(e) a swap, obliges the mutual fund to accept delivery of the underlying interest or receive cash;

"management expense ratio" means the ratio, expressed as a percentage, of the expenses of a mutual fund to its average net asset value, calculated in accordance with Part 16;(25)

"manager" means a person or company that directs the business, operations and affairs of a mutual fund;(26)

"member of the organization" has the meaning ascribed to that term in National Instrument 81-105 Mutual Fund Sales Practices;(27)

"money market fund" means a mutual fund that has and intends to continue to have

(a) all of its assets invested in any or all of

(i) cash,

(ii) cash equivalents,

(iii) evidences of indebtedness, other than cash equivalents, that have remaining terms to maturity of 365 days or less, or

(iv) floating rate evidences of indebtedness not referred to in subparagraph (ii) and (iii), if the principal amounts of the obligations will continue to have a market value of approximately par at the time of each change in the rate to be paid to the holders of the evidences of indebtedness,

(b) a portfolio with a dollar-weighted average term to maturity not exceeding 90 days, calculated on the basis that the term of a floating rate obligation is the period remaining to the date of the next rate setting,

(c) not less than 95 percent of its assets invested in cash, cash equivalents or evidences of indebtedness denominated in a currency in which the net asset value of the mutual fund is calculated, and

(d) not less than 95 percent of its assets invested in any or all of

(i) cash,

(ii) cash equivalents, or

(iii) evidences of indebtedness of issuers the commercial paper of which has an approved credit rating;

"mortgage" includes a hypothec or security that creates a charge on real property in order to secure a debt;

"mutual fund conflict of interest investment restrictions" means the provisions of securities legislation[(28)] that

(a) prohibit a mutual fund from knowingly making or holding an investment in an issuer in which the mutual fund, alone or together with one or more mutual funds under common management, is a substantial securityholder as defined by securities legislation, or

(b) prohibit the portfolio adviser of the mutual fund, the mutual fund or a responsible person, as defined in securities legislation, from selling portfolio assets of the mutual fund to, or purchasing portfolio assets from, another mutual fund under common management;

"mutual fund conflict of interest reporting requirements" means the provisions of securities legislation that require the filing of a report with the securities regulatory authority[(29)] in prescribed form that discloses every transaction of purchase or sale of portfolio assets between the mutual fund and specified related persons or companies;

"non-resident sub-adviser" means a person or company providing portfolio management advice

(a) whose principal place of business is outside of Canada,

(b) that advises a portfolio adviser to a mutual fund, and

(c) that is not registered under securities legislation in the jurisdiction in which the portfolio adviser that it advises is located;

"option" means an agreement that provides the holder with the right, but not the obligation, to do one or more of the following on terms or at a price established by or determinable by reference to the agreement at or by a time established by the agreement:

1. Receive an amount of cash determinable by reference to a specified quantity of the underlying interest of the option.

2. Purchase a specified quantity of the underlying interest of the option.

3. Sell a specified quantity of the underlying interest of the option;[(30)]

"option on futures" means an option the underlying interest of which is a standardized future;

"order receipt office" means, for a mutual fund

(a) the principal office of the mutual fund,

(b) the principal office of the principal distributor of the mutual fund, or

(c) a location[(31)] to which a purchase order or redemption order for securities of the mutual fund is required or permitted by the mutual fund to be delivered by participating dealers or the principal distributor of the mutual fund;

"participating dealer" means a dealer other than the principal distributor that distributes securities of a mutual fund;

"participating fund" means a mutual fund in which an asset allocation service permits investment;

"performance data" means a rating, ranking, quotation, discussion or analysis regarding an aspect of the investment performance of a mutual fund, an asset allocation service, a security, an index or a benchmark;[(32)]

"permitted gold certificate" means a certificate representing gold if the gold is

(a) available for delivery in Canada, free of charge, to or to the order of the holder of the certificate,

(b) of a minimum fineness of 995 parts per 1,000,

(c) held in Canada,

(d) in the form of either bars or wafers, and

(e) if not purchased from a bank listed in Schedule I or II of the *Bank Act* (Canada), fully insured against loss and bankruptcy by an insurance company licensed under the laws of Canada or a jurisdiction;[(33)]

"permitted supranational agency" means the African Development Bank, the Asian Development Bank, the Caribbean Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Finance Corporation, and any person or company prescribed under paragraph (g) of the definition of "foreign property" in subsection 206(1) of the ITA;

"physical commodity", means, in an original or processed state, an agricultural product, forest product, product of the sea, mineral, metal, hydrocarbon fuel product, precious stone or other gem;

"portfolio adviser" means a person or company that provides investment advice or portfolio management services under a contract with the mutual fund or with the manager of the mutual fund;

"portfolio asset" means an asset of a mutual fund;

"pricing date" means, for the sale of a security of a mutual fund, the date on which the net asset value per security of the mutual fund is calculated for the purpose of determining the price at which that security is to be issued;

"principal distributor" means a person or company through whom securities of a mutual fund are distributed under an arrangement with the mutual fund or its manager that provides

(a) an exclusive right to distribute the securities of the mutual fund in a particular area, or

(b) a feature that gives or is intended to give the person or company a material competitive advantage over others in the distribution of the securities of the mutual fund;

"public quotation" includes, for the purposes of calculating the amount of illiquid assets held by a mutual fund, any quotation of a price for a fixed income security made through the inter-dealer bond market;

"purchase" means, in connection with an acquisition of a portfolio asset by a mutual fund, an acquisition that is the result of a decision made and action taken by the mutual fund;(34)

"report to securityholders" means a report that includes annual or semi-annual financial statements and that is delivered to securityholders of a mutual fund;

"restricted security" means a security, other than a specified derivative, the resale of which is restricted or limited by a representation, undertaking or agreement by the mutual fund or by the mutual fund's predecessor in title, or by law;

"sales communication" means a communication relating to, and by, a mutual fund or asset allocation service, its promoter, manager, portfolio adviser, principal distributor, a participating dealer or a person or company providing services to any of them, that

(a) is made

(i) to a securityholder of the mutual fund or participant in the asset allocation service, or

(ii) to a person or company that is not a securityholder of the mutual fund or participant in the asset allocation service, to induce the purchase of securities of the mutual fund or the use of the asset allocation service, and

(b) is not contained in any of the following documents of the mutual fund:

1. A preliminary or *pro forma* prospectus.

2. A simplified prospectus or preliminary or *pro forma* simplified prospectus.

3. An annual information form or preliminary or *pro forma* annual information form.

4. Financial statements, including the notes to the financial statements and the auditor's report on the financial statements.

5. A trade confirmation.

6. A statement of account;(35)

"short position" means a position held by a mutual fund that, for

(a) an option, obliges the mutual fund, at the election of another, to purchase, sell, receive or deliver the underlying interest, or, instead, pay or receive cash,

(b) a standardized future or forward contract, obliges the mutual fund, at the election of another, to deliver the underlying interest or, instead, pay or receive cash,

(c) a call option on futures, obliges the mutual fund, at the election of another, to assume a short position in standardized futures, and

(d) a put option on futures, obliges the mutual fund, at the election of another, to assume a long position in standardized futures;

"significant change" means

(a) a change in the business, operations or affairs of a mutual fund that would be considered important

(i) by a reasonable investor in determining whether to purchase securities of the mutual fund, or

(ii) by a reasonable securityholder of the mutual fund in determining whether to continue to hold securities of the mutual fund, or

(b) a decision to implement a change referred to in paragraph (a) made

(i) by senior management of the mutual fund who believe that confirmation of the decision by the board of directors of the mutual fund is probable, or

(ii) by senior management of the manager of the mutual fund who believe that confirmation of the decision by the board of directors of the manager of the mutual fund is probable;(36)

"special warrant" means a security that, by its terms or the terms of an accompanying contractual obligation, entitles or requires the holder to acquire another security without payment of material additional consideration and obliges the issuer of the special warrant or the other security to undertake efforts to file a prospectus to qualify the distribution of the other security;

"specified asset-backed security" means a security that

(a) is primarily serviced by the cashflows of a discrete pool of financial assets that by their terms convert into cash within a finite time together with any rights or assets designed to assure the servicing or timely distribution of proceeds to securityholders, and

(b) by its terms entitles an investor in that security to a return of the investment of that investor at or by a time established by or determinable by reference to the agreement, except as a result of losses incurred on, or the non-performance of, the financial assets;

"specified dealer" means a dealer other than a dealer whose activities as a dealer are restricted by the terms of its registration to one or both of

(a) acting solely in respect of mutual fund securities, or

(b) acting solely in respect of transactions in which a person or company registered in the category of limited market dealer in a jurisdiction is permitted to engage;

"specified derivative" means an instrument, agreement or security, the market price, value or payment obligations of which are derived from, referenced to or based on an underlying interest, other than

(a) a conventional convertible security,

(b) a specified asset-backed security,

(c) an index participation unit,

(d) a government or corporate strip bond,

(e) a capital, equity dividend or income share of a subdivided equity or fixed income security,

(f) a conventional warrant or right, or

(g) a special warrant;(37)

"standardized future" means an agreement traded on a futures exchange pursuant to standardized conditions contained in the by-laws, rules or regulations of the futures exchange, and cleared by a clearing corporation, to

do one or more of the following at a price established by or determinable by reference to the agreement and at or by a time established by or determinable by reference to the agreement:

1. Make or take delivery of the underlying interest of the agreement.

2. Settle the obligation in cash instead of delivery of the underlying interest;

"sub-custodian" means, for a mutual fund, an entity that has been appointed to hold portfolio assets of the mutual fund in accordance with section 6.1 by either the custodian or a sub-custodian of the mutual fund;

"swap" means an agreement that provides for

(a) an exchange of principal amounts,

(b) the obligation to make, and the right to receive, cash payments based upon the value, level or price, or on relative changes or movements of the value, level or price, of one or more underlying interests, which payments may be netted against each other, or

(c) the right or obligation to make, and the right or obligation to receive, physical delivery of an underlying interest instead of the cash payments referred to in paragraph (b);(38)

"synthetic cash" means a position that in aggregate provides the holder with the economic equivalent of the return on a banker's acceptance accepted by a bank listed in Schedule I of the *Bank Act* (Canada) and that consists of

(a) a long position in a portfolio of shares and a short position in a standardized future of which the underlying interest consists of a stock index, if

(i) there is a high degree of positive correlation between changes in the value of the portfolio of shares and changes in the value of the stock index, and

(ii) the ratio between the value of the portfolio of shares and the standardized future is such that, for any change in the value of one, a change of similar magnitude occurs in the value of the other, or

(b) a long position in the evidences of indebtedness issued, or fully and unconditionally guaranteed as to principal and interest, by any of the government of Canada or the government of a jurisdiction and a short position in a standardized future of which the underlying interest consists of evidences of indebtedness of the same issuer and same term to maturity, if

(i) there is a high degree of positive correlation between changes in the value of the portfolio of evidences of indebtedness and changes in the value of the standardized future, and

(ii) the ratio between the value of the evidences of indebtedness and the standardized future is such that, for any change in the value of one, a change of similar magnitude occurs in the value of the other;

"timely disclosure requirements" means the requirements in securities legislation for a reporting issuer to file a press release and a report when a material change occurs in the affairs of the reporting issuer;

"underlying interest" means, for a specified derivative, the security, commodity, financial instrument, currency, interest rate, foreign exchange rate, economic indicator, index, basket, agreement, benchmark or any other reference, interest or variable, and, if applicable, the relationship between any of the foregoing, from, to or on which the market price, value or payment obligation of the specified derivative is derived, referenced or based; and

"underlying market exposure" means, for a position of a mutual fund in

(a) an option, the quantity of the underlying interest of the option position multiplied by the market value of one unit of the underlying interest, multiplied, in turn, by the delta of the option,

(b) a standardized future or forward contract, the quantity of the underlying interest of the position multiplied by the current market value of one unit of the underlying interest; or

(c) a swap, the underlying market exposure, as calculated under paragraph (b), for the long position of the mutual fund in the swap.(39)

1.2 Application - This Instrument only applies to

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

(b) a person or company in respect of activities pertaining to a mutual fund referred to in paragraph (a).

1.3 Interpretation - Each section, part, class or series of a class of securities of a mutual fund that is referable to a separate portfolio of assets is considered to be a separate mutual fund for purposes of this Instrument.

PART 2 INVESTMENTS(40)

2.1 Concentration Restriction

(1) A mutual fund shall not purchase a security of an issuer if, immediately after the purchase, more than 10 percent of the net assets of the mutual fund, taken at market value at the time of the purchase, would be invested in securities of that issuer.

(2) Subsection (1) does not apply to a purchase of a government security or a security issued by a clearing corporation.(41)

(3) In determining a mutual fund's compliance with the restrictions contained in this section, the mutual fund shall, for each specified derivative that is held by the mutual fund for purposes other than hedging and for each index participation unit held by the mutual fund, consider that it holds directly the underlying interest of that specified derivative or its proportionate share of the securities held by the issuer of the index participation unit.(42)

(4) Despite subsection (3), the mutual fund shall not include in the determination referred to in subsection (3) a security or instrument that is a component of, but that represents less than 10 percent of

(a) a stock or bond index that is the underlying interest of a specified derivative; or

(b) the securities held by the issuer of a index participation unit.(43)

2.2 Control Restrictions

(1) A mutual fund shall not

(a) purchase a security of an issuer if, immediately after the purchase, the mutual fund would hold securities representing more than 10 percent of

(i) the votes attaching to the outstanding voting securities of that issuer; or

(ii) the outstanding equity securities(44) of that issuer; or

(b) purchase a security for the purpose of exercising control over or management of the issuer of the security.[45]

(2) If a mutual fund acquires a security of an issuer other than as the result of a purchase, and the acquisition results in the mutual fund exceeding the limits described in paragraph (1)(a), the mutual fund shall as quickly as is commercially reasonable, and in any event no later than 90 days after the acquisition, reduce its holdings of those securities so that it does not hold securities exceeding those limits.[46]

(3) In determining its compliance with the restrictions contained in this section, a mutual fund shall

(a) assume the conversion of special warrants held by it; and

(b) consider that it holds directly the underlying securities represented by any American depositary receipts held by it.[47]

2.3 Restrictions Concerning Types of Investments -

A mutual fund shall not

(a) purchase real property;

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

(c) purchase a guaranteed mortgage if, immediately after the purchase, more than 10 percent of the net assets of the mutual fund, taken at market value at the time of the purchase, would consist of guaranteed mortgages;

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

(e) purchase gold or a permitted gold certificate if, immediately after the purchase, more than 10 percent of the net assets of the mutual fund, taken at market value at the time of the purchase, would consist of gold and permitted gold certificates;

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

(g) purchase, sell or use a specified derivative other than in compliance with sections 2.7 to 2.11[48];

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

(i) a physical commodity other than gold,

(ii) a specified derivative of which the underlying interest is a physical commodity other than gold;[49] or

(i) purchase an interest in a loan syndication or loan participation if the purchase would require the mutual fund to assume any responsibilities in administering the loan in relation to the borrower[50].

2.4 Restrictions Concerning Illiquid Assets

(1) A mutual fund shall not purchase an illiquid asset if, immediately after the purchase, more than 10 percent of the net assets of the mutual fund, taken at market value at the time of the purchase, would consist of illiquid assets.

(2) A mutual fund shall not have invested, for a period of 90 days or more, more than 15 percent of its net assets, taken at market value, in illiquid assets.

(3) If more than 15 percent of the net assets of a mutual fund, taken at market value, are illiquid assets, the

mutual fund shall, as quickly as is commercially reasonable, take all necessary steps to reduce the percentage of its net assets made up of illiquid assets to 15 percent or less.(51)

2.5 Investments in Other Mutual Funds

(1) A mutual fund shall not purchase a security of another mutual fund unless

(a) immediately after the purchase, not more than 10 percent of the net assets of the mutual fund, taken at market value at the time of the purchase, would be invested in securities of other mutual funds,

(b) there is no duplication of management fees and sales charges between the mutual funds and this is described in the simplified prospectus of the mutual fund, and

(c) either

(i) the other mutual fund is qualified for distribution under a simplified prospectus in the jurisdictions in which the securities of the mutual fund are qualified for distribution under a simplified prospectus, or

(ii) the other mutual fund was established with the approval of the government of a foreign jurisdiction(52), the only means by which the mutual fund may invest in the securities of issuers of that foreign jurisdiction is through a mutual fund so established, and there is disclosure in the simplified prospectus of the mutual fund of the risk factors that may be associated with the investment in that foreign jurisdiction.

(2) Subsection (1) does not apply to the purchase of

(a) an index participation unit that is a security of a mutual fund; or

(b) a mutual fund that is listed and posted for trading on a Canadian stock exchange.(53)

2.6 Investment Practices - A mutual fund shall not

(a) borrow money or encumber its portfolio assets unless

(i) the transaction is a temporary measure to accommodate requests for the redemption of securities of the mutual fund while the mutual fund effects an orderly liquidation of portfolio assets, and, after giving effect to the transaction, the outstanding amount of all borrowings of the mutual fund does not exceed five percent of the net assets of the mutual fund taken at market value at the time of the borrowing,

(ii) the encumbrance is required to enable the mutual fund to post margin to effect a specified derivative transaction under this Instrument, or

(iii) the encumbrance secures a claim for the fees and expenses of the custodian or a sub-custodian of the mutual fund for services rendered in that capacity as permitted by subsection 6.4(3), or

(iv) the transaction is permitted by subsection 6.8(3);

(b) purchase securities on margin, unless permitted by section 2.7 or 2.8;

(c) sell securities short, unless permitted by section 2.7 or 2.8;

(d) purchase a security, other than a specified derivative, that by its terms may require the mutual fund to make a contribution in addition to the payment of the purchase price;

(e) engage in the business of underwriting, or marketing to the public, securities of any other issuer;

(f) lend money or portfolio assets other than money;

(g) guarantee securities or obligations of a person or company; or

(h) purchase securities other than through market facilities through which these securities are normally bought and sold unless the purchase price approximates the prevailing market price or the parties are at arm's length in connection with the transaction.

2.7 Transactions in Specified Derivatives for Hedging and Non-hedging Purposes(54)

(1) A mutual fund shall not purchase an option that is not a clearing corporation option or enter into a swap or a forward contract unless

(a) the option, swap or contract has a remaining term to maturity of

(i) three years or less, or

(ii) between three and five years if, at the time of the transaction, the option, swap or contract provides the mutual fund with a right, at its election, to eliminate its exposure under the option, swap or contract no later than three years after the mutual fund has purchased the option or entered into the swap or contract; and

(b) at the time of the transaction, the option, swap or contract, or equivalent debt of the counterparty, or of a person or company that has fully and unconditionally guaranteed the obligations of the counterparty in respect of the option, swap or contract, has an approved credit rating.

(2) If the credit rating of an option that is not a clearing corporation option, the credit rating of a swap or forward contract, or the credit rating of the equivalent debt of the writer or guarantor of the option, swap or contract, falls below the level of approved credit rating while the option, swap or contract is held by a mutual fund, the mutual fund shall take the steps that are reasonably required to close out its position in the option, swap or contract in an orderly and timely fashion.

(3) Despite any other provisions contained in this Part, a mutual fund may enter into a trade to close out all or part of a position in a specified derivative, in which case the cash cover held to cover the underlying market exposure of the part of the position that is closed out may be released.

(4) The mark-to-market value of specified derivatives positions of a mutual fund with any one counterparty other than an acceptable clearing corporation or a clearing corporation that clears and settles transactions made on a futures exchange listed in Appendix A, calculated in accordance with subsection (5), shall not exceed, for a period of 30 days or more, 10 percent of the net assets of the mutual fund.(55)

(5) The mark-to-market value of specified derivatives positions of a mutual fund with any one counterparty shall be, for the purposes of subsection (4)

(a) if the mutual fund has an agreement with the counterparty that provides for netting or the right of set-off, the net mark-to-market value of the specified derivatives positions of the mutual fund; and

(b) in all other cases, the aggregated mark-to-market value of the specified derivative positions of the mutual fund.(56)

2.8 Transactions in Specified Derivatives for Purposes Other than Hedging

(1) A mutual fund shall not

(a) purchase a debt-like security that has an options component or an option, unless, immediately after the purchase, not more than 10 percent of the net assets of the mutual fund, taken at market value at the time of the

purchase, would consist of those instruments held for purposes other than hedging;

(b) write a call option, or have outstanding a written call option, that is not an option on futures unless, as long as the position remains open, the mutual fund holds

(i) an equivalent quantity of the underlying interest of the option,

(ii) a right or obligation, exercisable at any time that the option is exercisable, to acquire an equivalent quantity of the underlying interest of the option, and cash cover that, together with margin on account for the position, is not less than the amount, if any, by which the strike price of the right or obligation to acquire the underlying interest exceeds the strike price of the option, or

(iii) a combination of the positions referred to in subparagraphs (i) and (ii) that is sufficient, without recourse to other assets of the mutual fund, to enable the mutual fund to satisfy its obligations to deliver the underlying interest of the option;

(c) write a put option, or have outstanding a written put option, that is not an option on futures, unless, as long as the position remains open, the mutual fund holds

(i) a right or obligation, exercisable at any time that the option is exercisable, to sell an equivalent quantity of the underlying interest of the option, and cash cover in an amount that, together with margin on account for the position, is not less than the amount, if any, by which the strike price of the option exceeds the strike price of the right or obligation to sell the underlying interest,

(ii) cash cover that, together with margin on account for the option position, is not less than the strike price of the option, or

(iii) a combination of the positions referred to in subparagraphs (i) and (ii) that is sufficient, without recourse to other assets of the mutual fund, to enable the mutual fund to acquire the underlying interest of the option;

(d) open or maintain a long position in a debt-like security that has a component that is a long position in a forward contract, or in a standardized future or forward contract, unless the mutual fund holds cash cover in an amount that, together with margin on account for the specified derivative and the market value of the specified derivative, is not less than, on a daily mark-to-market basis, the underlying market exposure of the specified derivative;

(e) open or maintain a short position in a standardized future or forward contract, unless the mutual fund holds

(i) an equivalent quantity of the underlying interest of the future or contract,

(ii) a right or obligation to acquire an equivalent quantity of the underlying interest of the future or contract and cash cover that together with margin on account for the position is not less than the amount, if any, by which the strike price of the right or obligation to acquire the underlying interest exceeds the forward price of the contract, or

(iii) a combination of the positions referred to in subparagraphs (i) and (ii) that is sufficient, without recourse to other assets of the mutual fund, to enable the mutual fund to deliver the underlying interest of the future or contract; or

(f) enter into, or maintain, a swap position unless[(57)]

(i) for periods when the mutual fund would be entitled to receive payments under the swap, the mutual fund holds cash cover in an amount that, together with margin on account for the swap and the market value of the swap, is not less than, on a daily mark-to-market basis, the underlying market exposure of the swap; and

(ii) for periods when the mutual fund would be required to make payments under the swap, the mutual fund holds

(A) an equivalent quantity of the underlying interest of the swap,

(B) a right or obligation to acquire an equivalent quantity of the underlying interest of the swap and cash cover that, together with margin on account for the position, is not less than the aggregate amount of the obligations of the mutual fund under the swap,

(C) a combination of the positions referred to in clauses (A) and (B) that is sufficient, without recourse to other assets of the mutual fund, to enable the mutual fund to satisfy its obligations under the swap.

(2) A mutual fund shall treat any synthetic cash position on any date as providing the cash cover equal to the notional principal value of a banker's acceptance then being accepted by a bank listed in Schedule I of the *Bank Act* (Canada) that would produce the same annualized return as the synthetic cash position is then producing.

2.9 Transactions in Specified Derivatives for Hedging Purposes - Sections 2.1, 2.2, 2.4 and 2.8 do not apply to the use of specified derivatives by a mutual fund for hedging purposes.

2.10 Adviser Requirements

(1) If a portfolio adviser of a mutual fund receives advice from a non-resident sub-adviser concerning the use of options or standardized futures by the mutual fund, the mutual fund shall not invest in or use options or standardized futures unless

(a) the obligations and duties of the non-resident sub-adviser are set out in a written agreement with the portfolio adviser; and

(b) the portfolio adviser contractually agrees with the mutual fund to be responsible for any loss that arises out of the failure of the non-resident sub-adviser

(i) to exercise the powers and discharge the duties of its office honestly, in good faith and in the best interests of the mutual fund, and

(ii) to exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.

(2) A mutual fund shall not relieve a portfolio adviser of the mutual fund from liability for loss for which the portfolio manager has assumed responsibility under paragraph (1)(b) that arises out of the failure of the relevant non-resident sub-adviser

(a) to exercise the powers and discharge the duties of its office honestly, in good faith and in the best interests of the mutual fund, or

(b) to exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.

(3) Despite subsection 4.4(3), a mutual fund may indemnify a portfolio adviser against legal fees, judgments and amounts paid in settlement, actually and reasonably incurred by that person or company in connection with services provided by a non-resident sub-adviser for which the portfolio adviser has assumed responsibility under paragraph (1)(b), only if

(a) those fees, judgments and amounts were not incurred as a result of a breach of the standard of care described in subsection (1) or (2); and

(b) the mutual fund has reasonable grounds to believe that the action or inaction that caused the payment of the

fees, judgments and amounts paid in settlement was in the best interests of the mutual fund.

(4) A mutual fund shall not incur the cost of any portion of liability insurance that insures a person or company for a liability except to the extent that the person or company may be indemnified for that liability under this section.(58)

2.11 Commencement of Use of Specified Derivatives by a Mutual Fund

(1) A mutual fund that has not used specified derivatives shall not begin using specified derivatives unless

(a) its simplified prospectus contains the disclosure required for mutual funds using derivatives; and

(b) the mutual fund has provided to its securityholders, not less than 60 days before it begins using specified derivatives, written notice that discloses its intent to begin using specified derivatives and the disclosure required for mutual funds using derivatives.

(2) A mutual fund is not required to provide the notice referred to in paragraph (1)(b) if each simplified prospectus of the mutual fund since its inception contains the disclosure required for mutual funds using derivatives.

PART 3 NEW MUTUAL FUNDS

3.1 Initial Investment in a New Mutual Fund

(1) No person or company shall file a simplified prospectus for a new mutual fund unless

(a) an investment of at least $150,000 in securities of the mutual fund has been made before the time of filing by

(i) the manager, portfolio adviser, promoter or sponsor of the mutual fund,

(ii) the partners, directors, officers or securityholders of any of the manager, the portfolio adviser, the promoter or the sponsor of the mutual fund, or

(iii) a combination of the persons and companies referred to subparagraphs (i) and (ii); or

(b) the simplified prospectus of the mutual fund states that the mutual fund will not issue securities unless subscriptions aggregating not less than $500,000 have been received from investors other than the persons and companies referred to in paragraph (a) and accepted by the mutual fund.

(2) A mutual fund shall not redeem a security issued upon an investment in the mutual fund referred to in paragraph (1)(a) until $500,000 has been received from persons or companies other than the persons and companies referred to in paragraph (1)(a).

3.2 Prohibition Against Distribution - If a simplified prospectus of a mutual fund contains the disclosure described in paragraph 3.1(1)(b), the mutual fund shall not distribute any securities unless the subscriptions described in that disclosure, together with payment for the securities subscribed for, have been received.(59)

3.3 Prohibition Against Reimbursement of Organization Costs - None of the costs of incorporation, formation or initial organization of a mutual fund, or of the preparation and filing of any of the preliminary simplified prospectus, preliminary annual information form, initial simplified prospectus or annual information form of the mutual fund shall be borne by the mutual fund or its securityholders.

PART 4 CONFLICTS OF INTEREST

4.1 Prohibited Investments

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

(2) A dealer managed mutual fund shall not knowingly make an investment in a class of securities of an issuer of which a partner, director, officer or employee of the dealer manager of the mutual fund, or a partner, director, officer or employee of an affiliate or associate of the dealer manager, is a partner, director or officer, unless the partner, director, officer or employee

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

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

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

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

4.2 Self-Dealing - A mutual fund shall not purchase a security from, or sell a security to, any of the following persons or companies, if that person or company would be selling to the mutual fund, or purchasing from the mutual fund, as principal:

1. The manager, portfolio adviser or trustee of the mutual fund.

2. A partner, director or officer of the mutual fund or of the manager, portfolio adviser or trustee of the mutual fund.

3. An associate or affiliate of a person or company referred to in paragraph 1 or 2.

4. A person or company, having fewer than 100 securityholders of record, of which a partner, director or officer of the mutual fund or a partner, director or officer of the manager or portfolio adviser of the mutual fund is a partner, director, officer or securityholder.

4.3 Exception - Section 4.2 does not apply to a purchase or sale of a security by a mutual fund if the price payable for the security is

(a) not more than the ask price of the security as reported by any available public quotation in common use, in the case of a purchase by the mutual fund; or

(b) not less than the bid price of the security as reported by any available public quotation in common use, in the case of a sale by the mutual fund.(60)

4.4 Liability and Indemnification

(1) An agreement or declaration of trust by which a person or company acts as manager of a mutual fund shall provide that the manager is responsible for any loss that arises out of the failure of the manager, or of any person or company providing services to the mutual fund or to the manager in connection with the mutual fund

(a) to exercise the powers and discharge the duties of its office honestly, in good faith and in the best interests of the mutual fund, and

(b) to exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.

(2) A mutual fund shall not relieve the manager of the mutual fund from liability for loss that arises out of the failure of the manager, or of any person providing services to the mutual fund or to the manager in connection with the mutual fund

(a) to exercise the powers and discharge the duties of its office honestly, in good faith and in the best interests of the mutual fund, or

(b) to exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.(61)

(3) A mutual fund may indemnify a person or company providing services to it against legal fees, judgments and amounts paid in settlement, actually and reasonably incurred by that person or company in connection with services provided by that person or company to the mutual fund, if

(a) those fees, judgments and amounts were not incurred as a result of a breach of the standard of care described in subsection (1) or (2); and

(b) the mutual fund has reasonable grounds to believe that the action or inaction that caused the payment of the fees, judgments and amounts paid in settlement was in the best interests of the mutual fund.

(4) A mutual fund shall not incur the cost of any portion of liability insurance that insures a person or company for a liability except to the extent that the person or company may be indemnified for that liability under this section.

(5) This section does not apply to any losses to a mutual fund or securityholder arising out of an action or inaction by a custodian or sub-custodian of the mutual fund.(62)

PART 5 FUNDAMENTAL CHANGES

5.1 Matters Requiring Securityholder Approval - The prior approval of the securityholders of a mutual fund, given as provided in section 5.2, is required before

(a) the basis of the calculation of a fee or expense that is charged to the mutual fund is changed in a way that could result in an increase in charges to the mutual fund;

(b) the manager of the mutual fund is changed, unless the new manager is an affiliate of the current manager;(63)

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

(d) the auditor of the mutual fund is changed;

(e) the mutual fund decreases the frequency of the calculation of its net asset value;

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

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

(ii) the transaction results in the securityholders of the mutual fund becoming securityholders in the other mutual fund; or

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

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

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

(iii) the transaction would be a significant change to the mutual fund.(64)

5.2 Approval of Securityholders

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

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

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

5.3 Circumstances in Which Approval of Securityholders Not Required

(1) Despite section 5.1, the approval of securityholders of a mutual fund is not required to be obtained for a change referred to in paragraph 5.1(a)

(a) if

(i) the mutual fund is at arm's length to the person or company charging the fee or expense to the mutual fund referred to in paragraph 5.1(a) that is changed,

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

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

(b) if

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

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

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

5.4 Formalities Concerning Meetings of Securityholders

(1) A meeting of securityholders of a mutual fund called to consider any matter referred to in section 5.1 shall be called on written notice sent not less than 21 days before the date of the meeting.

(2) The notice referred to in subsection (1) shall contain or be accompanied by a statement that includes

(a) a description of the change or transaction proposed to be made or entered into and, if the matter is one referred to in paragraph 5.1(a), the effect that the change would have had on the management expense ratio of the mutual fund had the change been in force throughout the mutual fund's last completed financial year;

(b) the date of the proposed implementation of the change or transaction; and

(c) all other information and documents necessary to comply with the applicable proxy solicitation requirements of securities legislation for the meeting.

5.5 Approval of Securities Regulatory Authority

(1) The approval of the securities regulatory authority is required before

(a) the manager of a mutual fund is changed, unless the new manager is an affiliate of the current manager;(65)

(b) a reorganization or transfer of assets of a mutual fund is implemented, if the transaction will result in the securityholders of the mutual fund becoming securityholders in another mutual fund;

(c) a change of the custodian of a mutual fund is implemented, if there has been or will be, in connection with the proposed change, a change of the type referred to in paragraph (a); or

(d) a mutual fund suspends, other than under section 10.6, the rights of securityholders to request that the mutual fund redeem their securities.(66)

(2) No person or company, or affiliate or associate of that person or company, may act as manager of a mutual fund if that person or company, or an affiliate or associate of that person or company, has acquired control of a manager of the mutual fund unless the approval of the securities regulatory authority has been obtained for the change in control.

5.6 Pre-Approved Reorganizations and Transfers(67)

(1) Despite subsection 5.5(1), the approval of the securities regulatory authority is not required to implement a transaction referred to in paragraph 5.5(1)(b) if

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

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

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

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

(iv) has a current simplified prospectus in the local jurisdiction;

(b) the transaction is a "qualifying exchange" within the meaning of section 132.2 of the ITA;

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

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

(i) may be acquired by the other mutual fund in compliance with this Instrument, and

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

(e) the transaction is approved

(i) by the securityholders of the mutual fund in accordance with paragraph 5.1(f), and

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

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

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

(ii) if not previously sent to all securityholders, the current simplified prospectus and the most recent annual and interim financial statements that have been made public for the mutual fund into which the mutual fund will be reorganized, and

(iii) a statement that securityholders may obtain an annual information form for the mutual fund into which the mutual fund will be reorganized by contacting that mutual fund at a specified address or telephone number;

(g) the mutual fund has complied with section 5.10 in connection with the making of the decision to proceed with the transaction by the board of directors of the manager of the mutual fund or of the mutual fund;

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

(i) securityholders of the mutual fund continue to have the right to redeem securities of the mutual fund up to the close of business on the business day immediately before the effective date of the transaction.

(2) A mutual fund that has continued after a transaction described in paragraph 5.5(1)(b) shall, if the audit report accompanying its audited financial statements for its first completed financial year after the transaction contains a reservation in respect of the value of the portfolio assets acquired by the mutual fund in the transaction, send a copy of those financial statements to each person or company that was a securityholder of a mutual fund that was terminated as a result of the transaction and that is not a securityholder of the mutual fund.

5.7 Applications

(1) An application for an approval required under section 5.5 shall contain

(a) if the application is required by paragraph 5.5(1)(a) or subsection 5.5(2)

(i) details of the proposed transaction,

(ii) details of the proposed new manager or the person or company proposing to acquire control of the manager,

(iii) as applicable, the names, residence addresses and birthdates of

(A) all proposed new partners, directors or officers of the manager,

(B) all partners, directors or officers of the person or company proposing to acquire control of the manager,

(C) any proposed new individual trustee of the mutual fund, and

(D) any new directors or officers of the mutual fund,

(iv) all information necessary to permit the securities regulatory authority to conduct security checks on the individuals referred to in subparagraph (iii),

(v) sufficient information to establish the integrity and experience of the persons or companies referred to in subparagraphs (ii) and (iii), and

(vi) details of how the proposed transaction will affect the management and administration of the mutual fund;

(b) if the application is required by paragraph 5.5(1)(b)

(i) details of the proposed transaction,

(ii) details of the total annual returns of each of the mutual funds for each of the previous five years,

(iii) a description of the differences between the fundamental investment objectives, investment strategies, valuation procedures and fee structure of each of the mutual funds and any other material differences between the mutual funds, and

(iv) a description of those elements of the proposed transaction that make section 5.6 inapplicable;

(c) if the application is required by paragraph 5.5(1)(c), sufficient information to establish that the proposed custodial arrangements will be in compliance with Part 6;

(d) if the application relates to a matter that would constitute a significant change for the mutual fund, a draft of an amendment to the simplified prospectus of the mutual fund reflecting the change; and

(e) if the matter is one that requires the approval of securityholders, confirmation that the approval has been obtained or will be obtained before the change is implemented.

(2) A mutual fund that applies for an approval under paragraph 5.5(1)(d) shall

(a) make that application to the securities regulatory authority or regulator(68) in the jurisdiction in which the head office or registered office of the mutual fund is situate; and

(b) concurrently file a copy of the application so made with the securities regulatory authority or the regulator in the local jurisdiction if the head office or registered office of the mutual fund is not situated in the local jurisdiction.

(3) A mutual fund that has complied with subsection (2) in the local jurisdiction may suspend the right of securityholders to request that the mutual fund redeem their securities if

(a) the securities regulatory authority or regulator in the jurisdiction in which the head office or registered office of the mutual fund is situate has granted approval to the application made under paragraph (2)(a); and

(b) the securities regulatory authority or regulator in the local jurisdiction has not notified the mutual fund, by the close of business on the business day immediately following the day on which the copy of the application referred to in paragraph (2)(b) was received, either that

(i) the securities regulatory authority or regulator has refused to grant approval to the application, or

(ii) this subsection may not be relied upon by the mutual fund in the local jurisdiction.

5.8 Matters Requiring Notice

(1) No person or company that is a manager of a mutual fund may continue to act as manager of the mutual fund following a direct or indirect change of control of the person or company unless

(a) notice of the change of control was given to all securityholders of the mutual fund at least 60 days before the change; and

(b) the notice referred to in paragraph (a) contains the information that would be required by law to be provided to securityholders if securityholder approval of the change were required to be obtained.(69)

(2) No mutual fund shall terminate unless notice of the termination is given to all securityholders of the mutual fund at least 60 days before termination.(70)

(3) The manager of a mutual fund that has terminated shall give notice of the termination to the securities regulatory authority within 30 days of the termination.(71)

5.9 Relief from Certain Regulatory Requirements

(1) The mutual fund conflict of interest investment restrictions and the mutual fund conflict of interest reporting requirements do not apply to a transaction referred to in paragraph 5.5(1)(b) if the approval of the securities regulatory authority has been given to the transaction.

(2) The mutual fund conflict of interest investment restrictions and the mutual fund conflict of interest reporting requirements do not apply to a transaction described in section 5.6.

5.10 Significant Changes - Upon the occurrence of a significant change with respect to a mutual fund, the mutual fund shall

(a) comply with the timely disclosure requirements in connection with the significant change as if the significant change were a material change in the affairs of the mutual fund; and

(b) file an amendment to its simplified prospectus that discloses the significant change in accordance with the requirements of securities legislation as if the amendment were required to be filed under securities legislation. (72)

PART 6 CUSTODIANSHIP OF PORTFOLIO ASSETS

6.1 General

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

(2) Except as provided in subsection 6.5(3) and sections 6.8 and 6.9, all portfolio assets of a mutual fund shall be held

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

(b) outside Canada by the custodian or a sub-custodian of the mutual fund, if required to execute portfolio transactions of the mutual fund outside Canada.

(3) The custodian or a sub-custodian of a mutual fund may appoint one or more sub-custodians to hold portfolio assets of the mutual fund, if, for each appointment

(a) written consent to the appointment has been provided by the mutual fund and, if the appointment is by a sub-custodian, the custodian of the mutual fund;

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

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

(d) the appointment is otherwise in compliance with this Instrument.(73)

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

(5) A custodian or sub-custodian shall provide to the mutual fund a list of each person or company that is appointed sub-custodian under a general consent referred to in subsection (4).(74)

6.2 Entities Qualified to Act as Custodian or Sub-Custodian for Assets Held in Canada - The custodian of a mutual fund, and a sub-custodian of a mutual fund that is to hold portfolio assets of the mutual fund in Canada, shall be one of the following:

1. A bank listed in Schedule I or II of the *Bank Act* (Canada).

2. A trust company that is incorporated under the laws of Canada or a jurisdiction and licensed or registered under the laws of Canada or a jurisdiction, and that has shareholders' equity, as reported in its most recent audited financial statements that have been made public, of not less than $10,000,000.

3. A company that is incorporated under the laws of Canada or of a jurisdiction, and that is an affiliate(75) of a bank or trust company referred to in paragraph 1 or 2, if

(a) the company has shareholders' equity, as reported in its most recent audited financial statements that have been made public, of not less than $10,000,000; or

(b) the bank or trust company has assumed responsibility for all of the custodial obligations of the company in respect of that mutual fund.(76)

6.3 Entities Qualified to Act as Sub-Custodian for Assets Held outside Canada - A sub-custodian of a mutual fund that is to hold portfolio assets of the mutual fund outside of Canada shall be one of the following:

1. An entity referred to in section 6.2.

2. An entity that

(a) is incorporated or organized under the laws of a country, or a political subdivision of a country, other than Canada;

(b) is regulated as a banking institution or trust company by the government, or an agency of the government, of the country under whose laws it is incorporated or organized or a political subdivision of that country; and

(c) has shareholders' equity, as reported in its most recent audited financial statements that have been made public, of not less than the equivalent of $100,000,000.

3. An affiliate[(77)] of an entity referred to in paragraph 1 or 2 if

(a) the affiliate has shareholders' equity, as reported in its most recent audited financial statements that have been made public, of not less than the equivalent of $100,000,000; or

(b) the entity referred to in paragraph 1 or 2 has assumed responsibility for all of the custodial obligations of the subsidiary in respect of that mutual fund.[(78)]

6.4 Contents of Custodian and Sub-Custodian Agreements

(1) All custodian agreements and sub-custodian agreements of a mutual fund shall provide for matters relating to

(a) the requirements concerning the location of portfolio assets contained in subsection 6.1(2);

(b) the appointment of a sub-custodian required by subsection 6.1(3);

(c) the requirements concerning lists of sub-custodians contained in subsection 6.1(5);

(d) the method of holding portfolio assets required by section 6.5 and subsection 6.8(4);

(e) the standard of care and responsibility for loss required by section 6.6; and

(f) the review and compliance reports required by section 6.7.

(2) A sub-custodian agreement concerning the portfolio assets of a mutual fund shall provide for the safekeeping of portfolio assets on terms consistent with the custodian agreement of the mutual fund.

(3) No custodian agreement or sub-custodian agreement concerning the portfolio assets of a mutual fund shall

(a) provide for the creation of any encumbrance on the portfolio assets of the mutual fund except for a good faith claim for payment of the fees and expenses of the custodian or sub-custodian for acting in that capacity; or

(b) contain a provision that would require the payment of a fee to the custodian or sub-custodian for the transfer of the beneficial ownership of portfolio assets of the mutual fund.[(79)]

6.5 Holding of Portfolio Assets and Payment of Fees

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

(2) Portfolio assets of a mutual fund issued in bearer form shall be designated or segregated by the custodian or a sub-custodian of the mutual fund or the applicable nominee so as to show that the beneficial ownership of the property is vested in the mutual fund.

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

(4) The custodian or sub-custodian of a mutual fund arranging for the deposit of portfolio assets of the mutual

fund with, and their delivery to, a depository, or clearing agency, that operates a book-based system shall ensure that the records of any of the applicable participants in that book-based system or the custodian contain an account number or other designation sufficient to show that the beneficial ownership of the portfolio assets is vested in the mutual fund.

(5) A mutual fund shall not pay a fee to a custodian or sub-custodian for the transfer of beneficial ownership of portfolio assets of the mutual fund.[(80)]

6.6 Standard of Care[(81)]

(1) The custodian and each sub-custodian of a mutual fund, in carrying out their duties concerning the safekeeping of, and dealing with, the portfolio assets of the mutual fund shall exercise

(a) the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances; or

(b) at least the same degree of care as they exercise with respect to their own property of a similar kind, if this is a higher degree of care than the degree of care referred to in paragraph (a).[(82)]

(2) A mutual fund shall not relieve the custodian or a sub-custodian of the mutual fund from liability to the mutual fund or to a securityholder of the mutual fund for loss that arises out of the failure of the custodian or sub-custodian to exercise the standard of care imposed by subsection (1).

(3) A mutual fund may indemnify a custodian or sub-custodian against legal fees, judgments and amounts paid in settlement, actually and reasonably incurred by that entity in connection with custodial or sub-custodial services provided by that entity to the mutual fund, if

(a) those fees, judgments and amounts were not incurred as a result of a breach of the standard of care described in subsection (1); and

(b) the mutual fund has reasonable grounds to believe that the action or inaction that caused the payment of the fees, judgments and amounts paid in settlement was in the best interests of the mutual fund.

(4) A mutual fund shall not incur the cost of any portion of liability insurance that insures a custodian or sub-custodian for a liability, except to the extent that the custodian or sub-custodian may be indemnified for that liability under this section.

6.7 Review and Compliance Reports

(1) The custodian of a mutual fund shall, on a periodic basis not less frequently than annually

(a) review the custodian agreement and all sub-custodian agreements of the mutual fund to determine if those agreements are in compliance with this Part;

(b) make reasonable enquiries as to whether each sub-custodian satisfies the applicable requirements of section 6.2 or 6.3; and

(c) make or cause to be made any changes that may be necessary to ensure that

(i) the custodian and sub-custodian agreements are in compliance with this Part; and

(ii) all sub-custodians of the mutual fund satisfy the applicable requirements of section 6.2 or 6.3.

(2) The custodian of a mutual fund shall, not more than 60 days after the end of each financial year of the mutual

fund, advise the mutual fund in writing

(a) of the names and addresses of all sub-custodians of the mutual fund;

(b) whether the custodian and sub-custodian agreements are in compliance with this Part; and

(c) whether, to the best of the knowledge and belief of the custodian, each sub-custodian satisfies the applicable requirements of section 6.2 or 6.3.

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

6.8 Custodial Provisions relating to Derivatives

(1) A mutual fund may deposit portfolio assets as margin for transactions in Canada involving clearing corporation options, options on futures or standardized futures with a dealer that is a member of an SRO that is a participating member of CIPF(83) if the amount of initial margin deposited does not, when aggregated with the amount of margin already held by the dealer on behalf of the mutual fund, exceed 10 percent of the net assets of the mutual fund, taken at market value as at the time of deposit.

(2) A mutual fund may deposit portfolio assets with a dealer as margin for transactions outside Canada involving clearing corporation options, options on futures or standardized futures if

(a) in the case of standardized futures and options on futures, the dealer is a member of a futures exchange or, in the case of clearing corporation options, is a member of a stock exchange, and, as a result in either case, is subject to a regulatory audit;

(b) the dealer has a net worth, determined from its most recent audited financial statements that have been made public, in excess of the equivalent of $50 million; and

(c) the amount of margin deposited does not, when aggregated with the amount of margin already held by the dealer on behalf of the mutual fund, exceed 10 percent of the net assets of the mutual fund, taken at market value as at the time of deposit.

(3) A mutual fund may deposit portfolio assets with its counterparty as collateral in transactions involving forward contracts or options that are not clearing corporation options.

(4) The agreement by which portfolio assets of a mutual fund are deposited in accordance with this section shall require the person or company holding portfolio assets of the mutual fund so deposited to ensure that its records show that the beneficial ownership of the portfolio assets is vested in the mutual fund.

6.9 Separate Account for Paying Expenses - A mutual fund may deposit money in Canada with an institution referred to in paragraph 1 or 2 of section 6.2 to facilitate the payment of regular operating expenses of the mutual fund.

PART 7 INCENTIVE FEES

7.1 Incentive Fees - A mutual fund shall not pay, or enter into arrangements that would require it to pay, and no securities of a mutual fund shall be sold on the basis that an investor would be required to pay, a fee that is determined by the performance of the mutual fund, unless

(a) the fee is calculated with reference to a benchmark or index that

(i) reflects the market sectors in which the mutual fund invests according to its fundamental investment

objectives[(84)],

(ii) is available to persons or companies other than the mutual fund and persons providing services to it, and

(iii) is a total return benchmark or index;

(b) the payment of the fee is based upon a comparison of the cumulative total return of the mutual fund against the cumulative total percentage increase or decrease of the benchmark or index for the period that began immediately after the last period for which the performance fee was paid; and

(c) the method of calculation of the fee and details of the composition of the benchmark or index are described in the simplified prospectus of the mutual fund.

7.2 Multiple Portfolio Advisers - Section 7.1 applies to fees payable to a portfolio adviser of a mutual fund that has more than one portfolio adviser, if the fees are calculated on the basis of the performance of the portfolio assets under management by that portfolio adviser, as if those portfolio assets were a separate mutual fund.

PART 8 CONTRACTUAL PLANS

8.1 Contractual Plans - No securities of a mutual fund shall be sold by way of a contractual plan unless

(a) the contractual plan was established, and its terms described in a prospectus or simplified prospectus that was filed with the securities regulatory authority, before the date that this Instrument came into force;

(b) there have been no changes made to the contractual plan or the rights of securityholders under the contractual plan since the date that this Instrument came into force; and

(c) the contractual plan has continued to be operated in the same manner after the date that this Instrument came into force as it was on that date.

PART 9 SALE OF SECURITIES OF A MUTUAL FUND

9.1 Transmission and Receipt of Purchase Orders

(1) Each purchase order for securities of a mutual fund received by a participating dealer at a location[(85)] that is not its principal office shall, on the day the order is received, be sent by same day or next day courier, same day or next day priority post, telephone or electronic means, without charge to the person or company placing the order or to the mutual fund, to the principal office of the participating dealer.

(2) Each purchase order for securities of a mutual fund received by a participating dealer at its principal office or by the principal distributor of the mutual fund at a location that is not an order receipt office of the mutual fund shall, on the day the order is received, be sent by same day or next day courier, same day or next day priority post, telephone or electronic means, without charge to the person or company placing the order or to the mutual fund, to an order receipt office of the mutual fund.[(86)]

(3) Despite subsections (1) and (2), a purchase order for securities of a mutual fund received at a location referred to in those subsections after normal business hours on a business day, or on a day that is not a business day, may be transmitted, in the manner and to the place required by those subsections, on the next business day.

(4) A participating dealer or principal distributor that sends purchase orders electronically may

(a) specify a time on a business day by which a purchase order must be received in order that it be sent electronically on that business day; and

(b) despite subsections (1) and (2), send electronically on the next business day a purchase order received after the time so specified.[87]

(5) A mutual fund is deemed to have received a purchase order for securities of the mutual fund when the order is received at an order receipt office of the mutual fund.

(6) Despite subsection (5), a mutual fund may provide that a purchase order for securities of the mutual fund received at an order receipt office of the mutual fund after a specified time on a business day, or on a day that is not a business day, will be considered to be received by the mutual fund on the next business day following the day of actual receipt.

(7) A principal distributor or participating dealer shall ensure that a copy of each purchase order received in a jurisdiction is sent, by the time it is sent to the order receipt office of the mutual fund under subsection (2), to a person responsible for approving the opening of new client accounts and for the supervision of trades made on behalf of clients for the principal distributor or participating dealer in the jurisdiction.[88]

9.2 Acceptance of Purchase Orders - A mutual fund may reject a purchase order for the purchase of securities of the mutual fund if

(a) the rejection of the order is made no later than 24 hours[89] after receipt by the mutual fund of the order;

(b) upon rejection of the order, all money received with the order is refunded immediately; and

(c) the simplified prospectus of the mutual fund states that the right to reject a purchase order for securities of the mutual fund is reserved and reflects the requirements of paragraphs (a) and (b).

9.3 Issue Price of Securities - The issue price of a security of a mutual fund to which a purchase order pertains shall be the net asset value per security of that class, or series of a class, next determined after the receipt by the mutual fund of the order.[90]

9.4 Delivery of Funds and Settlement

(1) A principal distributor or participating dealer shall forward any money received for payment of the issue price of securities of a mutual fund to an order receipt office of the mutual fund so that the money arrives at the order receipt office as soon as practicable and in any event no later than the third business day after the pricing date.[91]

(2) Payment of the issue price of securities of a mutual fund shall be made to the mutual fund on or before the third business day after the pricing date for the securities by

(a) a payment of cash in a currency in which the net asset value of the mutual fund is calculated; or

(b) good delivery of securities if

(i) the mutual fund would at the time of payment be permitted to purchase those securities,

(ii) the securities are acceptable to the portfolio adviser of the mutual fund and consistent with the mutual fund's investment objectives, and

(iii) the value of the securities is at least equal to the issue price of the securities of the mutual fund for which they are payment, valued as if the securities were portfolio assets of the mutual fund.

(3) If payment of the issue price of securities of a mutual fund is made by the good delivery of securities as contemplated by paragraph (2)(b), the statement of portfolio transactions next prepared by the mutual fund shall include a note providing details of the securities so delivered.

(4) If payment of the issue price of the securities of a mutual fund to which a purchase order pertains is not made on or before the third business day after the pricing date or if the mutual fund has been paid the issue price by a cheque that is subsequently not honoured(92)

(a) the mutual fund shall redeem the securities to which the purchase order pertains as if it had received an order for the redemption of the securities immediately before the close of business on the third business day after the pricing date or on the day on which the mutual fund first knows that the cheque will not be honoured; and

(b) the amount of the redemption proceeds derived from the redemption shall be applied to reduce the amount owing to the mutual fund on the purchase of the securities and any banking costs incurred by the mutual fund in connection with the dishonoured cheque.

(5) If the amount of the redemption proceeds referred to in subsection (4) exceeds the aggregate of the issue price of the securities and any banking costs incurred by the mutual fund in connection with the dishonoured cheque, the difference shall belong to the mutual fund.

(6) If the amount of the redemption proceeds referred to in subsection (4) is less than the issue price of the securities and any banking costs incurred by the mutual fund in connection with the dishonoured cheque

(a) if the mutual fund has a principal distributor, the principal distributor shall pay, immediately upon notification by the mutual fund, to the mutual fund the amount of the deficiency; or

(b) if the mutual fund does not have a principal distributor, the participating dealer that delivered the relevant purchase order to the mutual fund shall pay immediately, upon notification by the mutual fund, to the mutual fund the amount of the deficiency.(93)

PART 10 REDEMPTION OF SECURITIES OF A MUTUAL FUND

10.1 Requirements for Redemptions

(1) No mutual fund shall pay redemption proceeds unless

(a) if the security of the mutual fund to be redeemed is represented by a certificate, the mutual fund has received the certificate or appropriate indemnities in connection with a lost certificate; and

(b) either

(i) the mutual fund has received a written redemption order, duly completed and executed by or on behalf of the securityholder, or

(ii) the mutual fund permits the making of redemption orders by telephone or electronic means by, or on behalf of, a securityholder who has made prior arrangements with the mutual fund in that regard and the relevant redemption order is made in compliance with those arrangements.

(2) A mutual fund may establish reasonable requirements applicable to securityholders who wish to have the mutual fund redeem securities, not contrary to this Instrument, as to procedures to be followed and documents to be delivered

(a) by the time of delivery of a redemption order to an order receipt office of the mutual fund; or

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

(3) The manager shall provide securityholders of a mutual fund at least annually a statement outlining the requirements referred to in subsection (1) and established by the mutual fund under subsection (2), and containing

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

(b) detailed instructions on the manner in which documentation is to be delivered to participating dealers or the mutual fund;

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

(d) an explanation of the consequences of failing to meet timing requirements.(94)

(4) The statement referred to in subsection (3) is not required to be separately provided, in any year, if the requirements are described in the mutual fund's annual financial statements or annual report, or in a simplified prospectus that is sent to all securityholders in that year.

10.2 Transmission and Receipt of Redemption Orders

(1) Each redemption order for securities of a mutual fund received by a participating dealer at a location that is not its principal office shall, on the day the order is received, be sent by same day or next day courier, same day or next day priority post, telephone or electronic means, without charge to the relevant securityholder or to the mutual fund, to the principal office of the participating dealer.

(2) Each redemption order for securities of a mutual fund received by a participating dealer at its principal office or by the principal distributor of the mutual fund at a location that is not an order receipt office of the mutual fund shall, on the day the order is received, be sent by same day or next day courier, same day or next day priority post, telephone or electronic means, without charge to the relevant securityholder or to the mutual fund, to an order receipt office of the mutual fund.

(3) Despite subsections (1) and (2), a redemption order for securities of a mutual fund received at a location referred to in those subsections after normal business hours on a business day, or on a day that is not a business day, may be sent, in the manner and to the place required by those subsections, on the next business day.

(4) A participating dealer or principal distributor that sends redemption orders electronically may

(a) specify a time on a business day by which a redemption order must be received in order that it be sent electronically on that business day; and

(b) despite subsections (1) and (2), send electronically on the next business day a redemption order received after the time so specified.(95)

(5) A mutual fund is deemed to have received a redemption order for securities of the mutual fund when the order is received at an order receipt office of the mutual fund or all requirements of the mutual fund established under paragraph 10.1(2)(a) have been satisfied, whichever is later.

(6) If a mutual fund determines that its requirements established under paragraph 10.1(2)(a) have not been satisfied, the mutual fund shall notify the securityholder making the redemption order, by the close of business on the business day after the date of the delivery to the mutual fund of the incomplete redemption order, that its requirements established under paragraph 10.1(2)(a) have not been satisfied and shall specify procedures still to be followed or the documents still to be delivered by that securityholder.

(7) Despite subsection (5), a mutual fund may provide that orders for the redemption of securities that are received at an order receipt office of the mutual fund after a specified time on a business day, or on a day that is not a business day, will be considered to be received by the mutual fund on the next business day following the day of actual receipt.

10.3 Redemption Price of Securities - The redemption price of a security of a mutual fund to which a redemption order pertains shall be the net asset value of a security of that class, or series of a class, next

determined after the receipt by the mutual fund of the order.[(96)]

10.4 Payment of Redemption Price

(1) Subject to subsection 10.1(1) and to compliance with any requirements established by the mutual fund under paragraph 10.1(2)(b), a mutual fund shall pay the redemption price for securities that are the subject of a redemption order

(a) within three business days after the date of calculation of the net asset value used in establishing the redemption price; or

(b) if payment of the redemption price was not made at the time referred to in paragraph (a) because a requirement established under paragraph 10.1(2)(b) or a requirement of subsection 10.1(1) had not been satisfied, within three business days of

(i) the satisfaction of the relevant requirement, or

(ii) the decision by the mutual fund to waive the requirement, if the requirement was a requirement established under paragraph 10.1(2)(b).

(2) The redemption price of a security, less any applicable investor fees, shall be paid to or to the order of the securityholder of the security.[(97)]

(3) A mutual fund shall pay the redemption price of a security

(a) in the currency in which the net asset value of the redeemed security was denominated; or

(b) with the prior written consent of the securityholder, by making good delivery to the securityholder of portfolio assets, the value of which is equal to the amount at which those portfolio assets were valued in calculating the net asset value used to establish the redemption price.

(4) If payment of the redemption price of securities of a mutual fund is made under paragraph (3)(b),[(98)] the statement of portfolio transactions next prepared by the mutual fund shall include a note describing the portfolio assets delivered to the securityholder and the value assigned to the portfolio assets.

(5) If the redemption price of a security is paid in currency,[(99)] a mutual fund is deemed to have made payment

(a) when the mutual fund, its manager or principal distributor mails a cheque or transmits funds in the required amount to or to the order of the securityholder of the securities; or

(b) if the securityholder has requested that redemption proceeds be delivered in a currency other than that permitted in subsection (3), when the mutual fund delivers the redemption proceeds to the manager or principal distributor of the mutual fund for conversion into that currency and delivery forthwith to the securityholder.

10.5 Failure to Complete Redemption Order

(1) If a requirement of a mutual fund referred to in subsection 10.1(1) or established under paragraph 10.1(2)(b) has not been satisfied on or before the close of business on the tenth business day after the date of the redemption of the relevant securities, and, in the case of a requirement established under paragraph 10.1(2)(b), the mutual fund does not waive satisfaction of the requirement, the mutual fund shall

(a) issue, to the person or company that immediately before the redemption held the securities that were redeemed, a number of securities equal to the number of securities that were redeemed, as if the mutual fund had received from the person or company on the tenth business day after the redemption, and accepted immediately

before the close of business on the tenth business day after the redemption, an order for the purchase of that number of securities; and

(b) apply the amount of the redemption proceeds to the payment of the issue price of the securities.

(2) If the amount of the issue price of the securities referred to in subsection (1) is less than the redemption proceeds, the difference shall belong to the mutual fund.

(3) If the amount of the issue price of the securities referred to in subsection (1) exceeds the redemption proceeds

(a) if the mutual fund has a principal distributor, the principal distributor shall pay immediately to the mutual fund the amount of the deficiency;

(b) if the mutual fund does not have a principal distributor, the participating dealer that delivered the relevant redemption order to the mutual fund shall pay immediately to the mutual fund the amount of the deficiency; or

(c) if the mutual fund has no principal distributor and no dealer delivered the relevant redemption order to the mutual fund, the manager of the mutual fund shall pay immediately to the mutual fund the amount of the deficiency.

10.6 Suspension of Redemptions

(1) A mutual fund may suspend the right of securityholders to request that the mutual fund redeem its securities for the whole or any part of a period during which normal trading is suspended on a stock exchange, options exchange or futures exchange within or outside Canada on which securities are listed and traded, or on which specified derivatives are traded, if those securities or specified derivatives represent more than 50 percent by value, or underlying market exposure, of the total assets of the mutual fund without allowance for liabilities and if those securities or specified derivatives are not traded on any other exchange that represents a reasonably practical alternative for the mutual fund.

(2) A mutual fund that has an obligation to pay the redemption price for securities that have been redeemed in accordance with subsection 10.4(1) may postpone payment during a period in which the right of securityholders to request redemption of their securities is suspended, whether that suspension was made under subsection (1) or pursuant to an approval of the securities regulatory authority.[(100)]

(3) A mutual fund shall not accept a purchase order for securities of the mutual fund during a period in which it is exercising rights under subsection (1) or at a time in which it is relying on an approval of the securities regulatory authorities contemplated by paragraph 5.5(1)(d).

PART 11 COMMINGLING OF MONEY[(101)]

11.1 Principal Distributors

(1) Money received by a principal distributor of a mutual fund, or by a person or company providing services to the mutual fund or the principal distributor, for investment in, or upon the redemption of, securities of the mutual fund, or upon the distribution of assets of the mutual fund, until disbursed as permitted by subsection (3)

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

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

(2) Except as permitted by subsection (3), the principal distributor or person or company providing services to the mutual fund or principal distributor shall not use any of the money referred to in subsection (1) to finance its

own or any other operations in any way.

(3) The principal distributor or person or company providing services to a mutual fund or principal distributor may withdraw money from a trust account referred to in paragraph (1)(a) for the purpose of

(a) remitting to the mutual fund the amount or, if subsection (5) applies, the net amount, to be invested in the securities of the mutual fund;

(b) remitting to the relevant persons or companies redemption or distribution proceeds being paid on behalf of the mutual fund; or

(c) paying investor fees to which a person or company may be entitled.

(4) All interest earned on money held in a trust account referred to in paragraph (1)(a) shall be paid to securityholders or to each of the mutual funds to which the trust account pertains, pro rata based on cash flow

(a) no less frequently than monthly if the amount owing to a mutual fund or to a securityholder is $10 or more; and

(b) no less frequently than once a year.(102)

(5) When making payments to a mutual fund, the principal distributor or service provider may offset the proceeds of redemption of securities of the mutual fund or amounts held for distributions to be paid on behalf of the mutual fund held in the trust account, against amounts held in the trust account for investment in the mutual fund.

11.2 Participating Dealers

(1) Money received by a participating dealer, or by a person or company providing services to a participating dealer, for investment in, or upon the redemption of, securities of a mutual fund, or upon the distribution of assets of a mutual fund, until disbursed as permitted by subsection (3)

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

(b) may only be commingled with money received by the participating dealer or service provider for the sale or upon the redemption of other mutual fund securities.

(2) Except as permitted by subsection (3), the participating dealer or person or company providing services to the participating dealer shall not use any of the money referred to subsection (1) to finance its own or any other operations in any way.

(3) A participating dealer or person or company providing services to the participating dealer may withdraw money from a trust account referred to in paragraph (1)(a) for the purpose of

(a) remitting to the mutual fund or the principal distributor of the mutual fund the amount or, if subsection (5) applies, the net amount, to be invested in the securities of the mutual fund;

(b) remitting to the relevant persons or companies redemption or distribution proceeds being paid on behalf of the mutual fund; or

(c) paying investor fees to which a person or company may be entitled.

(4) All interest earned on money held in a trust account referred to in paragraph (1)(a) shall be paid to securityholders or to each of the mutual funds to which the trust account pertains, pro rata based on cash flow

(a) no less frequently than monthly if the amount owing to a mutual fund or to a securityholder is $10 or more; and

(b) no less frequently than once a year.

(5) When making payments to a mutual fund, a participating dealer or service provider may offset the proceeds of redemption of securities of the mutual fund and amounts held for distributions to be paid on behalf of a mutual fund held in the trust account, against amounts held in the trust account for investment in the mutual fund.

(6) A participating dealer or person providing services to the participating dealer shall permit the mutual fund and the principal distributor, through their respective auditors or other designated representatives, to examine the books and records of the participating dealer to verify the compliance of the participating dealer or person providing services with this section.

11.3 Trust Accounts

(1) A principal distributor or participating dealer that deposits money into a trust account in accordance with section 11.1 or 11.2 shall

(a) advise, in writing, the financial institution with whom the account is opened at the time of the opening of the account, that

(i) the account is established for the purpose of holding client funds in trust,

(ii) the account is to be labelled by the financial institution as a "trust account",

(iii) the account is not to be accessed by any person other than authorized representatives of the principal distributor or participating dealer, and

(iv) the money in the trust account may not be used to cover shortfalls in any accounts of the principal distributor or participating dealer;

(b) ensure that the trust account bears interest at rates equivalent to comparable accounts of the financial institution; and

(c) ensure that any charges against the trust account are not paid or reimbursed out of the trust account.(103)

11.4 Exemption

(1) Sections 11.1 and 11.2 do not apply to members of The Investment Dealers Association of Canada, The Alberta Stock Exchange, The Montreal Exchange, The Toronto Stock Exchange or the Vancouver Stock Exchange.

(2) A participating dealer that is a member of an SRO referred to in subsection (1) shall permit the mutual fund and the principal distributor, through their respective auditors or other designated representatives, to examine the books and records of the participating dealer to verify the participating dealer's compliance with the requirements of its association or exchange that relate to the commingling of money.

11.5 Right of Inspection - The mutual fund, its trustee, manager and principal distributor shall ensure that all contractual arrangements made between any of them and any person or company providing services to the mutual fund permit the representatives of the mutual fund, its manager, trustee, and principal distributor to examine the books and records of those persons or companies in order to monitor compliance with this Instrument.

PART 12 COMPLIANCE REPORTS

12.1 Compliance Reports

(1) A mutual fund that does not have a principal distributor shall complete and file, within 140 days[(104)] after the financial year end of the mutual fund

(a) a report in the form contained in Appendix B-1 describing compliance by the mutual fund during that financial year with the applicable requirements of Parts 9, 10 and 11; and

(b) a report by the auditor of the mutual fund, in the form contained in Appendix B-1, concerning the report referred to in paragraph (a).

(2) The principal distributor of a mutual fund shall complete and file, within 90 days after the financial year end of the principal distributor

(a) a report in the form contained in Appendix B-2 describing compliance by the principal distributor during that financial year with the applicable requirements of Parts 9, 10 and 11; and

(b) a report by the auditor of the principal distributor, in the form contained in Appendix B-2, concerning the report referred to in paragraph (a).

(3) Each participating dealer that distributes securities of a mutual fund in a financial year of the participating dealer shall complete and file, within 90 days after the end of that financial year

(a) a report in the form contained in Appendix B-3 describing compliance by the participating dealer during that financial year with the applicable requirements of Parts 9, 10 and 11 in connection with its distribution of securities of all mutual funds in that financial year; and

(b) a report by the auditor of the participating dealer, in the form contained in Appendix B-3, concerning the report referred to in paragraph (a).[(105)]

(4) Subsection (3) does not apply to members of The Investment Dealers Association of Canada, The Alberta Stock Exchange, The Montreal Exchange, The Toronto Stock Exchange or the Vancouver Stock Exchange.[(106)]

PART 13 CALCULATION OF NET ASSET VALUE

13.1 Frequency and Currency of Calculation of Net Asset Value

(1) The net asset value of a mutual fund shall be calculated

(a) if the mutual fund does not use specified derivatives, at least once in each week; or

(b) if the mutual fund uses specified derivatives, at least once every business day.

(2) Despite subsection (1)(a), a mutual fund that, at the date that this Instrument comes into force, calculates net asset value no less frequently than once a month may continue to calculate net asset value at least as frequently as it does at that date.

(3) The net asset value of a mutual fund shall be calculated in the currency of Canada or in the currency of the United States of America or both.

(4) A mutual fund that arranges for the publication of its net asset value in the financial press shall ensure that its current net asset value is provided on a timely basis to the financial press.[(107)]

13.2 Portfolio Transactions - Each transaction of purchase or sale of a portfolio asset effected by a mutual fund

shall be reflected in a calculation of net asset value of the mutual fund made not later than the first calculation of net asset value made after the date on which the transaction becomes binding.

13.3 Capital Transactions - The issue or redemption of a security of a mutual fund shall be reflected in the first calculation of net asset value of the mutual fund made after the calculation of net asset value used to establish the issue or redemption price.

13.4 Valuation of Restricted Securities - A mutual fund shall value a restricted security at the lesser of

(a) the value based on reported quotations of that restricted security in common use; and

(b) that percentage of the market value of the securities of the class or series of a class of which the restricted security forms part that are not restricted securities, equal to the percentage that the mutual fund's acquisition cost was of the market value of the securities at the time of acquisition, but taking into account, if appropriate, the amount of time remaining until the restricted securities will cease to be restricted securities.

13.5 Valuation of Specified Derivatives - A mutual fund shall value specified derivatives transactions and positions in accordance with the following principles:

1. A long position in an option or a debt-like security shall be valued at the current market value of the position.

2. For options written by a mutual fund

(a) the premium received by the mutual fund for those options shall be reflected as a deferred credit that shall be valued at an amount equal to the current market value of the option that would have the effect of closing the position;

(b) any difference resulting from revaluation shall be treated as an unrealized gain or loss on investment;

(c) the deferred credit shall be deducted in calculating the net asset value of the mutual fund; and

(d) any securities that are the subject of a written option shall be valued at their current market value.(108)

3. The value of a forward contract shall be the gain or loss on the contract that would be realized if, on the date that valuation is made, the position in the forward contract were to be closed out.

4. The value of a standardized future shall be

(a) if the futures exchange through which the standardized future was issued does not impose daily limits applicable to the standardized future, the gain or loss on the standardized future that would be realized if, on the date that valuation is made, the position in the standardized future were to be closed out; or

(b) if the futures exchange through which the standardized future was issued imposes daily limits applicable to the standardized future, the current market value of the underlying interest of the standardized future.

5. Margin paid or deposited on a standardized futures or forward contracts

(a) shall be reflected as an account receivable; and

(b) if not in the form of money, shall be noted as held for margin.

6. The value of a swap shall be the mark-to-market value of the swap.(109)

PART 14 RECORD DATE

14.1 Record Date - The record date for determining the right of securityholders of a mutual fund to receive a dividend or distribution by the mutual fund shall either be

(a) the day on which the net asset value per security is determined for the purpose of calculating the amount of the payment of the dividend or distribution; or

(b) if the day referred to in paragraph (a) is not a business day, the last day on which the net asset value of the mutual fund was calculated before the day referred to in paragraph (a).(110)

PART 15 SALES COMMUNICATIONS AND PROHIBITED REPRESENTATIONS(111)

15.1 Ability to Make Sales Communications - Sales communications pertaining to a mutual fund may be made by a person or company only in accordance with this Part.(112)

15.2 Sales Communications - General Requirements

(1) Despite any other provision of this Part, no sales communication shall

(a) be untrue or misleading; or

(b) include a statement that conflicts with information that is contained in the preliminary simplified prospectus, the preliminary annual information form, the simplified prospectus or annual information form

(i) of a mutual fund, or

(ii) in which an asset allocation service is described.(113)

(2) All text of a written sales communication shall be at least as large as 10-point type.(114)

15.3 Prohibited Disclosure in Sales Communications

(1) A sales communication shall not compare the performance of a mutual fund or asset allocation service with the performance or change of any benchmark or investment unless

(a) it includes all facts that, if disclosed, would be likely to alter materially the conclusions reasonably drawn or implied by the comparison;

(b) it presents data for each subject of the comparison for the same period or periods;

(c) it explains clearly any factors necessary to make the comparison fair and not misleading; and(115)

(d) in the case of a comparison with a benchmark, the benchmark existed and was widely available during the period for which the comparison is made.(116)

(2) A sales communication for a mutual fund or asset allocation service that is prohibited by paragraph 15.6(a) from disclosing performance data shall not provide performance data for any benchmark or investment other than a mutual fund or asset allocation service under common management with the mutual fund or asset allocation service to which the sales communication pertains.(117)

(3) A sales communication shall not refer to a performance rating or ranking of a mutual fund or asset allocation service unless

(a) the rating or ranking is prepared by an organization that is not a member of the organization of the mutual

fund; and

(b) standard performance data is provided for any mutual fund or asset allocation service for which a performance rating or ranking is given.(118)

(4) A sales communication shall not refer to a credit rating of securities of a mutual fund unless

(a) the rating is current and was prepared by an approved credit rating organization;

(b) there has been no announcement by the approved credit rating organization of which the mutual fund or its manager is or ought to be aware that the credit rating of the securities may be down-graded; and

(c) no approved credit rating organization is currently rating the securities at a lower level.(119)

(5) A sales communication shall not refer to a mutual fund as, or imply that it is, a money fund, cash fund or money market fund unless, at the time the sales communication is used and for each period for which money market fund standard performance data is provided, the mutual fund is and was a money market fund, either under National Policy Statement No. 39 or under this Instrument.(120)

(6) A sales communication shall not state or imply that a registered retirement savings plan, registered retirement income fund or registered education savings plan in itself, rather than the mutual fund to which the sales communication relates, is an investment.(121)

15.4 Required Disclosure and Warnings in Sales Communications(122)

(1) A written sales communication shall

(a) bear the name of the principal distributor or participating dealer that distributed the sales communication; and

(b) if the sales communication is not an advertisement, contain the date of first publication of the sales communication.(123)

(2) A sales communication that includes a rate of return or a mathematical table illustrating the potential effect of a compound rate of return shall contain a statement in substantially the following words:

"[The rate of return or mathematical table shown] is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of [the mutual fund or asset allocation service] or returns on investment [in the mutual fund or from the use of the asset allocation service].".(124)

(3) A sales communication, other than a report to securityholders, of a mutual fund that is not a money market fund and that does not contain performance data shall contain a warning in substantially the following words:

"PLEASE READ the fund's simplified prospectus carefully before investing. There is no guarantee that the full amount of your investment in the fund will be returned to you. The value of the fund's [units] [shares] changes frequently. How the fund has performed in the past does not necessarily indicate how it will perform in the future.".(125)

(4) A sales communication, other than a report to securityholders, of a money market fund that does not contain performance data shall contain a warning in substantially the following words:

"PLEASE READ the fund's simplified prospectus carefully before investing. Mutual fund securities are not covered by the Canada Deposit Insurance Corporation or by any other government deposit insurer. There can be no assurances that the fund will be able to maintain its net asset value at a constant amount or that the full

amount of your investment in the fund will be returned to you. How the fund has performed in the past does not necessarily indicate how it will perform in the future.".(126)

(5) A sales communication for an asset allocation service that does not contain performance data shall contain a warning in substantially the following words:

"PLEASE READ the simplified prospectus of [the asset allocation service or [funds in which the asset allocation service may invest] carefully before investing. There is no guarantee that the full amount of your investment through the asset allocation service will be returned to you. The value of the asset allocation service's [units] [shares] changes frequently. How the asset allocation service and the funds in which it invests have performed in the past does not necessarily indicate how they will perform in the future."(127)

(6) A sales communication, other than a report to securityholders, of a mutual fund that is not a money market fund and that contains performance data shall contain a warning in substantially the following words:

"PLEASE READ the fund's simplified prospectus carefully before investing. There is no guarantee that the full amount of your investment in the fund will be returned to you. The value of the fund's [units] [shares] changes frequently. The indicated rate[s] of return is [are] the historical annual compounded total return[s] including changes in [share or unit] value and reinvestment of all [dividends or distributions] and does [do] not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. How the fund has performed in the past does not necessarily indicate how it will perform in the future.".(128)

(7) A sales communication, other than a report to securityholders, of a money market fund that contains performance data shall contain

(a) a warning in substantially the following words:

"PLEASE READ the fund's simplified prospectus carefully before investing. Mutual fund securities are not covered by the Canada Deposit Insurance Corporation or by any other government deposit insurer. There can be no assurances that the fund will be able to maintain its net asset value at a constant amount or that the full amount of your investment in the fund will be returned to you. The performance data provided assumes reinvestment of distributions only and does not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. How the fund has performed in the past does not necessarily indicate how it will perform in the future."; and

(b) a statement in substantially the following words, immediately following the performance data:

"This is an annualized historical yield based on the seven day period ended on [date] [annualized in the case of effective yield by compounding the seven day return] and does not represent an actual one year return.".(129)

(8) A sales communication for an asset allocation service that contains performance data shall contain a warning in substantially the following words:

"The indicated rate[s] of return is [are] the historical annual compounded total return[s] assuming the investment strategy recommended by the asset allocation service is used and after deduction of the fees and charges in respect of the service. The return[s] is [are] based on the historical annual compounded total returns of the participating funds including changes in [share] [unit] value and reinvestment of all [dividends or distributions] and does [do] not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder in respect of a participating fund that would have reduced returns. How the asset allocation service or the funds in which it invests have performed in the past does not necessarily indicate how they will perform in the future.".(130)

(9) A sales communication distributed after the issue of a receipt for a preliminary prospectus or preliminary

simplified prospectus of the mutual fund described in the sales communication but before the issue of a receipt for its prospectus or simplified prospectus shall contain a warning in substantially the following words:

"A preliminary simplified prospectus relating to the fund has been filed with certain Canadian securities commissions or similar authorities. You cannot buy [units] [shares] of the fund until the relevant securities commissions or similar authorities issue receipts for the simplified prospectus of the fund.".(131)

(10) A sales communication for a mutual fund or asset allocation service that purports to guarantee or arrange for insurance in either case in order to protect all or some of the principal amount of an investment in the mutual fund or asset allocation service, shall

(a) identify the person or company providing the guarantee or insurance;

(b) provide the material terms of the guarantee or insurance, including the maturity date of the guarantee or insurance;

(c) if applicable, state that the guarantee or insurance does not apply to the amount of any redemptions before the maturity date of the guarantee or before the death of the securityholder and that redemptions before that date would be based on the net asset value of the mutual fund at the time; and

(d) modify any other disclosure required by this section appropriately.(132)

(11) Despite the requirements of subsections (1) through (9), a sales communication that does not contain performance data need not contain the warning required by those subsections if the applicable warning, if it were included, would constitute more than 50 percent of the text of the sales communication, more than 50 percent of the area of a sign or if the sales communication is a radio or television advertisement, if the sales communication contains a warning in substantially the following words:

"PLEASE READ the [fund's] simplified prospectus carefully before investing. Obtain a copy from [name of dealer] [a registered dealer]. How the fund has performed in the past does not necessarily indicate how it will perform in the future."(133)

(12) The warnings referred to in this section shall be communicated in a manner that a reasonable person would consider clear and easily understood at the same time as, and through the medium by which, the related sales communication is communicated.(134)

(13) A mutual fund that files a prospectus rather than a simplified prospectus shall amend the warnings required by this section to refer to a prospectus, as applicable.(135)

15.5 Disclosure Regarding Distribution Fees(136)

(1) No person or company shall describe a mutual fund in a sales communication as a "no-load fund" or use words of like effect if investor fees are payable by an investor on a purchase or redemption of securities of the mutual fund to any of the manager, the principal distributor or a participating dealer of the mutual fund, other than

(a) fees and charges related to specific optional services;

(b) for a mutual fund that is not a money market fund, redemption fees on the redemption of securities of the mutual fund that are redeemed within 90 days after the purchase of the securities, if the existence of the fees is disclosed in the sales communication, or in the simplified prospectus of the mutual fund; or

(c) costs that are payable only on the set-up or closing of a securityholder's account and that reflect the administrative costs of establishing or closing the account, if the existence of the costs is disclosed in the sales

communication, or in the simplified prospectus of the mutual fund.

(2) If a sales communication describes a mutual fund as "no-load" or uses words to like effect, the sales communication shall

(a) indicate the principal distributor or a participating dealer through which an investor may purchase the mutual fund on a no-load basis;

(b) include a summary of the fees and charges paid by the mutual fund; and

(c) disclose the existence of any trailing commissions paid by a member of the organization of the mutual fund. (137)

(3) A sales communication containing a reference to the existence or absence of fees or charges, other than the disclosure required by section 15.4 or a reference to the term "no-load", shall provide a summary of the types of fees and charges that exist.

(4) The rate of sales charges or commissions for the sale of securities of a mutual fund or the use of an asset allocation service shall be expressed in a sales communication as a percentage of the amount paid by the purchaser and as a percentage of the net amount invested if a reference is made to sales charges or commissions.

15.6 Conditions of Disclosure of Performance Data - No sales communication pertaining to a mutual fund or asset allocation service shall contain performance data of the mutual fund or asset allocation service unless

(a) either

(i) the mutual fund has offered securities under a simplified prospectus in a jurisdiction for at least one completed financial year, or the asset allocation service has been operated for at least 12 months and has invested only in participating mutual funds each of which has offered securities under a simplified prospectus in a jurisdiction for at least one completed financial year, or

(ii) if the sales communication pertains to a mutual fund or asset allocation service that does not satisfy the requirements of subparagraph (i), the sales communication is sent only to securityholders of the mutual fund or participants in the asset allocation service;(138)

(b) the sales communication also contains standard performance data of the mutual fund or asset allocation service and, in the case of a written sales communication, the standard performance data is presented in type size that is equal to or larger than that used to present the other performance data;(139)

(c) the performance data reflects or includes references to all elements of return;(140) and

(d) the sales communication does not contain performance data for a period that is before the time when the mutual fund offered its securities under a simplified prospectus or before the asset allocation service commenced operation.(141)

15.7 Advertisements(142) - An advertisement for a mutual fund or asset allocation service shall not compare the performance of the mutual fund or asset allocation service with any benchmark or investment other than

(a) one or more mutual funds or asset allocation services that are under common management or administration with the mutual fund or asset allocation service to which the advertisement pertains;

(b) one or more mutual funds or asset allocation services that have fundamental investment objectives that a reasonable person would consider similar to the mutual fund or asset allocation service to which the advertisement pertains; or

(c) an index.[(143)]

15.8 Performance Measurement Periods Covered by Performance Data

(1) A sales communication, other than a report to securityholders, that relates to a money market fund may provide standard performance data only if

(a) the standard performance data has been calculated for the most recent seven day period for which it is practicable to calculate, taking into account publication deadlines; and

(b) the seven day period does not start more than 45 days before the date of the appearance, use or publication of the sales communication.[(144)]

(2) A sales communication, other than a report to securityholders, that relates to an asset allocation service or to a mutual fund other than a money market fund may provide standard performance data only if

(a) the standard performance data has been calculated for the 10, five, three and one year periods and the period since the inception of the mutual fund if the mutual fund has been offering securities by way of simplified prospectus for more than one and less than 10 years,[(145)]; and

(b) the periods referred to in paragraph (a) end on the same calendar month end that is

(i) not more than 45 days before the date of the appearance or use of the advertisement in which it is included, and

(ii) not more than three months before the date of first publication of any other sales communication in which it is included.[(146)]

(3) A report to securityholders may contain standard performance data only if

(a) the standard performance data has been calculated for the 10, five, three and one year periods and the period since the inception of the mutual fund if the mutual fund has been offering securities by way of simplified prospectus for more than one and less than 10 years; and

(b) the periods referred to in paragraph (a) end on the day as of which the balance sheet of the financial statements contained in the report to securityholders was prepared.[(147)]

(4) A sales communication shall clearly identify the periods for which performance data is calculated and shall indicate how more current standard performance data may be obtained.[(148)]

15.9 Changes affecting Performance Data

(1) If, during or after a performance measurement period of performance data contained in a sales communication, there have been changes in the business, operations or affairs of the mutual fund or asset allocation service to which the sales communication pertains that could have materially affected the performance of the mutual fund or asset allocation service, the sales communication shall contain

(a) summary disclosure of the changes, and of how those changes could have affected the performance had those changes been in effect throughout the performance measurement period; and

(b) for a money market fund that during the performance measurement period did not pay or accrue the full amount of any fees and charges of the type described under paragraph 15.11(1)1, disclosure of the difference between the full amounts and the amounts actually charged, expressed as an annualized percentage on a basis comparable to current yield.[(149)]

(2) If a mutual fund has, in the last 10 years, undertaken a reorganization with, or acquired assets from, another mutual fund in a transaction that was a significant change for the mutual fund or would have been a significant change for the mutual fund had this Instrument been in force at the time of the transaction, then, in any sales communication of the mutual fund

(a) the mutual fund shall provide summary disclosure of the transaction;

(b) the mutual fund may include its performance data covering any part of a period before the transaction only if it also includes the performance data for the other fund for the same periods;

(c) the mutual fund shall not include its performance data for any part of a period after the transaction unless

(i) 12 months have passed since the transaction, or

(ii) the mutual fund includes in the sales communication the performance data for itself and the other mutual fund referred to in paragraph (b); and

(d) the mutual fund shall not include any performance data for any period that is composed of both time before and after the transaction.(150)

15.10 Formula for Calculating Standard Performance Data(151)

(1) The standard performance data of a mutual fund shall be calculated in accordance with this section.

(2) In this Part

"current yield" means the yield of a money market fund expressed as a percentage and determined by applying the following formula:

current yield = [seven day return x 365/7] x 100;

"effective yield" means the yield of a money market fund expressed as a percentage and determined by applying the following formula:

effective yield = $[(\text{seven day return} + 1)^{365/7} - 1] \times 100$;

"seven day return" means the income yield of an account of a securityholder in a money market fund that is calculated by

(a) determining the net change, exclusive of new subscriptions other than from the reinvestment of distributions or proceeds of redemption of securities of the money market fund, in the value of the account,

(b) subtracting all fees and charges of the type referred to in paragraph 15.11(1)3 for the seven day period, and

(c) dividing the result by the value of the account at the beginning of the seven day period;

"standard performance data" means

(a) for a money market fund

(i) the current yield, or

(ii) the current yield and effective yield, if the effective yield is reported in a type size that is at least equal to that of the current yield, and

(b) for any mutual fund other than a money market fund, the total return

calculated in each case in accordance with this section; and

"total return" means the annual compounded rate of return for a mutual fund for a period that would equate the initial value to the redeemable value at the end of the period, expressed as a percentage, and determined by applying the following formula:

total return = $[(\text{redeemable value}/\text{initial value})^{(1/N)}-1] \times 100$

where N = the length of the performance measurement period in years, with a minimum value of 1.

(3) If there are fees and charges of the type described in paragraph 15.11(1)1 relevant to the calculation of redeemable value and initial value of the securities of a mutual fund, the redeemable value and initial value of securities of a mutual fund shall be the net asset value of one unit or share of the mutual fund at the beginning or at the end of the performance measurement period, minus the amount of those fees and charges calculated by applying the assumptions referred to in that paragraph to a hypothetical securityholder account.(152)

(4) If there are no fees and charges of the type described in paragraph 15.11(1)1 relevant to a calculation of total return, the calculation of total return for a mutual fund may assume a hypothetical investment of one security of the mutual fund and be calculated as follows:

(a) "initial value" means the net asset value of one unit or share of a mutual fund at the beginning of the performance measurement period; and

(b) "redeemable value" =

$R \times (1 + D_1/P_1) \times (1 + D_2/P_2) \times (1 + D_3/P_3) \ldots \times (1 + D_n/P_n)$

where R = the net asset value of one unit or security of the mutual fund at the end of the performance measurement period,

D = the dividend or distribution amount per security of the mutual fund at the time of each distribution,

P = the dividend or distribution reinvestment price per security of the mutual fund at the time of each distribution, and

n = the number of dividends or distributions during the performance measurement period.

(5) Standard performance data of an asset allocation service shall be based upon the standard performance data of its participating funds.

(6) Performance data

(a) for a mutual fund other than a money market fund shall be calculated to the nearest one-tenth of one percent; and

(b) for a money market fund shall be calculated to the nearest one-hundredth of one percent.

15.11 Assumptions for Calculating Standard Performance Data(153)

(1) The following assumptions shall be made in the calculation of standard performance data of a mutual fund:

1. Recurring fees and charges that are payable by all securityholders

(a) are accrued or paid in proportion to the length of the performance measurement period;

(b) if structured in a manner that would result in the performance information being dependent upon the size of an investment, are calculated on the basis of an investment equal to the greater of $10,000 or the minimum amount that may be invested; and

(c) if fully negotiable, are calculated on the basis of the average fees paid by accounts of the size referred to in paragraph (b).

2. There are no fees and charges related to specific optional services.

3. All fees and charges payable by the mutual fund are accrued or paid.

4. Dividends or distributions by the mutual fund are reinvested in the mutual fund at the net asset value per security of the mutual fund on the reinvestment dates during the performance measurement period.

5. There are no non-recurring fees and charges that are payable by some or all securityholders and no recurring fees and charges that are payable by some but not all securityholders.

6. A complete redemption occurs at the end of the performance measurement period so that the ending redeemable value includes elements of return that have been accrued but not yet paid to securityholders.

(2) The following assumptions shall be made in the calculation of standard performance data of an asset allocation service:

1. Fees and charges that are payable by participants in the asset allocation service

(a) are accrued or paid in proportion to the length of the performance measurement period;

(b) if structured in a manner that would result in the performance information being dependent upon the size of an investment, are calculated on the basis of an investment equal to the greater of $10,000 or the minimum amount that may be invested; and

(c) if fully negotiable, are calculated on the basis of the average fees paid by accounts of the size referred to in paragraph (b).

2. There are no fees and charges related to specific optional services.

3. The investment strategy recommended by the asset allocation service is utilized for the performance measurement period.

4. Transfer fees are

(a) accrued or paid;

(b) if structured in a manner that would result in the performance information being dependent upon the size of an investment, calculated on the basis of an account equal to the greater of $10,000 or the minimum amount that may be invested; and

(c) if the fees and charges are fully negotiable, calculated on the basis of the average fees paid by an account of the size referred to in paragraph (b).

5. A complete redemption occurs at the end of the performance measurement period so that the ending redeemable value includes elements of return that have been accrued but not yet paid to securityholders.

(3) The calculation of standard performance data shall be based on actual historical performance and the fees and charges payable by the mutual fund and securityholders, or the asset allocation service and participants, in effect during the performance measurement period.

15.12 Sales Communications During the Waiting Period - If a sales communication is used after the issue of a receipt for a preliminary simplified prospectus of the mutual fund described in the sales communication but before the issue of a receipt for its simplified prospectus, the sales communication shall only state

(a) whether the security represents a share in a corporation or an interest in a non-corporate entity;

(b) the name of the mutual fund and its manager;

(c) the fundamental investment objectives of the mutual fund;

(d) without giving details, whether the security is or will be a qualified investment for a registered retirement savings plan, registered retirement income fund or registered education savings plan or qualifies or will qualify the holder for special tax treatment; and

(e) any additional information permitted by securities legislation.(154)

15.13 Prohibited Representations

(1) Securities issued by an unincorporated mutual fund shall be described by a term that is not and does not include the word "shares".

(2) No communication by a mutual fund or asset allocation service, its promoter, manager, portfolio adviser, principal distributor, participating dealer or a person providing services to the mutual fund or asset allocation service shall describe a mutual fund as a commodity pool or as a vehicle for investors to participate in the speculative trading of, or leveraged investment in, derivatives, unless the mutual fund is a commodity pool within the meaning of National Instrument 81-104 Commodity Pools.

(3) No communication relating to a mutual fund shall describe the mutual fund as a money market fund or imply that the mutual fund is a money market fund unless the mutual fund is a money market fund.(155)

PART 16 CALCULATION OF MANAGEMENT EXPENSE RATIO(156)

16.1 Calculation of Management Expense Ratio

(1) A mutual fund may disclose its management expense ratio only if the management expense ratio is calculated for a financial year of the mutual fund and if it is calculated by

(a) dividing

(i) the total expenses of the mutual fund for the financial year as shown on its statement of operations;

by

(ii) the average net asset value of the mutual fund for the financial year, obtained by

(A) adding together the net asset values of the mutual fund as at the close of business of the mutual fund on each day during the financial year on which the net asset value of the mutual fund has been calculated, and

(B) dividing the amount obtained under clause (A) by the number of days during the financial year on which the net asset value of the mutual fund has been calculated; and

(b) multiplying the result obtained under paragraph (a) by 100.

(2) If any fees and expenses otherwise payable by a mutual fund in a financial year were waived or otherwise absorbed by a member of the organization of the mutual fund, the mutual fund shall disclose in a note to the disclosure of its management expense ratio, details of

(a) what the management expense ratio would have been without any waivers or absorptions;

(b) the length of time that the waiver or absorption is expected to continue;

(c) whether the waiver or absorption can be terminated at any time by the member of the organization of the mutual fund; and

(d) any other arrangements concerning the waiver or absorption.

(3) If a management fee was paid directly by investors of a mutual fund during the period to which the disclosed management expense ratio relates, the mutual fund shall include those management fees in its calculation of the management expense ratio with an appropriate explanation in a note to the disclosure.

(4) If the aggregate amount of a management fee payable directly by investors of a mutual fund during the period to which the disclosed management expense ratio relates is not ascertainable, the mutual fund shall include the maximum amount of management fees that could have been paid by those investors in its calculation of the management expense ratio.

(5) Management fees rebated by a manager or a mutual fund to a securityholder shall not be deducted from total expenses of the mutual fund in determining the management expense ratio of the mutual fund.(157)

(6) A mutual fund that has separate classes or series of securities shall calculate a management expense ratio for each class or series, in the manner required by this section, modified as appropriate(158).

16.2 Fund of Funds Calculation - For the purposes of subparagraph 16.1(1)(a)(i), the total expenses of a mutual fund for a financial year that invests in securities of other mutual funds is equal to the sum of

(a) the total expenses incurred by the mutual fund attributable to its investment in each underlying mutual fund as calculated by

(i) multiplying the total expenses of each underlying mutual fund for the financial year as shown on the statement of operations of each underlying mutual fund,

by

(ii) the average proportion of securities of the underlying mutual fund held by the mutual fund during the financial year, calculated by

(A) adding together the proportion of securities of the underlying mutual fund held by the mutual fund on each day in the financial year, and

(B) dividing the amount obtained under clause (A) by the number of days in the financial year;

(b) the total expenses of the mutual fund for the financial year as shown on its statement of operations.

PART 17 FINANCIAL STATEMENT REQUIREMENTS

17.1 Information About Specified Derivatives

(1) A mutual fund shall in the statement of investment portfolio included in the annual and interim financial statements of the mutual fund, or in the notes to that statement, disclose

(a) for long positions in clearing corporation options, the number of options, the underlying interest, the strike price, the expiration month and year, the cost and the market value;

(b) for long positions in options on futures, the number of options on futures, the futures contracts that form the underlying interest, the strike price, the expiration month and year of the option on futures, the delivery month and year of the futures contract that forms the underlying interest of the option on futures, the cost and the market value;

(c) for clearing corporation options written by the mutual fund, the particulars of the deferred credit account, indicating the number of options, the underlying interest, the strike price, the expiration month and year, the premium received and the value as determined under section 13.5;

(d) for options purchased by the mutual fund that are not clearing corporation options, the number of options, the credit rating of the issuer of the options, whether the rating has fallen below the approved credit rating, the underlying interest, the principal amount or quantity of the underlying interest, the strike price, the expiration date, the cost and the market value;

(e) for options written by the mutual fund that are not clearing corporation options, the particulars of the deferred credit account, indicating the number of options, the underlying interest, the principal amount or quantity of the underlying interest, the exercise price, the expiration date, the premium received and the value as determined under section 13.5;

(f) for positions in standardized futures, the number of standardized futures, the underlying interest, the price at which the contract was entered into, the delivery month and year and the value as determined under section 13.5;

(g) for positions in forward contracts, the number of forward contracts, the credit rating of the counterparty, whether the rating has fallen below the approved credit rating level, the underlying interest, the quantity of the underlying interest, the price at which the contract was entered into, the settlement date and the value as determined under section 13.5; and

(h) for debt-like securities, the principal amount of the debt, the interest rate, the payment dates, the underlying interest, the principal amount or quantity of the underlying interest, a description of whether the derivative component is an option or a forward contract with respect to the underlying interest, the strike price in the case of an options component and the set price in the case of a forward component, and the value as determined under section 13.5.

(2) If applicable, the statement of investment portfolio included in the annual and interim financial statements of the mutual fund, or the notes to that statement, shall identify by an asterisk or other notation the underlying interest that is being hedged by each position taken by the mutual fund in a specified derivative.

17.2 Additional Disclosure Requirements

(1) The annual financial statements of a mutual fund shall

(a) set out in appropriate detail the amounts of all fees, charges and expenses, if any, that have been charged to the mutual fund during each financial year reported upon in the financial statements; and

(b) set out the net asset value per security of the mutual fund as at the end of the last completed financial year and as at the end of each of the four preceding completed financial years, or such fewer number of financial years as the mutual fund has been in existence.

(2) The annual and interim financial statements of a mutual fund shall disclose

(a) the management expense ratio of each class or series of a class of securities of the mutual fund for each of the last five completed financial years of the mutual fund or such fewer number of financial years as the mutual fund has been in existence, and shown for periods of less than 12 months on an annualized basis with reference to the period covered and the fact that the management expense ratio shown is annualized; and

(b) a brief description of the method of calculating the management expense ratio.

17.3 Approval of Financial Statements

(1) The board of directors of a mutual fund that is a corporation shall

(a) approve the annual financial statements of the mutual fund that are to be delivered on request to purchasers of its securities; and

(b) authorize two directors of the mutual fund to sign those financial statements to evidence that approval.

(2) The manager or the trustee or trustees of a mutual fund that is a trust, or another person or company authorized to do so by the constating documents of the mutual fund, shall

(a) approve the annual financial statements of the mutual fund that on and after the date the simplified prospectus of the mutual fund is filed, are to be delivered to purchasers of its securities with the prospectus or the simplified prospectus or are incorporated by reference into the simplified prospectus; and

(b) authorize two appropriate persons to sign those financial statements to evidence that approval.

PART 18 SECURITYHOLDER RECORDS

18.1 Maintenance of Records - A mutual fund that is not a corporation shall maintain, or cause to be maintained, for at least as long as the mutual fund is in existence,(159) up to date records(160) of

(a) the names and latest known addresses of each securityholder of the mutual fund;

(b) the number and class or series of a class of securities held by each securityholder of the mutual fund; and

(c) the date and details of each issue and redemption of securities, and each distribution, of the mutual fund.

18.2 Availability of Records

(1) A mutual fund that is not a corporation shall make, or cause to be made, the records referred to in section 18.1 available for inspection, free of charge, during normal business hours at its principal or head office by a securityholder or a representative of a securityholder, if the securityholder has agreed in writing that the information contained in the register will not be used by the securityholder for any purpose other than attempting to influence the voting of securityholders of the mutual fund or a matter relating to the administration of the mutual fund.(161)

(2) A mutual fund shall, upon written request by a securityholder, provide, or cause to be provided, to the securityholder a copy of the records referred to in paragraphs 18.1(a) and (b) if the securityholder

(a) has agreed in writing that the information contained in the register will not be used by the securityholder for any purpose other than attempting to influence the voting of securityholders of the mutual fund or a matter relating to the administration of the mutual fund; and

(b) has paid a reasonable fee to the mutual fund that does not exceed the reasonable costs to the mutual fund of providing the copy of the register.

PART 19 EXEMPTIONS AND APPROVALS

19.1 Exemption[(162)]

(1) The regulator or securities regulatory authority may grant an exemption from this Instrument, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

(2) Despite subsection (1), in Ontario, only the regulator may grant such an exemption.

19.2 Exemption or Approval under Prior Policy

(1) A mutual fund that has obtained, from the regulator or securities regulatory authority, an exemption or waiver from, or approval under, a provision of National Policy Statement No. 39 before this Instrument came into force is exempt from any substantially similar provision of this Instrument, if any, on the same conditions, if any, as are contained in the earlier exemption or approval, unless the regulator or securities regulatory authority has revoked that exemption or waiver under authority provided to it in securities legislation.

(2) Despite Part 7, a mutual fund that has obtained, from the regulator or securities regulatory authority, approval under National Policy Statement No. 39 to pay incentive fees may continue to pay incentive fees on the terms of that approval if disclosure of the method of calculation of the fees and details of the composition of the benchmark or index used in calculating the fees are described in the simplified prospectus of the mutual fund.

(3) A mutual fund that intends to rely upon subsection (1) shall, at the time of the first filing of its *pro forma* simplified prospectus after this Instrument comes into force, send to the regulator a letter or memorandum containing

(a) a brief description of the nature of the exemption from, or approval under, National Policy Statement No. 39 previously obtained; and

(b) the provision in the Instrument that is substantially similar to the provision in National Policy Statement No. 39 from or under which the exemption or approval was previously obtained.[(163)]

PART 20 TRANSITIONAL

20.1 Effective Date - This Instrument comes into force on , 1999.

20.2 Sales Communications - Sales communications, other than advertisements, that were printed before , 1999 may be used until , 2000, despite any requirements in this Instrument.[(164)]

20.3 Reports to Securityholders - This Instrument does not apply to reports to securityholders printed before this Instrument came into force.

20.4 Mortgage Funds - Paragraphs 2.3(b) and (c) do not apply to a mutual fund that has adopted fundamental investment objectives to permit it to invest in mortgages in accordance with National Policy Statement No. 29 if

(a) a National Instrument replacing National Policy Statement No. 29 has not come into force;

(b) the mutual fund was established, and has a prospectus or simplified prospectus for which a receipt was issued, before the date that this Instrument came into force; and

(c) the mutual fund complies with National Policy Statement No. 29.[(165)]

20.5 Delayed Coming into Force

(1) Despite section 20.1, the following provisions of this Instrument do not come into force until , 2000 [one year after the date that will be shown in section 20.1]:

1. Subsection 2.4(2).(166)

2. Subsection 2.7(4).(167)

3. Subsection 6.4(1).(168)

(2) Despite section 20.1, subsection 4.4(1)(169) does not come into force until , 2000 [six months after the date that will be shown in section 20.1].

NATIONAL INSTRUMENT 81-102

APPENDIX A

Futures Exchanges for the Purpose of

Subsection 2.7(4) - Derivative Counterparty Exposure Limits

Futures Exchanges

Australia

Sydney Futures Exchange

Australian Financial Futures Market

Austria

Osterreichische Termin-und Option borse (OTOB - The Austrian Options and Futures Exchange)

Belgium

Belfox CV (Belgium Futures and Options Exchange)

Brazil

Bolsa Brasileira de Futuros

Bolsa de Mercadorias & Futuros

Bolsa de Valores de Rio de Janeiro

Canada

The Winnipeg Commodity Exchange

The Toronto Futures Exchange

The Montreal Exchange

Denmark

Kobenhavus Fondsbors (Copenhagen Stock Exchange)

Garenti fonden for Dankse Optioner og Futures (Guarantee Fund for Danish Options and Futures)

Futop (Copenhagen Stock Exchange)

Finland

Suomen Optionmeklarit Oy (Finnish Options Market)

Oy Suomen Optiopörssi (Finnish Options Exchange)

France

Marché à terme international de France S.A. (MATIF S.A.)

Germany

DTB Deutsche Terminbörse GmbH

Hong Kong

Hong Kong Futures Exchange Limited

Ireland

Irish Futures and Options Exchange

Italy

Milan Italiano Futures Exchange

Japan

Osaka Shoken Torihikisho (Osaka Securities Exchange)

The Tokyo Commodity Exchange for Industry

The Tokyo International Financial Futures Exchange

Tokyo Stock Exchange

Netherlands

EOE-Optiebeurs (European Options Exchange)

Financiele Termijnmarkt Amsterdam N.V.

New Zealand

New Zealand Futures and Options Exchange

Philippines

Manila International Futures Exchange

Singapore

Singapore International Monetary Exchange Limited (SIMEX)

Spain

Meff Renta Fija

Meff Renta Variable

Sweden

OM Stockholm Fondkommission AB

Switzerland

Swiss Options and Financial Futures Exchange (SOFFEX)

United Kingdom

London International Financial Futures and Options Exchange (LIFFE)

OM London

United States

Chicago Board of Trade (CBOT)

Chicago Mercantile Exchange (CME)

Commodity Exchange, Inc. (COMEX)

Financial Instrument Exchange (Finex) a division of the New York Cotton Exchange

Board of Trade of Kansas City, Missouri, Inc.

Mid-America Commodity Exchange

New York Futures Exchange, Inc. (NYFE)

Pacific Stock Exchange

Philadelphia Board of Trade (PBOT)

Twin Cities Board of Trade

NATIONAL INSTRUMENT 81-102

APPENDIX B-1

Compliance Report

TO: [The appropriate Canadian securities regulatory authorities(170)]

FROM: [Name of mutual fund]

RE: Compliance Report on National Instrument 81-102

For the year ended [insert date]

We hereby confirm that we have complied with the applicable requirements of Parts 9, 10 and 11 of National Instrument 81-102 for the year ended [insert date] [except as follows:] [list exceptions, if any].

[NAME of mutual fund]

Signature

Name and office of the person

executing this report

Date

NATIONAL INSTRUMENT 81-102

APPENDIX B-1

Audit Report

TO: [The appropriate Canadian securities regulatory authorities]

RE: Compliance Report on National Instrument 81-102

For the year ended [insert date]

We have audited [name of mutual fund]'s report made under section 12.1 of National Instrument 81-102 regarding its compliance for the year ended [insert date] with the applicable requirements of Parts 9, 10 and 11 of that National Instrument. Compliance with these requirements is the responsibility of the management of [name of mutual fund] (the "Fund"). Our responsibility is to express an opinion on management's compliance report based on our audit.

We conducted our audit in accordance with the standards for assurance engagements established by The Canadian Institute of Chartered Accountants. Those standards require that we plan and perform an audit to obtain reasonable assurance as a basis for our opinion. Such an audit includes examining, on a test basis, evidence supporting the assertions in management's compliance report.

In our opinion, the Fund's report presents fairly, in all material respects, the Fund's compliance for the year ended [insert date] with the applicable requirements of Parts 9, 10 and 11 of National Instrument 81-102.

This report is provided solely for the purpose of assisting the securities regulatory authority [ies] to which it is addressed in discharging its [their] responsibilities and should not be used for any other purpose.

City

Date Chartered Accountants

APPENDIX B-2

Compliance Report

TO: [The appropriate Canadian securities regulatory authorities]

FROM: [Name of principal distributor] (the "Distributor")

RE: Compliance Report on National Instrument 81-102

For the year ended [insert date]

FOR: [Name(s) of the mutual fund (the "Fund[s]")]

We hereby confirm that we have complied with the applicable requirements of Parts 9, 10 and 11 of National Instrument 81-102 in respect of the Fund[s] for the year ended [insert date] [except as follows:] [list exceptions, if any].

[NAME of the Distributor]

Signature

Name and office of the person

executing this report

Date

NATIONAL INSTRUMENT 81-102

APPENDIX B-2

Audit Report

TO: [The appropriate Canadian securities regulatory authorities]

RE: Compliance Report on National Instrument 81-102

For the year ended [insert date]

We have audited [name of principal distributor]'s report made under section 12.1 of National Instrument 81-102 regarding its compliance for the year ended [insert date] with the applicable requirements of Parts 9, 10 and 11 of that National Instrument in respect of the [name of mutual funds] (the "Funds"). Compliance with these requirements is the responsibility of the management of [name of principal distributor] (the "Company"). Our responsibility is to express an opinion on management's compliance report based on our audit.

We conducted our audit in accordance with the standards for assurance engagements established by The Canadian Institute of Chartered Accountants. Those standards require that we plan and perform an audit to obtain reasonable assurance as a basis for our opinion. Such an audit includes examining, on a test basis, evidence supporting the assertions in management's compliance report.

In our opinion, the Company's report presents fairly, in all material respects, the Company's compliance for the year ended [insert date] with the applicable requirements of Parts 9, 10 and 11 of National Instrument 81-102 in respect of the Funds.

This report is provided solely for the purpose of assisting the securities regulatory authority [ies] to which it is addressed in discharging its [their] responsibilities and should not be used for any other purpose.

City

Date Chartered Accountants

NATIONAL INSTRUMENT 81-102

APPENDIX B-3

Compliance Report

TO: [The appropriate Canadian securities regulatory authorities]

FROM: [Name of participating dealer] (the "Distributor")

RE: Compliance Report on National Instrument 81-102

For the year ended [insert date]

We hereby confirm that we have sold mutual fund securities to which National Instrument 81-102 is applicable. In connection with our activities in distributing these securities, we have complied with the applicable requirements of Parts 9, 10 and 11 of National Instrument 81-102 for the year ended [insert date] [except as follows:] [list exceptions, if any].

[NAME of the Distributor]

Signature

Name and office of the person

executing this report

Date

NATIONAL INSTRUMENT 81-102

APPENDIX B-3

Audit Report

TO: [The appropriate Canadian securities regulatory authorities]

RE: Compliance Report on National Instrument 81-102

For the year ended [insert date]

We have audited [name of participating dealer]'s report made under section 12.1 of National Instrument 81-102 regarding its compliance for the year ended [insert date] with the applicable requirements of Parts 9, 10 and 11 of that National Instrument in respect of sales of mutual fund securities. Compliance with these requirements is the responsibility of the management of [name of participating dealer] (the "Company"). Our responsibility is to express an opinion on management's compliance report based on our audit.

We conducted our audit in accordance with the standards for assurance engagements established by The

Canadian Institute of Chartered Accountants. Those standards require that we plan and perform an audit to obtain reasonable assurance as a basis for our opinion. Such an audit includes examining, on a test basis, evidence supporting the assertions in management's compliance report.

In our opinion, the Company's report presents fairly, in all material respects, the Company's compliance for the year ended [insert date] with the applicable requirements of Parts 9, 10 and 11 of National Instrument 81-102 in respect of sales of mutual fund securities.

This report is provided solely for the purpose of assisting the securities regulatory authority [ies] to which it is addressed in discharging its [their] responsibilities and should not be used for any other purpose.

City

Date Chartered Accountants

COMPANION POLICY 81-102CP
TO NATIONAL INSTRUMENT 81-102
MUTUAL FUNDS

COMPANION POLICY 81-102CP TO NATIONAL INSTRUMENT 81-102
MUTUAL FUNDS
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PART TITLE

COMPANION POLICY 81-102CP TO NATIONAL INSTRUMENT 81-102

MUTUAL FUNDS

PART 1 PURPOSE

1.1 Purpose - The purpose of this Policy is to state the views of the Canadian securities regulatory authorities on various matters relating to National Instrument 81-102 Mutual Funds (the "Instrument"), including

(a) the interpretation of various terms used in the Instrument;

(b) recommendations concerning the operating procedures that the Canadian securities regulatory authorities suggest that mutual funds, or persons performing services for mutual funds, adopt to ensure compliance with the Instrument;

(c) discussions of circumstances in which the Canadian securities regulatory authorities have granted relief from particular requirements of National Policy Statement No. 39 ("NP39"), the predecessor to the Instrument, and the conditions that those authorities imposed in granting that relief; and

(d) recommendations concerning applications for approvals required under, or relief from, provisions of the Instrument.

PART 2 COMMENTS ON DEFINITIONS CONTAINED IN THE INSTRUMENT

2.1 "asset allocation service"- The definition of "asset allocation service" in the Instrument includes only specific administrative services in which an investment in mutual funds subject to the Instrument is an integral part. The Canadian securities regulatory authorities do not view this definition as including general investment services such as discretionary portfolio management that may, but are not required to, invest in mutual funds subject to this Instrument.

2.2 "cash equivalent" - The definition of "cash equivalent" in the Instrument includes certain evidences of indebtedness of Canadian financial institutions. This would include banker's acceptances.

2.3 "clearing corporation" - The definition of "clearing corporation" in the Instrument includes both incorporated and unincorporated organizations, which may, but need not, be part of an options or futures exchange.

2.4 "debt-like security" - Paragraph (b) of the definition of "debt-like security" in the Instrument provides that the value of the component of an instrument that is not linked to the underlying interest of the instrument must account for less than 80 percent of the aggregate value of the instrument in order that the instrument be considered a debt-like security. The Canadian securities regulatory authorities have structured this provision in this manner to emphasize what they consider the most appropriate manner to value these instruments. That is, one should first value the component of the instrument that is not linked to the underlying interest, as this is often much easier to value than the component that is linked to the underlying interest. The Canadian securities regulatory authorities recognize the valuation difficulties that can arise if one attempts to value, by itself, the component of an instrument that is linked to the underlying interest.

2.5 "fundamental investment objectives" - One component of the definition of "fundamental investment objectives" is that those objectives distinguish a mutual fund from other mutual funds. It is noted that this component does not imply that the fundamental investment objectives for each mutual fund must be unique. Two or more mutual funds can have identical fundamental investment objectives.

2.6 "guaranteed mortgage" - A mortgage insured under the *National Housing Act* (Canada) or similar provincial statutes is a "guaranteed mortgage" for the purposes of the Instrument.

2.7 "hedging"

(1) One component of the definition of "hedging" is the requirement that hedging transactions result in a "high degree of negative correlation between changes in the value of the investment or position, or group of investments or positions, being hedged and changes in the value of the instrument or instruments with which the investment or position is hedged". The Canadian securities regulatory authorities are of the view that there need not be complete congruence between the hedging instrument or instruments and the position or positions being hedged if it is reasonable to regard the one as a hedging instrument for the other, taking into account the closeness of the relationship between fluctuations in the price of the two and the availability and pricing of hedging instruments.

(2) The definition of "hedging" includes a reference to the "maintaining" of the position resulting from a hedging transaction or series of hedging transactions. The inclusion of this component in the definition requires a mutual fund to ensure that a transaction continues to offset specific risks of the mutual fund in order that the transaction be considered a "hedging" transaction under the Instrument; if the "hedging" position ceases to provide an offset to an existing risk of a mutual fund, then that position is no longer a hedging position under the Instrument, and can be held by the mutual fund only in compliance with the specified derivatives rules of the Instrument that apply to non-hedging positions. The component of the definition that requires the "maintaining" of a hedge position does not mean that a mutual fund is locked into a specified derivatives position; it simply means that the specified derivatives position must continue to satisfy the definition of "hedging" in order to receive hedging treatment under the Instrument.

(3) Paragraph (b) of the definition of "hedging" has been included to ensure that currency cross hedging continues to be permitted under the Instrument. Currency cross hedging is the substitution of currency risk associated with one currency for currency risk associated with another currency, if neither currency is a currency in which the mutual fund determines its net asset value and the aggregate amount of currency risk to which the mutual fund is exposed is not increased by the substitution. Currency cross hedging is to be distinguished from currency hedging, as that term is ordinarily used. Ordinary currency hedging, in the context of mutual funds, would involve replacing the mutual fund's exposure to a "non-net asset value" currency with exposure to a currency in which the mutual fund calculates its net asset value. That type of currency hedging is subject to paragraph (a) of the definition of "hedging".

2.8 "illiquid asset" - A portfolio asset of a mutual fund that meets the definition of "illiquid asset" will be an illiquid asset even if a person or company, including the manager or the portfolio adviser of a mutual fund or a partner, director or officer of the manager or portfolio adviser of a mutual fund or any of their respective associates or affiliates, has agreed to purchase the asset from the mutual fund. That type of agreement does not affect the words of the definition, which defines "illiquid asset" in terms of whether that asset cannot be readily disposed of through market facilities on which public quotations in common use are widely available.

2.9 "investor fees" - The Canadian securities regulatory authorities are of the view that the definition of "investor fees" would include all contingent or deferred sales charges, distribution fees, administration fees and account set-up or closing charges.

2.10 "manager" - The definition of "manager" under the Instrument only applies to the person or company that actually directs the business of the mutual fund, and does not apply to others, such as trustees, that do not actually carry out this function. Also, a "manager" would not include a person or company whose duties are limited to acting as a service provider to the mutual fund, such as a portfolio adviser.

2.11 "option" - The definition of "option" includes warrants, whether or not the warrants are listed on a stock exchange or quoted on an over-the-counter market.

2.12 "performance data" - The term "performance data" includes data on an aspect of the investment performance of a mutual fund, an asset allocation service, security, index or benchmark. This could include data concerning return, volatility or yield. The Canadian securities regulatory authorities note that the term "performance data" would not include a rating prepared by an independent organization reflecting the credit quality, rather than the performance, of, for instance, a mutual fund's portfolio or the participating funds of an asset allocation service.

2.13 "public medium" - An "advertisement" is defined in the Instrument to mean a sales communication that is published or designed for use on or through a "public medium". The Canadian securities regulatory authorities interpret the term "public medium" to include print, television, radio, tape recordings, video tapes, computer disks, the Internet, displays, signs, billboards, motion pictures and telephones.

2.14 "purchase"

(1) The definition of a "purchase", in connection with the acquisition of a portfolio asset by a mutual fund, means an acquisition that is the result of a decision made and action taken by the mutual fund to make the acquisition.

(2) The Canadian securities regulatory authorities consider that the following types of transactions would generally be purchases of a security by a mutual fund under the definition:

1. The mutual fund effects an ordinary purchase of the security, or, at its option, exercises, converts or exchanges a convertible security held by it.

2. The mutual fund receives the security as consideration for a security tendered by the mutual fund into a take-over bid.

3. The mutual fund receives the security as the result of a merger, amalgamation, plan of arrangement or other reorganization for which the mutual fund voted in favour.

4. The mutual fund receives the security as a result of the automatic exercise of an exchange or conversion right attached to another security held by the mutual fund in accordance with the terms of that other security or the exercise of that exchange or conversion right at the option of the mutual fund.

(3) The Canadian securities regulatory authorities consider that the following types of transactions would generally not be purchases of a security by a mutual fund under the definition:

1. The mutual fund receives the security as a result of a compulsory acquisition by an issuer following completion of a successful take-over bid.

2. The mutual fund receives the security as a result of a merger, amalgamation, plan of arrangement or other reorganization that the mutual fund voted against.

3. The mutual fund receives the security as the result of the exercise of an exchange or conversion right attached to a security held by the mutual fund made at the discretion of the issuer of the security held by the mutual fund.

2.15 "restricted security" - A special warrant is a form of restricted security and, accordingly, the provisions of the Instrument applying to restricted securities apply to special warrants.

2.16 "sales communication"

(1) The term "sales communication" refers to a communication to a securityholder of a mutual fund and to a person or company that is not a securityholder if the purpose of the communication is to induce the purchase of securities of the mutual fund. A sales communication therefore does not include a communication solely between a mutual fund or its promoter, manager, principal distributor or portfolio adviser and a participating dealer, or between the principal distributor or a participating dealer and its registered salespersons, that is indicated to be internal or confidential and that is not designed to be passed on by any principal distributor, participating dealer or registered salesperson to any securityholder of, or potential investor in, the mutual fund. In the view of the Canadian securities regulatory authorities, if a communication of that type were so passed on by the principal distributor, participating dealer or registered salesperson, the communication would be a sales communication made by the party passing on the communication if the recipient of the communication were a securityholder of the mutual fund or if the intent of the principal distributor, participating dealer or registered salesperson in passing on the communication were to induce the purchase of securities of the mutual fund.

(2) The term "sales communication" is defined in the Instrument such that the communication need not be in writing and includes any oral communication. The Canadian securities regulatory authorities are of the view that the requirements in the Instrument pertaining to sales communications would apply to statements made at an investor conference to securityholders or to others to induce the purchase of securities of the mutual fund.

(3) The Canadian securities regulatory authorities are of the view that image advertisements that are intended to promote a corporate identity or the expertise of a mutual fund manager fall outside the definition of "sales communication". However, an advertisement or other communication that refers to a specific mutual fund or funds or promotes any particular investment portfolio or strategy would be a sales communication and therefore

be required to include warnings of the type now described in section 15.4 of the Instrument.

(4) Paragraph (b) of the definition of a "sales communication" in the Instrument excludes sales communications contained in certain documents that the mutual fund is required to prepare, including audited or unaudited financial statements (which include a statement of portfolio transactions), statements of account and confirmations of trade. The Canadian securities regulatory authorities are of the view that if information is contained in these types of documents that is not required to be so included by Canadian securities legislation, any such additional material is not excluded by paragraph (b) of the definition of sales communication and may, therefore, constitute a sales communication if the additional material otherwise falls within the definition of that term in the Instrument.

2.17 "specified derivative"

(1) The term "specified derivative" is defined to mean an instrument, agreement or security, the market price, value or payment obligations of which are derived from, referenced to or based on an underlying interest. Certain instruments, agreements or securities that would otherwise be specified derivatives within the meaning of the definition are then excluded from the definition for purposes of the Instrument.

(2) Because of the broad ambit of the lead-in language to the definition, it is impossible to list every instrument, agreement or security that might be caught by that lead-in language but that is not considered to be a derivative in any normal commercial sense of that term. The Canadian securities regulatory authorities consider conventional floating rate debt instruments, securities of a mutual fund or commodity pool, non-redeemable securities of an investment fund, American depositary receipts and instalment receipts to be within this category and will not treat those instruments as a specified derivative in administering the Instrument.

2.18 "standardized future" - The definition of "standardized future" refers to an agreement traded on a futures exchange. This type of agreement is called a "futures contract" in the legislation of some jurisdictions, and an "exchange contract" in the legislation of some other jurisdictions (such as British Columbia and Alberta). The term "standardized future" is used in the Instrument to refer to these types of contracts, to avoid conflict with existing local definitions.

2.19 "swap" - The Canadian securities regulatory authorities are of the view that the definition of a swap in the Instrument would include conventional interest rate and currency swaps, as well as equity swaps.

PART 3 INVESTMENTS

3.1 Evidences of Indebtedness of Foreign Governments and Supranational Agencies

(1) Section 2.1 of the Instrument prohibits mutual funds from purchasing a security of an issuer, other than a government security or a security issued by a clearing corporation if, immediately after the purchase, more than 10 percent of the net assets of the mutual fund, taken at market value at the time of the purchase, would be invested in securities of that issuer. The term "government security" is defined in the Instrument as an evidence of indebtedness that is issued, or fully and unconditionally guaranteed as to principal and interest, by any of the government of Canada, the government of a jurisdiction or the government of the United States of America.

(2) Before the Instrument came into force, the Canadian securities regulatory authorities granted relief from the predecessor provision of NP39 to a number of international bond funds in order to permit those mutual funds to pursue their fundamental investment objectives with greater flexibility.

(3) The Canadian securities regulatory authorities will continue to consider applications for relief from section 2.1 of the Instrument if the mutual fund making the application demonstrates that the relief will better enable the mutual fund to meet its fundamental investment objectives. This relief will ordinarily be restricted to international bond funds.

(4) The relief from paragraph 2.04(1)(a) of NP39, which is replaced by section 2.1 of the Instrument, that has been provided to a mutual fund has generally been limited to the following circumstances:

1. The mutual fund has been permitted to invest up to 20 percent of its net assets, taken at market value at the time of purchase, in evidences of indebtedness of any one issuer if those evidences of indebtedness are issued, or guaranteed fully as to principal and interest, by supranational agencies or governments other than the government of Canada, the government of a jurisdiction or the government of the United States of America and are rated "AA" by Standard & Poor's, or have an equivalent rating by one or more other approved credit rating organizations.

2. The mutual fund has been permitted to invest up to 35 percent of its net assets, taken at market value at the time of purchase, in evidences of indebtedness of any one issuer, if those securities are issued by issuers described in paragraph 1 and are rated "AAA" by Standard & Poor's, or have an equivalent rating by one or more other approved credit rating organizations.

(5) It is noted that the relief described in paragraphs 3.1(4)1 and 2 cannot be combined for one issuer.

(6) Despite subsection (4), the relief from paragraph 2.04(1)(a) of NP39, which is replaced by section 2.1 of the Instrument, provided to a mutual fund whose securities are a registered investment under the ITA or whose securities are not, and are described in the current prospectus or simplified prospectus of the mutual fund as not being, foreign property under the ITA has generally been restricted to allowing the mutual fund to invest no more than 20 percent of its net assets, taken at market value at the time of purchase, in securities issued by issuers described in subsection (4) if the securities of those issuers are foreign property under the ITA.

(7) In addition to the limitation described in subsection (6), the relief from paragraph 2.04(1)(a) of NP39, which is replaced by section 2.1 of the Instrument, has generally been provided only if

(a) the securities that may be purchased under the relief referred to in subsections (4) and (6) are traded on a mature and liquid market;

(b) the acquisition of the evidences of indebtedness by the mutual fund is consistent with its fundamental investment objectives;

(c) the prospectus or simplified prospectus of the mutual fund disclosed the additional risks associated with the concentration of the net assets of the mutual fund in securities of fewer issuers, such as the potential additional exposure to the risk of default of the issuer in which the fund has so invested and the risks, including foreign exchange risks, of investing in the country in which that issuer is located; and

(d) the prospectus or simplified prospectus of the mutual fund gave details of the relief provided by the Canadian securities regulatory authorities, including the conditions imposed and the type of securities covered by the exemption.

3.2 Special Warrants - A mutual fund is required by subsection 2.2(3) of the Instrument to assume the conversion of each special warrant it holds. This requirement is imposed because the nature of a special warrant is such that there is a high degree of likelihood that its conversion feature will be exercised shortly after its issuance, once a prospectus relating to the underlying security has been filed.

3.3 Investment in Other Mutual Funds

(1) Subsection 2.5(1) of the Instrument contains restrictions on the ability of a mutual fund to invest in the securities of another mutual fund. Subsection 2.5(2) of the Instrument provides that subsection (1) does not apply to the purchase of a mutual fund that is listed and posted for trading on a stock exchange.

(2) Subsection 2.5(2) of the Instrument removes from the fund of fund rules any security of an issuer that may technically be a mutual fund, such as a subdivided offering or an index participation unit, but that is not a conventional mutual fund and for which the fund of fund rules should not be applicable. Since those vehicles are generally listed on a stock exchange, the Canadian securities regulatory authorities have used this distinguishing feature to define the vehicles whose securities may be purchased by a mutual fund without regard to the fund of funds regime. The purchase of those vehicles is, of course, subject to the other investment restrictions of the

Instrument.

3.4 Instalments of Purchase Price - Paragraph 2.6(d) of the Instrument prohibits a mutual fund from purchasing a security, other than a specified derivative, that by its terms may require the mutual fund to make a contribution in addition to the payment of the purchase price. This prohibition does not extend to the purchase of securities that are paid for on an instalment basis in which the total purchase price and the amounts of all instalments are fixed at the time the first instalment is made.

3.5 Purchase of Evidences of Indebtedness - Paragraph 2.6(f) of the Instrument prohibits a mutual fund from lending either money or a portfolio asset other than money. The Canadian securities regulatory authorities are of the view that the purchase of an evidence of indebtedness, such as a bond or debenture, a loan participation or loan syndication as permitted by paragraph 2.3(i) of the Instrument, or the purchase of a preferred share that is treated as debt for accounting purposes, does not constitute the lending of money or a portfolio asset.

PART 4 USE OF SPECIFIED DERIVATIVES

4.1 Exercising Options on Futures - Paragraphs 2.8(1)(d) and (e) of the Instrument prohibit a mutual fund from, among other things, opening and maintaining a position in a standardized future except under the conditions referred to in those paragraphs. Opening and maintaining a position in a standardized future could be effected through the exercise by a mutual fund of an option on futures. Therefore, it should be noted that a mutual fund cannot exercise an option on futures and assume a position in a standardized future unless the applicable provisions of paragraphs 2.8(1)(d) or (e) are satisfied.

4.2 Registration Matters - The Canadian securities regulatory authorities remind industry participants of the following requirements contained in securities legislation:

1. A mutual fund may only invest in or use clearing corporation options and over-the-counter options if the portfolio adviser advising with respect to these investments

(a) is permitted, either by virtue of registration as an adviser under the securities legislation or commodity futures legislation of the jurisdiction in which the portfolio adviser is providing the advice or an exemption from the requirement to be registered, to provide that advice to the mutual fund under the laws of that jurisdiction; and

(b) has satisfied all applicable option proficiency requirements of that jurisdiction which, ordinarily, will involve completion of the Canadian Options Course.

2. A mutual fund may invest in or use futures and options on futures only if the portfolio adviser advising with respect to these investments or uses is registered as an adviser under the securities or commodity futures legislation of the jurisdiction in which the portfolio adviser is providing the advice, if this registration is required in that jurisdiction, and meets the proficiency requirements for advising with respect to futures and options on futures in the jurisdiction.

3. A portfolio adviser of a mutual fund that receives advice from a non-resident sub-adviser as contemplated by section 2.10 of the Instrument is not relieved from the registration requirements described in paragraphs 1 and 2.

4. In addition, section 2.10 does not exempt a non-resident sub-adviser from the requirement to be registered under the commodities futures legislation of Ontario. A non-resident sub-adviser should apply for an exemption in Ontario if it wishes to carry out the arrangements contemplated by section 2.10 without being registered in Ontario under that legislation.

4.3 Leveraging - The Instrument is designed to prevent the use of specified derivatives for the purpose of leveraging the assets of the mutual fund. The definition of "hedging" prohibits leveraging with specified derivatives used for hedging purposes. The provisions of subsection 2.8(1) of the Instrument restrict leveraging with specified derivatives used for non-hedging purposes.

PART 5 LIABILITY AND INDEMNIFICATION

5.1 Liability and Indemnification

(1) Subsection 4.4(1) of the Instrument contains provisions that require that any agreement or declaration of trust by which a person or company becomes the manager of a mutual fund provide that the manager is responsible for any loss that arises out of the failure of it, and any person or company providing services to the mutual fund or to the manager in connection with the mutual fund, to satisfy the standard of care referred to in that section. Subsection 4.4(2) of the Instrument provides that a mutual fund shall not relieve the manager from that liability.

(2) The purpose of these provisions is to ensure that the manager remains responsible to the mutual fund and therefore indirectly to its securityholders for the duty of care that is imposed by the Canadian securities legislation of most jurisdictions, and to clarify that the manager is responsible to ensure that service providers perform to the level of that standard of care. The Instrument does not regulate the contractual relationships between the manager and service providers; whether a manager can seek indemnification from a service provider that fails to satisfy that standard of care is a contractual issue between those parties.

(3) Subsection 4.4(5) of the Instrument provides that section 4.4 does not apply to any losses to a mutual fund or securityholder arising out an action or inaction by a custodian or sub-custodian. A separate liability regime is imposed on those entities by section 6.6 of the Instrument.

PART 6 SECURITYHOLDER MATTERS

6.1 Meetings of Securityholders - Subsection 5.4(1) of the Instrument imposes a requirement that a meeting of securityholders of a mutual fund called for the purpose of considering any of the matters referred to in section 5.1 of the Instrument must be called on notice sent at least 21 days before the date of the meeting. Industry participants are reminded that the provisions of National Instrument 54-101 Communication with Beneficial Owners of Securities of a Reporting Issuer may apply to any meetings of securityholders of mutual funds and that those provisions may require that a longer period of notice be given.

6.2 Limited Liability

(1) Mutual funds generally are structured in a manner that ensures that investors are not exposed to the risk of loss of an amount more than their original investment. The CSA consider this a very important and essential attribute of funds.

(2) Mutual funds that are structured as corporations do not raise pressing liability problems because of the limited liability regime of corporate statutes.

(3) Mutual funds that are structured as limited partnerships may raise some concerns about the loss of limited liability if limited partners participate in the management or control of the partnership. The Canadian securities regulatory authorities encourage managers of mutual funds that are structured as limited partnerships to consider this issue in connection with the holding of meetings of securityholders, even if required under section 5.1 of the Instrument. A manager that has determined that a problem may arise in a specific circumstance should consult with the Canadian securities regulatory authority in its jurisdiction. In addition, all managers of mutual funds that are structured as limited partnerships should consider whether disclosure and discussion of this issue should be included as a risk factor in simplified prospectuses.

6.3 Calculation of Fees - Paragraph 5.1(a) of the Instrument requires securityholder approval before the basis of the calculation of a fee or expense that is charged to a mutual fund is changed in a way that could result in an increase in charges to the mutual fund. The Canadian securities regulatory authorities note that the phrase "basis of the calculation" includes any increase in the rate at which a particular fee is charged to the mutual fund.

PART 7 CHANGES

7.1 Integrity and Competence of Mutual Fund Management Groups

(1) Paragraph 5.5(1)(a) of the Instrument requires that the approval of the securities regulatory authority be obtained before the manager of a mutual fund is changed. Subsection 5.5(2) of the Instrument contemplates similar approval to a change in control of a manager.

(2) In connection with each of these approvals, applicants are required by section 5.7 of the Instrument to provide information to the securities regulatory authority concerning the integrity and experience of the persons or companies that are proposed to be involved in, or control, the management of the mutual fund after the proposed transaction.

(3) The Canadian securities regulatory authorities would generally consider it helpful in their assessment of the integrity and experience of the proposed new management group that will manage a mutual fund after a change in manager if the application set out, among any other information the applicant wishes to provide

(a) the name, registered address and principal business activity or the name, residential address and occupation or employment of

(i) if the proposed manager is not a public company, each beneficial owner of securities of each shareholder, partner or limited partner of the proposed manager, and

(ii) if the proposed manager is a public company, each beneficial owner of securities of each shareholder of the proposed manager that is the beneficial holder, directly or indirectly, of more than 10 percent of the outstanding securities of the proposed manager; and

(b) information concerning

(i) if the proposed manager is not a public company, each shareholder, partner or limited partner of the proposed manager,

(ii) if the proposed manager is a public company, each shareholder that is the beneficial holder, directly or indirectly, of more than 10 percent of the outstanding securities of the proposed manager,

(iii) each director and officer of the proposed manager, and

(iv) each proposed director, officer or individual trustee of the mutual fund.

(4) The Canadian securities regulatory authorities would generally consider it helpful if the information relating to the persons and companies referred to in paragraph (3)(b) included

(a) for a company

(i) its name, registered address and principal business activity,

(ii) the number of securities or partnership units of the proposed manager beneficially owned, directly or indirectly, and

(iii) particulars of any existing or potential conflicts of interest that may arise as a result of the activities of the company and its relationship with the management group of the mutual fund; and

(b) for an individual

(i) his or her name, birthdate and residential address,

(ii) his or her principal occupation or employment,

(iii) his or her principal occupations or employment during the five years before the date of the application, with a particular emphasis on the individual's experience in the financial services industry,

(iv) the individual's educational background, including information regarding courses successfully taken that relate to the financial services industry,

(v) his or her position and responsibilities with the proposed manager or the controlling shareholders of the proposed manager or the mutual fund,

(vi) whether he or she is, or within five years before the date of the application has been, a director, officer or promoter of any reporting issuer other than the mutual fund, and if so, disclosing the names of the reporting issuers and their business purpose, with a particular emphasis on relationships between the individual and other mutual funds,

(vii) the number of securities or partnership units of the proposed manager beneficially owned, directly or indirectly,

(viii) particulars of any existing or potential conflicts of interest that may arise as a result of the individual's outside business interests and his or her relationship with the management group of the mutual fund, and

(ix) a description of the individual's relationships to the proposed manager and other service providers to the mutual fund.

(5) The Canadian securities regulatory authorities would generally consider it helpful in their assessment of the integrity and experience of the persons or companies that are proposed to manage a mutual fund after a change of control of the manager, if the application set out, among any other information that applicant wishes to provide, a description of

(a) the proposed corporate ownership of the manager of the mutual fund after the proposed transaction, indicating for each proposed direct or indirect shareholder of the manager of the mutual fund the information about that shareholder referred to in subsection (4);

(b) the proposed officers and directors of the manager of the mutual fund, of the mutual fund and of each of the proposed controlling shareholders of the mutual fund, indicating for each individual, the information about that individual referred to in subsection (4);

(c) any anticipated changes to be made to the officers and directors of the manager of the mutual fund, of the mutual fund and of each of the proposed controlling shareholders of the mutual fund that are not set out in paragraph (b); and

(d) the relationship of the members of the proposed controlling shareholders and the other members of the management group to the manager and any other service provider to the mutual fund.

7.2 Change of Fundamental Investment Objectives - Paragraph 5.1(c) of the Instrument requires that the approval of securityholders be obtained before any change is made to the fundamental investment objectives of a mutual fund. The fundamental investment objectives of a mutual fund are required to be disclosed in a simplified prospectus under National Instrument 81-101 and include both details about the fundamental nature of the investments to be made by the mutual fund and whether the mutual fund will be managed so as to constitute foreign property under the ITA. Accordingly, any change to the mutual fund requiring a change to that disclosure would trigger the requirement for securityholder approval under paragraph 5.1(c) of the Instrument.

7.3 Mergers and Conversions of Mutual Funds

(1) Subsection 5.6(1) of the Instrument provides that mergers or conversions of mutual funds may be carried out on the conditions described in that subsection without prior approval of the securities regulatory authority. The

Canadian securities regulatory authorities consider that the types of transactions contemplated by subsection 5.6 (1) of the Instrument when carried out in accordance with the conditions of that subsection address the fundamental regulatory concerns raised by mergers and conversions of mutual funds. Subsection 5.6(1) is designed to facilitate consolidations of mutual funds within fund families that have similar fundamental investment objectives and strategies and that are operated in a consistent and similar fashion. Since subsection 5.6(1) will be unavailable unless the mutual funds involved in the transaction have substantially similar fundamental investment objectives and strategies and are operated in a substantially similar fashion, the Canadian securities regulatory authorities do not expect that the portfolios of the consolidating funds will be required to be realigned to any great extent before a merger. If realignment is necessary, the Canadian securities regulatory authorities note that paragraph 5.6(1)(h) of the Instrument provides that none of the costs and expenses associated with the transaction may be borne by the mutual fund. Brokerage commissions payable as a result of any portfolio realignment necessary to carry out the transaction would, in the view of the Canadian securities regulatory authorities, be costs and expenses associated with the transaction.

(2) The Canadian securities regulatory authorities also note that, despite subsection 5.6(1) of the Instrument, approval for certain transactions may be required by section 277 and subsections 283(1) and 283(2) of the Regulations to the *Securities Act* (Quebec).

7.4 Regulatory Approval for Reorganizations

(1) Paragraph 5.7(1)(b) of the Instrument requires certain details to be provided in respect of an application for regulatory approval required by paragraph 5.5(1)(b) that is not automatically approved under subsection 5.6(1). The Canadian securities regulatory authorities will be reviewing this type of proposed transaction, among other things, to ensure that adequate disclosure of the differences between the funds participating in the proposed transaction is given to securityholders of the mutual fund that will be merged, reorganized or amalgamated with another mutual fund.

(2) If a mutual fund is proposed to be merged, amalgamated or reorganized with a mutual fund that has a net asset value that is smaller than the net asset value of the terminating mutual fund, the Canadian securities regulatory authorities will consider the implications of the proposed transaction on the smaller continuing mutual fund. The Canadian securities regulatory authorities believe that this type of transaction generally would constitute a significant change for the smaller continuing mutual fund, thereby triggering the requirements of paragraph 5.1(g) and section 5.10 of the Instrument.

7.5 Significant Changes

(1) The Canadian securities regulatory authorities will not outline all changes in a mutual fund that could constitute a significant change for the mutual fund within the meaning of the Instrument. However, they wish to state their views of two matters in this Policy.

(2) First, the Canadian securities regulatory authorities note that the change of portfolio adviser of a mutual fund will generally constitute a significant change for the mutual fund.

(3) In addition, the departure of a high-profile individual from the employ of a portfolio adviser of a mutual fund may constitute a significant change for the mutual fund, depending on the circumstances surrounding the individual. The definition of significant change is based on a change in the business, operations or affairs of a mutual fund that would be considered important by a reasonable investor or securityholder. Whether such a person would consider the departure of a high-profile individual to be important in this sense would likely depend substantially on how prominently the mutual fund featured that individual in its marketing. The Canadian securities regulatory authorities consider it unlikely that a mutual fund that emphasized the ability of a particular individual to encourage investors to purchase the fund could later take the position that the departure of that individual was immaterial to investors and therefore not a significant change.

PART 8 CUSTODIANSHIP OF PORTFOLIO ASSETS

8.1 Standard of Care - The standard of care prescribed by section 6.6 of the Instrument is a minimum standard

only. Similarly, the provisions of section 6.5 of the Instrument, designed to protect a mutual fund from loss in the event of the insolvency of those holding its portfolio assets, are minimum requirements. The Canadian securities regulatory authorities are of the view that the requirements set out in section 6.5 may require custodians and sub-custodians to take such additional steps as may be necessary or desirable properly to protect the portfolio assets of the mutual fund in that foreign jurisdiction and to ensure that those portfolio assets are unavailable to satisfy the claims of creditors of the custodian or sub-custodian, having regard to creditor protection and bankruptcy legislation of any foreign jurisdiction in which portfolio assets of a mutual fund may be located.

8.2 Book-Based System

(1) Subsection 6.5(3) of the Instrument provides that a custodian or sub-custodian of a mutual fund may arrange for the deposit of portfolio assets of the mutual fund with a depository, or clearing agency, that operates a book-based system. Such depositories or clearing agencies include The Canadian Depository For Securities Limited, the Depository Trust Company or any other domestic or foreign depository or clearing agency that is incorporated or organized under the laws of a country or a political subdivision of a country and operates a book-based system in that country or political subdivision or operates a transnational book-based system.

(2) A depository or clearing agency that operates a book-based system used by a mutual fund is not considered to be a custodian or sub-custodian of the mutual fund.

8.3 Compliance - Paragraph 6.7(1)(c) of the Instrument requires the custodian of a mutual fund to make any changes periodically that may be necessary to ensure that the custodian and sub-custodian agreements comply with Part 6, and that there is no sub-custodian of the mutual fund that does not satisfy the applicable requirements of sections 6.2 or 6.3. The Canadian securities regulatory authorities note that necessary changes to ensure this compliance could include a change of sub-custodian.

PART 9 CONTRACTUAL PLANS

9.1 Contractual Plans - Industry participants are reminded that the term "contractual plan" used in Part 8 of the Instrument is a defined term in the securities legislation of most jurisdictions, and that contractual plans as so defined are not the same as automatic or periodic investment plans. The distinguishing feature of a contractual plan is that sales charges are not deducted at a constant rate as investments in mutual fund securities are made under the plan; rather, proportionately higher sales charges are deducted from the investments made during the first year, or in some plans the first two years.

PART 10 SALES AND REDEMPTIONS OF SECURITIES

10.1 General - Parts 9, 10 and 11 of the Instrument are intended to ensure that

(a) investors' money is received by a mutual fund promptly;

(b) the opportunity for loss of an investors' money before investment in the mutual fund is minimized; and

(c) the mutual fund or the appropriate investor receives all interest that accrues on money during the periods between delivery of the money by an investor until investment in the mutual fund, in the case of the purchase of mutual fund securities, or between payment of the money by the mutual fund until receipt by the investor, in the case of redemptions.

10.2 Interpretation

(1) The Instrument refers to "securityholders" of a mutual fund in several provisions, most notably in Parts 9 and 10 when referring to purchase and redemption orders received by a mutual fund or a participating dealer or principal distributor from "securityholders".

(2) Mutual funds must keep a record of the holders of their securities. A mutual fund registers a holder of its

securities on this record as requested by the person or company placing a purchase order or as subsequently requested by that registered securityholder. The Canadian securities regulatory authorities are of the view that a mutual fund is entitled to rely on its register of holders of securities to determine the names of such holders and in its determination as to whom it is to take instructions from.

(3) Accordingly, when the Instrument refers to "securityholder" of a mutual fund, it is referring to the securityholder registered as a holder of securities on the records of the mutual fund. If that registered securityholder is a participating dealer acting for its client, the mutual fund deals with and takes instructions from that participating dealer. The Instrument does not regulate the relationship between the participating dealer and his or her client for whom the participating dealer is acting as agent. The Canadian securities regulatory authorities note however, that the participating dealer should, as a matter of prudent business practice, obtain appropriate instructions, in writing, from its client when dealing with the client's beneficial holdings in a mutual fund.

10.3 Receipt of Orders

(1) A principal distributor or participating dealer of a mutual fund should endeavour, to the extent possible, to receive money to be invested in the mutual fund at the time the order to which they pertain is placed.

(2) A dealer receiving an order for redemption should, at the time of receipt of the investor's order, obtain from the investor all relevant documentation required by the mutual fund in respect of the redemption including, without limitation, any written request for redemption that may be required by the mutual fund, duly completed and executed, and any certificates representing the mutual fund securities to be redeemed, so that all required documentation is available at the time the redemption order is transmitted to the mutual fund or to its principal distributor for transmittal to the mutual fund.

10.4 Backward Pricing - Sections 9.3 and 10.3 of the Instrument provide that the issue price or the redemption price of a security of a mutual fund to which a purchase order or redemption order pertains shall be the net asset value per security, next determined after the receipt by the mutual fund of the relevant order. For clarification, the Canadian securities regulatory authorities emphasize that the issue price and redemption price cannot be based upon any net asset value calculated before receipt by the mutual fund of the relevant order.

10.5 Coverage of Losses

(1) Subsection 9.4(6) of the Instrument provides that certain participating dealers may be required to compensate a mutual fund for a loss suffered as the result of a failed settlement of a purchase of securities of the mutual fund. Similarly, subsection 10.5(3) of the Instrument provides that certain participating dealers may be required to compensate a mutual fund for a loss suffered as the result of a redemption that could not be completed due to the failure to satisfy the requirements of the mutual fund concerning redemptions.

(2) The Canadian securities regulatory authorities have not carried forward into the Instrument the provisions contained in NP39 relating to a participating dealer's ability to recover from their clients or other participating dealers any amounts that they were required to pay to a mutual fund. If participating dealers wish to provide for such rights they should make the appropriate provisions in the contractual arrangements that they enter into with their clients or other participating dealers.(171)

PART 11 COMMINGLING OF MONEY

11.1 Commingling of Money

(1) Part 11 of the Instrument requires principal distributors and participating dealers to account separately for money they may receive for the purchase of, or upon the redemption of, mutual fund securities. Those principal distributors and participating dealers are prohibited from commingling any money so received with their other assets or with money held for the purchase or upon the sale of securities of other types of securities. The Canadian securities regulatory authorities are of the view that this means that dealers may not deposit into the

trust accounts established under Part 11 money obtained from the purchase or sale of other types of securities such as guaranteed investment certificates, government treasury bills, segregated funds, bonds or equity securities.

(2) Subsections 11.1(2) and 11.2(2) of the Instrument state that principal distributors and participating dealers, respectively, may not use any money received for the investment in mutual fund securities to finance their own operations. The Canadian securities regulatory authorities are of the view that any costs associated with returned client cheques that did not have sufficient funds to cover a trade ("NSF cheques") are a cost of doing business and should be borne by the applicable principal distributor or participating dealer and should not be offset by interest income earned on the trust accounts established under Part 11 of the Instrument.

(3) No overdraft positions should arise in these trust accounts.

(4) Subsections 11.1(3) and 11.2(3) of the Instrument prescribe the circumstances under which a principal distributor or participating dealer, respectively may withdraw funds from the trust accounts established under Part 11 of the Instrument. This would prevent the practice of "lapping". Lapping occurs as a result of the timing differences between trade date and settlement date, with money of a mutual fund client held for a trade which has not yet settled is used to settle a trade for another mutual fund client who has not provided adequate money to cover the settlement of that other trade on the settlement date. The Canadian securities regulatory authorities view this practice as a violation of subsections 11.1(3) and 11.2(3) of the Instrument.

(5) Subsections 11.1(4) and 11.2(4) of the Instrument require that interest earned on money held in the trust accounts established under Part 11 of the Instrument be paid to the applicable mutual fund or its securityholders "pro rata based on cash flow". The Canadian securities regulatory authorities are of the view that this requirement means, in effect, that the applicable mutual fund or securityholder should be paid the amount of interest that the mutual fund or securityholder would have received had the money held in trust for that mutual fund or securityholder been the only money held in that trust account.

PART 12 PROHIBITED REPRESENTATIONS AND SALES COMMUNICATIONS

12.1 Misleading Sales Communications

(1) Part 15 of the Instrument prohibits misleading sales communications relating to mutual funds and asset allocation services. Whether a particular description, representation, illustration or other statement in a sales communication is misleading depends upon an evaluation of the context in which it is made. The following list sets out some of the circumstances, in the view of the Canadian securities regulatory authorities, in which a sales communication would be misleading. No attempt has been made to enumerate all such circumstances since each sales communication must be assessed individually.

1. A statement would be misleading if it lacks explanations, qualifications, limitations or other statements necessary or appropriate to make the statement not misleading.

2. A representation about past or future investment performance would be misleading if it is

(a) a portrayal of past income, gain or growth of assets that conveys an impression of the net investment results achieved by an actual or hypothetical investment that is not justified under the circumstances;

(b) a representation about security of capital or expenses associated with an investment that is not justified under the circumstances or a representation about possible future gains or income; or

(c) a representation or presentation of past investment performance that implies that future gains or income may be inferred from or predicted based on past investment performance or portrayals of past performance.

3. A statement about the characteristics or attributes of a mutual fund or an asset allocation service would be misleading if

(a) it concerns possible benefits connected with or resulting from services to be provided or methods of operation and does not give equal prominence to discussion of any risks or associated limitations;

(b) it makes exaggerated or unsubstantiated claims about management skill or techniques; characteristics of the mutual fund or asset allocation service; an investment in securities issued by the fund or recommended by the service; services offered by the fund, the service or their respective manager; or effects of government supervision; or

(c) it makes unwarranted or incompletely explained comparisons to other investment vehicles or indices.

4. A sales communication that quoted a third party source would be misleading if the quote were out of context and proper attribution of the source were not given.

(2) Performance data information may be misleading even if it complies technically with the requirements of the Instrument. For instance, subsections 15.8(1) and (2) of the Instrument contain requirements that the standard performance data for mutual funds given in sales communications be for prescribed periods falling within prescribed amounts of time before the date of the appearance or use of the advertisement or first date of publication of any other sales communication. That standard performance data may be misleading if it does not adequately reflect intervening events occurring after the prescribed period. An example of such an intervening event would be, in the case of money market funds, a substantial decline in interest rates after the prescribed period.

(3) An advertisement that presents information in a manner that distorts information contained in the preliminary prospectus or prospectus, or preliminary simplified prospectus and annual information form, of a mutual fund or that includes a visual image that provides a misleading impression will be considered to be misleading.

(4) Any discussion of the income tax implications of an investment in a mutual fund security should be balanced with a discussion of any other material aspects of the offering.

(5) Paragraph 15.2(1)(b) of the Instrument provides that sales communications may not include any statement that conflicts with information that is contained in, among other things, a simplified prospectus. The Canadian securities regulatory authorities are of the view that a sales communication that provides performance data in compliance with the requirements of Part 15 of the Instrument for time periods that differ from the time periods for which performance data is required to be provided in a simplified prospectus under National Instrument 81-101 is not thereby in violation of the requirements of paragraph 15.2(1)(b) of the Instrument.

(6) Subsection 15.3(1) of the Instrument permits a mutual fund or asset allocation service to compare its performance to, among other things, other types of investments or benchmarks on certain conditions. Examples of such other types of investments or benchmarks to which the performance of a mutual fund or asset allocation service may be compared include consumer price indices; stock, bond or other types of indices; averages; returns payable on guaranteed investment certificates or other certificates of deposit; and returns from an investment in real estate.

(7) Paragraph 15.3(1)(c) of the Instrument requires that if the performance of a mutual fund or asset allocation service is compared to that of another investment or benchmark, the comparison sets out clearly any factors necessary to ensure that the comparison is fair and not misleading. Such factors would include an explanation of any relevant differences between the mutual fund or asset allocation service and the investment or benchmark to which it is compared. Examples of such differences include any relevant differences in the guarantees of, or insurance on, the principal of or return from the investment or benchmark; fluctuations in principal, income or total return; any differing tax treatment; and, for a comparison to an index or average, any differences between the composition or calculation of the index or average and the investment portfolio of the mutual fund or asset allocation service.

12.2 Other Provisions

(1) Subsection 15.9(1) of the Instrument imposes certain disclosure requirements for sales communications in

circumstances in which there was a change in the business, operations or affairs of a mutual fund or asset allocation service during or after a performance measurement period of performance data contained in the sales communication that could have materially affected the performance of the mutual fund or asset allocation service. Examples of these changes are changes in the management, investment objectives, portfolio adviser, ownership of the manager, fees and charges, or of policies concerning the waiving or absorbing of fees and charges, of the mutual fund or asset allocation service; or of a change in the characterization of the mutual fund as a money market fund.

(2) Paragraph 15.11(1)5 of the Instrument requires that no non-recurring fees and charges that are payable by some or all securityholders and no recurring fees and charges that are payable by some but not all securityholders be assumed in calculating standard performance data. Examples of non-recurring types of fees and charges are front-end sales commissions and contingent deferred sales charges, and examples of recurring types of fees and charges are the annual fees paid by purchasers who purchased on a contingent deferred charge basis.

(3) Paragraphs 15.11(1)2 and 15.11(2)2 of the Instrument require that no fees and charges related to optional services be assumed in calculating standard performance data. Examples of these fees and charges include transfer fees, except in the case of an asset allocation service, and fees and charges for registered retirement savings plans, registered retirement income funds, registered education savings plans, pre-authorized investment plans and systematic withdrawal plans.

(4) The Canadian securities regulatory authorities are of the view that it is inappropriate and misleading for a mutual fund that is continuing following a merger to prepare and use *pro forma* performance information or financial statements that purport to show the combined performance of the two funds during a period before their actual merger. The Canadian securities regulatory authorities are of the view that such *pro forma* information is hypothetical, involving the making of many assumptions that could affect the results.

PART 13 EXEMPTIONS AND APPROVALS

13.1 Need for Multiple or Separate Applications

(1) The Canadian securities regulatory authorities note that a person or company that obtains an exemption from a provision of the Instrument need not apply again for the same exemption at the time of each prospectus or simplified prospectus refiling unless there has been some change in an important fact relating to the granting of the exemption. This also applies to exemptions from NP39 granted before the Instrument; as provided in section 19.2 of the Instrument, it is not necessary to obtain an exemption from the corresponding provision of the Instrument.

(2) It should be noted that the principle described in subsection (1) does not necessarily apply to applications required to be made under the Regulations to the *Securities Act* (Quebec) for relief from provisions of those Regulations that are substantially similar to those contained in the Instrument. In that case, an application may be required with each refiling of a prospectus or simplified prospectus of a mutual fund.

(3) In Quebec, it may be necessary to apply separately for exemptions from Sections 277 to 293 of the Regulations to the *Securities Act* (Quebec) that duplicate the matters discussed in the Instrument, such as investment restrictions.

13.2 Exemptions under Prior Policies

(1) Subsection 19.2(1) of the Instrument provides that a mutual fund that has obtained, from the regulatory or securities regulatory authority, an exemption from a provision of NP 39 before the Instrument came into force is granted an exemption from any substantially similar provision of the Instrument, if any, on the same conditions, if any, contained in the earlier exemption.

(2) The Canadian securities regulatory authorities are of the view that the fact that a number of small amendments have been made to many of the provisions of the Instrument from the corresponding provision of NP39 should not lead to the conclusion that the provisions are not "substantially similar", if the general purpose

of the provisions remain the same. For instance, even though some changes have been made in the Instrument, the Canadian securities regulatory authorities consider paragraph 2.2(1)(a) of the Instrument to be substantially similar to paragraph 2.04(1)(b) of NP39, in that the primary purpose of both provisions is to prohibit mutual funds from acquiring securities of an issuer sufficient to permit the mutual fund to control or significantly influence the control of that issuer.

13.3 Waivers and Orders concerning "Fund of Funds" - The CSA in a number of jurisdictions have provided waivers and orders from NP39 and securities legislation to permit "fund of funds" to exist and carry on investment activities not otherwise permitted by NP39 or securities legislation. Some of those waivers and orders contained "sunset" provisions that provided that they expired when legislation or a CSA policy or rule came into force that effectively provided for a new "fund of funds" regime. For greater certainty, the Canadian securities regulatory authorities note that the coming into force of the Instrument will not trigger the "sunset" of those waivers and orders.

FootNotes

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1. In Ontario, at (1997) 20 OSCB (Supp2)3.

2. Part 18 of the proposed National Instrument is a reformulation of National Policy Statement No. 34 ("NP34"), which it will replace.

3. In Ontario, at (1998) 21 OSCB 4793.

4. Labour sponsored investment funds must also comply, if publicly offered in Ontario, with certain regulations contained in the Regulation made under the *Securities Act* (Ontario); mortgage funds must also comply with National Policy Statement No. 29 (which will, in due course, be reformulated as proposed National Instrument 81-103 Mortgage Funds); and commodity pools must also comply with OSC Policy Statement No. 11.4, which is being reformulated as proposed National Instrument 81-104 Commodity Pools.

5. The proposed National Instrument is based on National Policy Statement No. 39 ("NP39") and, in respect of Part 18, National Policy Statement No. 34 ("NP34"). The proposed National Instrument is expected to be adopted as a rule in British Columbia, Alberta, Manitoba, Ontario and Nova Scotia, as a Commission regulation in Saskatchewan and as a policy in all other jurisdictions represented by the CSA.

This is the second publication for comment of the proposed National Instrument, and amends the draft published in June 1997 (the "1997 Draft"). Amendments to the 1997 Draft have been made as the result of comments received on that draft and as the result of further consideration of this Instrument by the CSA. Substantive amendments from the 1997 Draft are discussed in the footnotes to this Instrument. Amendments from the 1997 Draft made only for clarification or drafting purposes are generally not discussed in the footnotes.

Proposed National Instrument 81-101 Mutual Fund Prospectus Disclosure ("NI81-101") and the related forms incorporate the disclosure obligations contained in the 1997 Draft. Those disclosure provisions have been deleted from this Instrument so that all disclosure provisions concerning conventional mutual funds will be contained in NI81-101 and the related forms. This Instrument is proposed to come into force at the same time as NI81-101.

6. Reference should be made to Part 2 of Companion Policy 81-102CP to this Instrument (the "Companion Policy") for a discussion of a number of the definitions in this Part.

7. A national definition instrument has been adopted as National Instrument 14-101 Definitions. It contains definitions of certain terms used in more than one national instrument. National Instrument 14-101 also provides that a term used in a national instrument and defined in the statute relating to securities of the applicable jurisdiction, the definition of which is not restricted to a specific portion of the statute, will have the meaning given to it in that statute, unless the context otherwise requires. National Instrument 14-101 also provides that a provision or a reference within a provision of a national instrument that specifically refers by name to a jurisdiction, other than the local jurisdiction, shall not have any effect in the local jurisdiction, unless otherwise stated in the provision.

8. This definition is new and is used in subsection 2.7(4), which limits the exposure that a mutual fund may have to any one counterparty in connection with specified derivatives transactions. Subsection 2.7(4) excludes from this limitation the exposure of mutual funds to acceptable clearing corporations.

9. Thomson BankWatch, Inc. has been added as an approved credit rating organization in response to comments received. The CSA note that this organization is recognized by the Securities and Exchange Commission ("SEC") in the U.S. as a "nationally recognized statistical rating organization" and by other securities and financial regulators throughout the world.

The rating categories for Thomson BankWatch, Inc. recognized in this Instrument as "approved credit ratings" are one level higher than the lowest investment grade category of Thomson. This approach is consistent with the other organizations' rating categories that are recognized in this Instrument as "approved credit ratings".

10. This definition has been amended from the 1997 Draft to recognize that asset allocation services may invest in other assets in addition to mutual funds.

This definition includes only specific administrative services in which an investment in mutual funds subject to this Instrument is an integral part. The definition does not include general investment services such as wrap accounts or discretionary portfolio management that may, but are not required to, invest in mutual funds subject to this Instrument. A discussion of this term is contained in section 2.1 of the Companion Policy.

11. This definition has been amended from the 1997 Draft in response to a comment to permit receivables, net of payables, arising from the disposition of portfolio assets, to be used for cash cover by a mutual fund.

12. The term "jurisdiction" is defined in National Instrument 14-101 Definitions as meaning a province or territory of Canada, except when used in the term foreign jurisdiction.

13. The term "Canadian financial institution" is defined in National Instrument 14-101 Definitions as meaning "a bank, loan corporation, trust company, insurance company, treasury branch, credit union or caisse populaire that, in each case, is authorized to carry on business in Canada or a jurisdiction, or the Confédération des caisses populaires et d'économie Desjardins du Québec".

14. This definition has been amended from the 1997 Draft to remove the requirement that the convertible security not be capable of being settled in cash. This definition is used as an exclusion from the definition of "specified derivatives", so that conventional convertible securities are not treated as specified derivatives under this Instrument. The CSA are satisfied that this treatment is appropriate for convertible securities, even if they are capable of being settled in cash.

15. This definition was not in the 1997 Draft, although the term "conventional floating rate debt instrument" was used in the 1997 Draft in order to define instruments that were excluded from the definition of "debt-like security". It is not intended that the definition of "debt-like security" would include debt based on underlying interests commonly used in commercial lending arrangements, such as prime rates or LIBOR. This definition has been added for greater certainty.

16. This definition has been amended in a similar manner, and for the same reasons, as the definition of "conventional convertible security". See the discussion contained in the footnote to that definition.

17. Paragraph (b) of this definition has been reversed from the 1997 Draft. The 1997 Draft provided that the value of the component of the debt-like security that was linked to an underlying interest must account for more than 20 percent of the value of the instrument in order that the instrument be considered a debt-like security. This definition now provides that the value of the component of the instrument that is not linked to the underlying interest must account for less than 80 percent of the purchase price of the instrument in order that the instrument be considered a debt-like security.

This amendment has been made to emphasize what the CSA consider to be the most appropriate manner to value these instruments. That is, one should first value the component of the instrument that is not linked to the underlying interest, as this is often much easier to value than the component that is linked to the underlying interest. The CSA recognize the difficulties of valuation that can arise if one attempts to value, by itself, the component of an instrument that is linked to

the underlying interest.

Paragraph (b) of this definition has also been amended to provide that the calculation described above is to be made as of the date of purchase of the instrument by a mutual fund, rather than at the date of issue. This change is proposed to recognize that, for long-term instruments, the character of the instruments may change as the date of maturity approaches; the value of the component that is linked to the underlying interest will decrease in value, and the value of the non-linked component may increase in value as the maturity date approaches.

18. The reference to "commercial paper" contained in the version of this definition that appeared in the 1997 Draft has been deleted as being redundant in light of the general reference to evidences of indebtedness.

19. This definition is based on the disclosure requirements of Form 81-101F1, the simplified prospectus form under proposed NI 81-101. The CSA are of the view that any amendment to the matters required to be disclosed under that Item should trigger the requirement for securityholder approval under paragraph 5.1(c) of this Instrument. A further discussion of this definition is contained in section 2.5 of the Companion Policy.

The term "ITA" is defined in National Instrument 14-101 Definitions as meaning "the *Income Tax Act* (Canada)".

20. This definition has been amended from the 1997 Draft to delete the requirement that a transaction be regarded as a hedge under Canadian GAAP in order to qualify as a hedge under this Instrument. The CSA understand that Canadian GAAP does not define transactions as hedges in a manner easily applicable to this Instrument.

In addition, the former subparagraph (a)(i) has been deleted. That subparagraph provided that the hedging position must provide equivalent underlying market exposure that is opposite to the position, or positions, being hedged. The CSA are satisfied that this subparagraph largely duplicated the combined effect of subparagraphs (a)(ii) and (iii).

The definition has also been amended to clarify which elements of the definition are to be satisfied based upon the intent of the person effecting the hedge, and which are to be satisfied using objective standards.

21. This definition has been amended to provide that a portfolio asset is illiquid only if it cannot be sold for a price that "approximates" the value at which the mutual fund carries the investment, rather than at an amount that "equals" the carrying value, as provided for in the 1997 Draft. The CSA have made the change to recognize that the sale price of securities will be reduced by transaction costs.

22. This definition has been amended from the 1997 Draft to delete the requirement that the unit be traded on and sponsored by a stock exchange in Canada. The definition now requires only that the security be traded on a stock exchange in Canada or the United States. Index participation units are excluded from the definition of "specified derivatives", and the CSA are satisfied that U.S.-traded index participation units, such as WEBs and SPDRs, may appropriately be acquired by mutual funds, subject to the investment limits established by sections 2.1 and 2.2.

23. The term "SRO" is defined in National Instrument 14-101 Definitions. The definition is "a self-regulatory organization, a self-regulatory body or an exchange".

24. This definition is new, and is used in the definition of "acceptable clearing corporation", which is used in subsection 2.7(4). See the footnote to subsection 2.7(4) for additional discussion.

25. The general requirements concerning the calculation of management expense ratio have been moved from N181-101 into Part 16 of this Instrument, as these provisions apply beyond a prospectus context. The provisions have already been published for comment as Part 6 of NI81-101, which was published for comment in July 1998; these provisions will be deleted from that Instrument. The CSA have taken into account comments received on N18-101 in preparing Part 16.

26. This definition has been amended to state more directly the definition of "manager". The references to "having the power" and "exercising the responsibility" to direct the affairs of a mutual fund contained in the 1997 Draft have been deleted.

27. This definition has been added as this term is used in Parts 15 and 16 of this Instrument.

28. The term "securities legislation" is defined in National Instrument 14-101 Definitions as meaning the particular statute and legislative instruments of the local jurisdiction set out in an appendix to that instrument and will generally include the statute, regulations and, in some cases, the rules, forms, rulings and orders relating to securities in the local jurisdiction.

29. The term "securities regulatory authority" is defined in National Instrument 14-101 Definitions as meaning, for a local jurisdiction, the securities commission or similar regulatory authority set out in an appendix to that instrument opposite the name of the local jurisdiction. The term "local jurisdiction" is defined in National Instrument 14-101 Definitions. The definition is "in a national instrument adopted or made by a Canadian securities regulatory authority, the jurisdiction in which the Canadian securities regulatory authority is situate".

30. The treatment of options in this Instrument has been amended from the 1997 Draft in the following manner:

(a) the CSA propose to permit both listed and unlisted warrants to be acquired by mutual funds as specified derivatives; as there is no longer a need to distinguish between listed and unlisted warrants in this Instrument, references to those terms have been deleted; the term "option" includes both listed and unlisted warrants. The requirements concerning options in this Instrument do not apply to "conventional warrants or rights", which are excluded from the definition of "specified derivatives"; and

(b) the definition of "over-the-counter option" has been deleted; the use of that term has been replaced, where appropriate, in this Instrument with a reference to an "option other than a clearing corporation option".

31. The reference to a "location" has replaced a reference to an "office" contained in the 1997 Draft in order to accommodate delivery of orders to electronic or Internet sites established by mutual funds.

32. This definition has been amended to apply to performance information about any security, index or benchmark, and not merely to performance information about a mutual fund or asset allocation service.

33. This definition has been amended to allow gold certificates issued by banks to be "permitted gold certificates" even if not insured in the manner specified.

34. The CSA have added this definition to deal with the issue of whether the "purchase" tests contained in this Instrument should apply in circumstances in which a mutual fund acquires securities other than through a decision made and action taken by the mutual fund. Examples of circumstances in which this issue arises are contained in section 2.14 of the Companion Policy.

35. This definition has been amended from the 1997 Draft to expand the list of documents considered not to be sales communications to include those documents that are prepared in response to statutory requirements and hence are not primarily promotional material.

36. This definition has been amended from the 1997 Draft to clarify its meaning without substantive change.

37. This definition has been amended from the 1997 Draft by the inclusion of capital shares and income shares in paragraph (e). Capital shares were included under the definition of "listed warrant" in the 1997 Draft. The CSA believe that capital shares and income shares do not have the risk characteristics of other derivatives, and should be excluded from the definition of "specified derivatives".

This Instrument has been amended to permit the use of swaps by mutual funds.

The requirements concerning options in this Instrument do not apply to "conventional warrants or rights", which are excluded from the definition of "specified derivatives".

38. This definition is new and has been added in connection with the proposal of the CSA to permit mutual funds to use

swaps.

39. Paragraph (c) has been added in connection with the proposed amendment of this Instrument to permit the use of swaps by mutual funds.

40. This Part has been reorganized into shorter sections to improve readability and clarity.

41. This section is based on paragraph 2.1(1)(a) and subsection 2.1(5) of the 1997 Draft.

42. This section is similar to subsection 2.1(2) of the 1997 Draft that dealt with similar requirements for derivatives.

43. This provision is based on subsection 2.1(3) of the 1997 Draft, but has been amended to include index participation units in the treatment given derivatives. This is necessary as index participation units are not treated as specified derivatives under the Instrument.

44. The term "equity security" is proposed to be defined in National Instrument 14-101. The proposed definition is "the meaning ascribed to that term in securities legislation".

45. Paragraph 2.2(1)(a) is based on paragraph 2.1(1)(b) of the 1997 Draft. The 1997 Draft restriction would have continued to prohibit mutual funds from acquiring more than 10 percent of a series or class of security in substantially the same manner as in NP39. The purpose of the restriction is to prevent a mutual fund from acquiring securities of an issuer that would enable the mutual fund to exert control over the issuer. The CSA have noted that this test has become increasingly problematic in that it has operated to prevent mutual funds from acquiring securities or instruments that in no manner provided the mutual fund with the opportunity to exert control over the issuer. For instance, the CSA understand that this prohibition has prevented mutual funds from acquiring warrants proposed to be offered by issuers in private placement transactions as "sweeteners" simply because the fund would be acquiring more than 10 percent of the class of warrants. The CSA also have noted that it would be necessary to provide for a large number of exceptions to the prohibition, if the prohibition continued to be structured as it is in NP39 and was proposed to be in the 1997 Draft.

Therefore, the CSA are proposing to amend the restriction so that it applies only to the acquisition of securities carrying more than 10 percent of the votes of an issuer, or to the acquisition of more than 10 percent of the equity securities of an issuer.

46. This provision is new and has been added to deal with the "involuntary" acquisition of securities by a mutual fund that might cause the mutual fund to exceed the securityholding limits prescribed by subsection 2.2(1). Examples of an "involuntary" acquisition of securities are contained in section 2.14 of the Companion Policy in connection with the new definition of "purchase".

47. This provision is similar to subsection 2.1(4) of the 1997 Draft, and has been amended to specify treatment of American depositary receipts.

48. The CSA are proposing the elimination of the term "permitted derivative" in order to clarify the drafting of this Instrument. No substantive changes are intended to result from this change.

49. Paragraph (h) contains the prohibitions against the use of commodity derivatives that was contained in the definition of "permitted derivatives" in the 1997 Draft.

50. Paragraph 2.3(i) has been amended from the 1997 Draft, which contained a prohibition against an acquisition of an interest in a loan syndication or loan participation by a mutual fund. The CSA recognize that there are few conceptual differences between these interests and the acquisition of evidences of indebtedness, so long as the mutual fund assumes no responsibility in administering the loan, such as managing the syndicate or dealing with the borrower, and are therefore proposing to permit the purchase of these interests with that condition. The CSA note that a mutual fund proposing to acquire such an interest should consider whether the interest is an illiquid asset within the meaning of this Instrument.

51. This section has been amended from the 1997 Draft by providing that, although a mutual fund may not purchase an illiquid asset if it would exceed the 10 percent threshold at the time of purchase, the mutual fund may hold up to 15 percent of the aggregate value of its portfolio assets in illiquid assets. The CSA are proposing this five percent cushion so as to reduce the likelihood that market fluctuations will put mutual funds in a position in which they would be required to dispose of illiquid investments under unfavourable circumstances. The CSA note that the SEC imposes a 15 percent illiquid asset restriction on U.S. mutual funds, and are satisfied that a 15 percent limit is not excessive for Canadian mutual funds.

52. The term "foreign jurisdiction" is defined in National Instrument 14-101 Definitions. The definition is "a country other than Canada, or political subdivision of a country other than Canada".

53. This subsection has been added to remove from the fund of fund rules any security of an issuer that may technically be a mutual fund, such as a subdivided offering or index participation unit, but that is not a conventional mutual fund and for which the fund of fund rules should not be applicable. Since those vehicles are virtually always listed on a stock exchange, the CSA have used this distinguishing feature to define the vehicles whose securities may be purchased by a mutual fund without regard to the fund of funds regime.

54. The derivatives sections of Part 2 have been reorganized from the 1997 Draft to improve readability and clarity.

55. This Instrument has been amended to delete clearing corporations from the list of organizations contained in Appendix A of the 1997 Draft. Instead, the Instrument uses a concept of "acceptable clearing corporation". An "acceptable clearing corporation" is one defined for that purpose under the Joint Regulatory Financial Questionnaire and Report. Subsection 2.7(4) now exempts from its application any futures contracts traded through a clearing corporation that settles transactions effected on a futures exchange listed in Appendix A.

56. The provision has been amended from the 1997 Draft to allow a mutual fund to use a net mark-to-market value in calculating its exposure to a counterparty with which the mutual fund has an agreement that permits netting or the right of set-off.

57. Paragraph (f) has been added in conjunction with the amendment of this Instrument to permit the use of swaps by mutual funds. Paragraph (f) in effect applies to swaps the rules that are contained in paragraphs (d) and (e) for forwards. The rules applicable to a long position in a forward contained in paragraph (d) are applicable for a swap when the mutual fund is in a net position in which it is owed money under the swap, and the rules applicable to a short position in a forward contract contained in paragraph (e) are applicable for a swap when the mutual fund is in a net position in which it owes money under the swap.

58. This section has been expanded from the 1997 Draft in order to ensure that the liability regime for a portfolio adviser that assumes responsibility for actions of a non-resident sub-adviser is consistent with the general liability regime now contained in section 4.4.

59. This provision is new, and imposes a direct prohibition on a mutual fund in respect of satisfying the initial capitalization requirements that are required to be described in the simplified prospectus of the mutual fund under paragraph 3.1(1)(b).

60. This provision is based on section 4.03 of NP39, but was not included in the 1997 Draft. The CSA did not include this provision in the 1997 Draft because the relief provided by the provision was never implemented in Ontario and because the CSA wanted to generally consider the provision in the context of a larger review of conflict of interest rules. See the discussion contained in footnote 116 of the 1997 Draft.

The CSA understand that some mutual funds have been relying on section 4.03 of NP39, and the CSA consider it best to preserve the status quo in this area pending the more general review of conflict issues in the future discussed in the Notice accompanying this Instrument. In particular, the CSA will, as part of that review, be considering the appropriateness of this section as outlined in footnote 116 of the 1997 Draft.

61. Subsections (1) and (2) have been amended from the 1997 Draft to ensure that these provisions correspond to the statutory standard of care imposed on managers under Canadian securities legislation. Subsections (1) and (2) are

designed to ensure that a manager remains responsible to the mutual fund for any breach of the statutory standard of care committed by it or anyone providing services to it or the mutual fund in connection with the mutual fund.

62. Subsection (5) has been added to clarify that a manager is not responsible for the actions of a custodian or sub-custodian of a mutual fund. A separate liability regime is imposed on those companies by section 6.6.

63. The CSA remind market participants that transactions of the type contemplated by this paragraph may trigger provisions of securities legislation that also relate to changes in the ownership or control of certain persons or companies. For instance, the regulations of securities legislation of some jurisdictions provide that, upon a change in the ownership or control of an investment counsel, the investment counsel must give a written explanation of the change to its clients and inform the clients of their right to withdraw their account.

64. Paragraph (g) has been added from the 1997 Draft to reflect the view of the CSA that the securityholders of a mutual fund that continues after a reorganization or merger transaction should be entitled to vote on the transaction if the transaction would be a significant change to that mutual fund.

65. See the footnote under paragraph 5.1(b).

66. The provisions relating to regulatory approvals of suspension of redemptions have been moved to this paragraph and subsection 5.7(2).

67. This section appeared as subsection 5.5(2) of the 1997 Draft and has been moved into a separate section for ease of reference.

68. The term "regulator" is defined in National Instrument 14-101 Definitions as meaning, in a local jurisdiction, the person set out in an appendix to that instrument opposite the name of the local jurisdiction.

69. This provision replaces subsection 5.1(2) of the 1997 Draft, which required securityholder approval for changes of control of a manager. The CSA are proposing that notice be given to securityholders of a proposed change of control of a manager, and have accepted comments that a requirement for securityholder approval would be too onerous, particularly in the case of changes of control that will have little or no impact on the operations or management of the mutual fund.

70. This provision is new, and has been included to reflect the view of the CSA that a termination of a mutual fund is sufficiently important to require notice to be given to securityholders.

71. This provision is new, and has been included to ensure that the records of the members of the CSA may be kept current and reflect terminations of mutual funds. This provision largely reflects current practice among mutual fund managers.

72. See section 7.5 of the Companion Policy for some examples of events that the CSA would consider to be significant changes.

73. The references to the "delegation of custodial authority" contained in the 1997 Draft, used with reference to the appointment of a sub-custodian, have been replaced in this Instrument with references to the "appointment of a sub-custodian", in order to use more direct language and avoid confusion over the legal meaning of the term "delegation".

74. Subsections (4) and (5) have been added in response to comments received in connection with the 1997 Draft. Commenters noted that subsection (3) of this Instrument would require separate documentation in connection with appointment of each sub-custodian; this approach was not practical or necessary in the context of the appointment of a global custodian or sub-custodian, where it is expected that the international network of affiliates of the global custodian would provide sub-custodians in different countries. Therefore, subsections (4) and (5) are designed to permit a mutual fund or custodian to consent generally to a list of sub-custodians that form the network of the global custodian or sub-custodian being appointed.

The CSA note that these provisions do not relieve custodians or sub-custodians from the requirements of sections 6.2 and 6.3.

75. This Instrument proposes to permit "affiliates" of banks or trust companies to be custodians or sub-custodians under prescribed conditions, rather than "wholly-owned subsidiaries" as in the 1997 Draft. The CSA are proposing this change to recognize the holding structure of a number of major international financial organizations, in which the entity providing custodial services may be an affiliate of, but not a wholly-owned subsidiary of, a bank or trust company. The CSA note that the bank or trust company must still assume responsibility for the custodial obligations of the affiliate unless the affiliate satisfies the shareholders' equity requirement.

76. This Instrument has been amended from the 1997 Draft to require that a bank or trust company "assume responsibility for the custodial obligations" of an entity proposing to act as custodian or sub-custodian, rather than guarantee those obligations. This amendment has been made in recognition that the banking law of some countries prevents banks from providing guarantees, but does permit a bank to support the obligations of another entity in its corporate group in other ways.

77. See the footnote to the word "affiliate" in section 6.2.

78. See the footnote to paragraph 3 of section 6.2.

79. Subsection 6.4(4) of the 1997 Draft, which required the manual delivery of custodian and sub-custodian agreements to the securities regulatory authorities, has been deleted as unnecessary.

80. Subsection (5) has been added to this Instrument from the 1997 Draft in order to impose a direct prohibition on mutual funds concerning the matters described in the subsection. The 1997 Draft contained only a requirement that such matters be dealt with in the custodian or sub-custodian agreements.

81. This section has been amended to conform to the provisions of section 4.4 in order to ensure that all service providers to a mutual fund are held, to the extent possible, to similar standards of care.

82. The standard of care imposed on custodians and sub-custodians has been amended by the addition of paragraph (a) in order to ensure that such entities are required to conform at least to an objective standard of care.

83. The term "CIPF" is defined in National Instrument 14-101 Definitions. The definition is "the Canadian Investor Protection Fund".

84. The language of subparagraph (i) has been amended to ensure that incentive fees are calculated in relation to an index that reflects the fundamental investment objectives of a mutual fund.

85. The reference to an "office" in the 1997 Draft has been amended here and elsewhere in Parts 9 and 10 to refer to a "location" to recognize both the possibility of the receipt of orders electronically or at a location other than an office. See also the discussion of a similar change in the footnote to the definition of "order receipt office".

86. The order of subsections 9.1(1) and (2) has been reversed from the 1997 Draft in response to a comment that such a change would be helpful in clarifying that purchase orders are first to be sent by a sales representative to his or her participating dealer and then by the participating dealer to the principal distributor. A similar change has been made to subsections 10.2(1) and (2).

87. This subsection is new and has been included in response to comments that suggested that a cut-off time for the electronic transmission of orders is necessary for some dealers. A corresponding provision has been added as subsection 10.2(4) in relation to redemption orders.

88. This subsection is new and has been added to ensure that an appropriate compliance review of an order is possible for a dealer in the relevant jurisdiction.

89. The time period within which a mutual fund can reject a purchase order has been reduced from the two day period provided in the 1997 Draft to 24 hours.

90. Section 10.4 of the Companion Policy contains a discussion of the prohibition against "backward pricing" and as a result parts of this section in the 1997 Draft were considered unnecessary and have been deleted.

91. This subsection has been simplified to respond to a comment received that the timing provisions in the 1997 Draft were overly complex and that it is only necessary to reflect here the industry practice of T+3 settlement.

92. This subsection and subsections (5) and (6) have been amended to reflect a comment received that if payment of a purchase order is made by cheque, it may be well after the third business day after the pricing date before an NSF cheque is returned to the mutual fund.

93. Paragraphs (a) and (b) have been amended to provide that a principal distributor or participating dealer need not pay any deficiency owing by them until they have been notified by the mutual fund of the amount of that deficiency.

94. This subsection has been revised from the 1997 Draft to clarify that it is the manager's responsibility to provide this statement to securityholders.

95. This subsection is new. See the discussion in the footnote to subsection 9.1(4).

96. As with section 9.3, this section has been simplified, and the discussion of backward pricing moved to section 10.4 of the Companion Policy.

97. The reference to a "registered holder" in this subsection and in subsection (5) in the 1997 Draft has been amended to "securityholder". See section 10.2 of the Companion Policy.

98. The wording of this clause has been simplified for greater clarity.

99. The reference to "money" in the 1997 Draft has been amended to "currency".

100. The provisions of the 1997 Draft relating to applications to the securities regulatory authorities for permission to suspend redemptions in circumstances other than those provided for in this section have been moved to paragraph 5.5 (1)(d).

101. Section 11.4 of the 1997 Draft has been deleted and replaced with references to service providers in sections 11.1 and 11.2. The CSA consider this a more direct way of ensuring that funds handled by service providers to dealers are subject to the rules applicable to dealers handling funds.

102. This subsection has been amended from the 1997 Draft to restore the ability of a principal distributor or person or company providing services to a mutual fund to pay interest on these funds to securityholders, or to mutual funds, pro rata according to cash flow. See subsection 11.1(5) of the Companion Policy for a discussion on the meaning of these terms. The provision has been expanded to minimize the sending of small cheques. Analogous changes have been made to subsection 11.2(4).

103. This provision is new, and has been added to clarify the CSA policy concerning the appropriate nature of the trust accounts required by this Part. Section 11.3 reflects existing CSA policy and is generally consistent with advice given by some members of the CSA to dealers in recent years.

104. The reference to 120 days in the 1997 Draft has been amended to 140 days as a result of a comment received that this time period should be consistent with the time period within which mutual funds are required to file their audited annual financial statements under securities legislation.

105. This section has been amended to accommodate the inclusion of forms of auditors' reports as appendices to the Instrument, for the convenience of market participants.

106. This section was not in the 1997 Draft and reflects the CSA agreement with a comment received that the value of the reports contemplated by this section does not justify the costs of requiring IDA and stock exchange members to prepare them, in light of the level of supervision exercised by these SROs over their members. This exemption does not exclude SRO members who act as principal distributors of a mutual fund from the requirement to file compliance reports under subsection 12.1(2). The CSA will review the dealer requirements of this Part once all dealers, except for dealers in Quebec, are members of an SRO.

107. This provision is new, and has been added to reflect the views of the CSA that mutual funds should ensure that "stale" net asset values of mutual funds not appear in the financial press.

108. These provisions have been revised to reflect definitional changes made to options and warrants. See the discussion contained in the footnote to the definition of "option".

109. Paragraph 6 has been added in connection with the amendments of this Instrument to permit the use of swaps by mutual funds.

110. This section has been amended by the deletion of reference to the issue of rights by mutual funds for purposes of improving the clarity of this section and having regard to the fact that mutual funds rarely, if ever, issue rights to their securityholders.

111. Part 15 has been reorganized into smaller sections to improve readability and clarity. In addition, Part 12 of the Companion Policy has been expanded to discuss a number of these provisions.

112. From section 15.1 of the 1997 Draft.

113. From subsection 15.2(1) of the 1997 Draft.

114. From subsection 15.2(4) of the 1997 Draft. This provision has been amended from the 1997 Draft to require 10-point, rather than 8-point, type.

115. From subsection 15.2(2) of the 1997 Draft.

116. Paragraph (d) is new, and has been added to prevent the use of hypothetical or reconstructed benchmarks by persons preparing sales communications for mutual funds.

117. This provision is new, and is designed to clarify the views of the CSA as to the performance data that is acceptable to be included in the sales communications of "young" funds or asset allocation services. Under this provision, no performance data may be included in those sales communications other than data relating to mutual funds or asset allocation services under common management as the "young" fund or asset allocation service.

118. From paragraph 15.4(o) of the 1997 Draft.

119. From subsection 15.2(8) of the 1997 Draft.

120. From subsection 15.2(6) of the 1997 Draft. This subsection has been revised to respond to a comment received by the CSA to clarify that a mutual fund should be able to advertise itself as a money market fund if it meets the definition of that term either under NP39 or under this Instrument.

121. From subsection 15.2(7) of the 1997 Draft.

122. This section consolidates the mandatory disclosure requirements for sales communications. The required disclosure required by section 15.4 of the 1997 Draft and the warnings required by section 15.6 of the 1997 Draft have been combined, where possible, in this section, to order to reduce duplication.

123. From subsection 15.2(3) of the 1997 Draft.

124. From subsection 15.2(5) of the 1997 Draft.

125. From subsection 15.6(1) of the 1997 Draft. The statement that "past performance may or may not be repeated" contained in a number of the warnings of section 15.6 of the 1997 Draft has been replaced with "how the fund has performed in the past does not necessarily indicate how it will perform in the future", which is based on a required disclosure statement for simplified prospectuses under NI81-101.

126. From subsection 15.6(2) of the 1997 Draft.

127. This provision is new, and replaces the general requirement contained in subsection 15.6(7) of the 1997 Draft to modify the prescribed mutual fund warnings, where required, for asset allocation services.

128. From subsection 15.6(3) and paragraph 15.4(1)(g) of the 1997 Draft.

129. From subsection 15.6(4) and paragraph 15.4(1)(f) of the 1997 Draft. The requirements now contained in paragraph (b) of this provision have been amended to require the disclosure relating to annualized returns to be located immediately after the performance data in the sales communication.

130. From paragraph 15.4(1)(h) of the 1997 Draft.

131. From subsection 15.6(5) of the 1997 Draft.

132. This subsection is new, and has been included in response to the recent development of guaranteed or insured mutual funds.

133. From subsection 15.6(9) of the 1997 Draft.

134. From subsection 15.6(8) of the 1997 Draft.

135. From subsection 15.6(6) of the 1997 Draft.

136. This section is based on section 15.3 of the 1997 Draft.

137. Paragraphs (b) and (c) are new, and have been added to respond to the concern expressed to the CSA at various times that the use of the term "no-load" can be misleading to some investors. The CSA wish to ensure that specific references to fees and charges paid by a no-load fund and the existence of trailer commissions paid in connection with the mutual fund be made in a sales communication in conjunction with the use of the term "no-load" to remove potential misunderstandings of that term.

138. From paragraph 15.4(1)(a) of the 1997 Draft.

139. From paragraph 15.4(1)(b) of the 1997 Draft. The 1997 Draft provided for standard performance data to be provided in type "at least as prominent" as that used to present other performance data. The same requirement applied to money market funds disclosing both current yield and effective yield. This section has been revised to respond to comments received by the CSA and to clarify that "at least as prominent" meant that the type size used to disclose standard performance data or current yield could not be smaller than that used for the other performance data or effective yield.

140. From paragraph 15.4(1)(c) of the 1997 Draft.

141. From paragraph 15.4(1)(d) of the 1997 Draft.

142. The CSA have deleted from this Instrument the prohibition against the disclosure of performance data in an advertisement broadcast on radio or television. Performance data in those advertisements is proposed to be permitted, subject to the ordinary requirements of this Part.

143. From paragraph 15.4(1)(e) of the 1997 Draft. This paragraph has been revised to provide a more objective test with respect to the reasonableness of the comparison between the performance data and the similar index or average.

144. From paragraph 15.4(1)(j) of the 1997 Draft.

145. This paragraph, and subsection (3), have been amended to respond to a comment that it should be clarified in these paragraphs that for funds in existence for less than 10 years, standard performance data must be provided from the fund's inception.

146. From paragraph 15.4(1)(k) of the 1997 Draft.

147. From paragraph 15.4(1)(l) of the 1997 Draft.

148. From paragraph 15.4(1)(m) of the 1997 Draft.

149. From paragraph 15.4(1)(i) of the 1997 Draft.

150. This provision is new and is included in order to clarify the nature of the performance data that may be provided for mutual funds that have continued after a merger or other reorganization with another mutual fund. The CSA are of the view that it is appropriate that a mutual fund continuing after a transaction that would be a significant change for it should disclose its performance data for periods before the merger only if similar performance data is provided for the other mutual fund in the transaction. Also, if the mutual fund does not wish to provide performance data for the period before the merger, then it must be treated as a new mutual fund, and not disclose performance data until at least 12 months after the transaction. In no circumstances, however, may any performance data that "straddles" the transaction be presented.

151. This section is based on subsections 15.5(3) through (7) of the 1997 Draft and has been reordered for greater readability and clarity.

152. This subsection and subsection (4) have been revised to respond to comments received by the CSA that greater specificity ought to be provided as to the meaning and calculation of "redeemable value" and "initial value".

153. This section is based on subsections 15.5(1) and (2) of the 1997 Draft.

154. From section 15.7 of the 1997 Draft.

155. From section 15.8 of the 1997 Draft.

156. This Part has been taken from the provisions of NI81-101 dealing with the calculation of a mutual fund's management expense ratio. See the footnote to the definition of "management expense ratio". Sections 16 and 17 of the 1997 Draft have been deleted, as they related to aspects of prospectus disclosure now dealt with in NI81-101.

157. This provision is new and is designed to clarify the view of the CSA that rebated management fees should be included as expenses of the mutual fund for purposes of the calculation of the management expense ratio.

158. This section is new and reflects existing practice in the industry.

159. This subsection has been amended to stipulate the amount of time that the records contemplated by this subsection must be maintained.

160. The reference to a "register" in the 1997 Draft has been amended to refer to "records", to clarify that the information required to be maintained by this section does not need to be contained in a single place.

161. This subsection has been amended to ensure that securityholder records need only be made available for appropriate purposes, comparable to the provisions of corporate law.

162. Section 20.2 of the 1997 Draft has been deleted. The CSA are of the view that it is appropriate that a separate approval document be issued by the CSA to evidence exemptions from, or orders given under, this Instrument.

163. The CSA have deleted from this Instrument the provisions contained in the 1997 Draft that provided the regulators or securities regulatory authorities with the authority to limit or remove the ability of a mutual fund to rely upon exemptions or approvals given under NP39. The CSA are of the view that mutual funds should be able to rely upon past exemptions or approvals, subject to the general ability of CSA to revoke or vary previous exemptions.

164. Mutual funds will be given an additional period during which they may use sales communications, other than advertisements, printed before the date this Instrument comes into force.

165. This section grandfathers mortgage funds that comply with National Policy Statement No. 29 ("NP29") and that are in existence and have prospectuses on the date that this Instrument comes into force. A person or company seeking to start a new mortgage fund after this Instrument comes into force, but before a new National Instrument replacing NP29 is in force, will be required to seek an exemption from paragraphs 2.3(b) and (c) of this Instrument. The CSA are engaged in preparing National Instrument 81-103 Mortgage Funds, which will replace NP29.

166. This is designed to give mutual funds adequate time to implement systems to monitor holdings of illiquid assets on an ongoing basis as required by subsection 2.4(2).

167. This is designed to give mutual funds adequate time to implement systems to monitor derivatives exposure to individual counterparties as required by subsection 2.7(4).

168. This is designed to permit mutual funds adequate time to amend all custodian and sub-custodian agreements to reflect the matters contemplated by section 6.4.

169. This is designed to allow mutual funds and persons and companies providing services to mutual funds adequate time to amend agreements to reflect the matters contemplated by subsection 4.4(1).

170. The term "Canadian securities regulatory authorities" is defined in National Instrument 14-101 Definitions as meaning the securities commissions or similar regulatory authorities set out in an appendix to that instrument.

171. Certain of the Canadian securities regulatory authorities do not have the authority to include a provision of this nature in the Instrument.