

# Chapter 1

## Notices / News Releases

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### 1.1 Notices

#### 1.1.1 OSC Staff Notice 81-728 – Use of “Index” in Investment Fund Names and Objectives

##### OSC STAFF NOTICE 81-728 USE OF “INDEX” IN INVESTMENT FUND NAMES AND OBJECTIVES

###### Purpose

This notice sets out guidance from staff of the Ontario Securities Commission (Staff) regarding the factors that Staff will consider in our prospectus reviews of investment funds whose investment objectives are to replicate the performance of an index, and which include the word “index” in their names (Index Tracking Funds).

###### Background

Staff have seen an increasing trend of prospectus filings by funds that purport to be Index Tracking Funds. In Staff’s view, the index whose performance an Index Tracking Fund seeks to replicate should generally satisfy two conditions: (i) absence of discretion and (ii) transparency, as outlined below. Where these conditions are not satisfied, in the course of our prospectus reviews, we will ask that references to the purported index in the fund’s investment objectives and name be removed.

Further, Staff note that an index that satisfies the conditions described in this notice may nonetheless not satisfy the definition of “index mutual fund” or “index participation unit” in National Instrument 81-102 *Investment Funds* (NI 81-102). In such a situation, even though the fund may include “index” in its name and investment objectives, the exemptions provided to index mutual funds or index participation units under NI 81-102 may not be relied on.

###### Absence of Discretion

An Index Tracking Fund seeks to replicate the performance of an identified index, which is generally considered a passive investment strategy. Accordingly, in Staff’s view, in order to be an Index Tracking Fund, the methodology governing the index whose performance is being replicated (the Methodology) should generally not allow for the application of material discretion on the part of the index provider or any other party involved in the administration of the index. This means that the index should use objective and verifiable data as inputs, and the Methodology should specify the rules by which the material aspects of the index, such as index value, weighting and constituents, are determined given such inputs.

If material discretion may be employed in administering the index, Staff will generally view the Methodology as being more akin to an active investment strategy. While an investment fund may employ such a strategy (provided it is otherwise permissible under NI 81-102), we think that it is misleading to investors to refer to such a strategy as an “index” in the fund’s name and investment objectives, or to market the fund in a way that suggests that it is an Index Tracking Fund.

###### Transparency of Index

Staff also expect the index whose performance an Index Tracking Fund seeks to replicate to be transparent. In our view, transparency can be achieved by making either the Methodology or the constituents of the index available to the public, by posting the Methodology or list of constituents on the website of the Index Tracking Fund or the index provider. Staff also expect the list of constituents to be updated as the index is rebalanced or reconstituted.

We would further expect an Index Tracking Fund’s prospectus to sufficiently describe the applicable index, including the key factors in determining the constituents of the index and how often the index is rebalanced and reconstituted,<sup>1</sup> and to include a link to the website where the Methodology or list of index constituents can be found. The Index Tracking Fund’s prospectus should also disclose how the Index Tracking Fund replicates the index (e.g., by direct investment in the constituents of the index, by stratified sampling, or by synthetic exposure through a derivative).

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<sup>1</sup> This position is consistent with previous guidance published by Staff on exchange-traded funds that replicate the performance of indices. See *Investment Funds Practitioner*, OSC, (2012) 35 OSCB 3597 at 3598.

Transparency of the index assists investors in understanding the index to assess whether the Index Tracking Fund is an appropriate investment for the investor. Generally, Staff will expect the Methodology to include sufficient detail to assist in making such a judgment.

In instances where a fund manager does not wish to disclose the Methodology or the constituents of the index, Staff have taken the view that the purported index is a proprietary quantitative model and, while the fund may employ that model as an investment strategy, it is generally inappropriate for the fund to market itself as an Index Tracking Fund. Accordingly, we have asked that such funds remove any reference to “index” from their names and investment objectives.

**Further Information**

Investment fund managers and their counsel are encouraged to contact Staff at an early stage in the structuring of an Index Tracking Fund that may give rise to any questions concerning the issues discussed in this notice.

**Questions**

If you have any questions, please refer them to:

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