

Chapter 6

Request for Comments

6.1 Request for Comments

6.1.1 National Instrument 81-102 - Notice of Proposed Amendments

**NOTICE OF PROPOSED AMENDMENTS TO
NATIONAL INSTRUMENT 81-102
AND COMPANION POLICY 81-102CP
MUTUAL FUNDS
AND TO
NATIONAL INSTRUMENT 81-101
AND COMPANION POLICY 81-101CP
MUTUAL FUND PROSPECTUS DISCLOSURE,
AND
FORM 81-101F1
CONTENTS OF SIMPLIFIED PROSPECTUS
AND
FORM 81-101F2
CONTENTS OF ANNUAL INFORMATION FORM**

Substance and Purpose of Proposed Amendments

Introduction

The Canadian Securities Administrators (the "CSA"), with this Notice, are publishing for comment proposals that would:

- allow an index mutual fund to invest a percentage of its net assets in any one issuer in excess of the 10 percent concentration restriction that is prescribed by section 2.1(1) of National Instrument 81-102;
- require an index mutual fund to include specific disclosure in its simplified prospectus about its fundamental investment objective, and the risks inherent in the fund investing in securities according to an index that is itself not widely diversified;
- require a mutual fund to disclose its management expense ratio in media other than the simplified prospectus, annual information form and annual financial statements, based on a "rolling" 12 month period; and
- require a mutual fund offering multiple classes of securities to provide cover page disclosure in its simplified prospectus of the classes offered and to provide performance and financial highlight disclosure in the simplified prospectus for different classes.

The Proposed Amendments also make a number of other changes to National Instrument 81-102 Mutual Funds ("NI 81-102"), Companion Policy 81-102CP ("81-102CP"), National Instrument 81-101 Mutual Fund Prospectus Disclosure ("NI 81-101"), Companion Policy 81-101CP ("81-101CP"), Form 81-

101F1 Contents of Simplified Prospectus ("Form 81-101F1") and Form 81-101F2 Contents of Annual Information Form ("Form 81-101F2") (collectively, the "Rules"). The Proposed Amendments address some issues that have been brought to the attention of the CSA following the coming into force of NI 81-101 and NI 81-102 on February 1, 2000.

Substance and Purpose of the Proposed Amendments to NI 81-102, 81-102CP, NI 81-101, 81-101CP, Form 81-101F1 and Form 81-101F2

Index Mutual Fund Amendments

Since the summer of 1999, the CSA have been urged to permit index mutual funds to invest their net assets in the securities of issuers that make up their target index without being limited by the 10 percent concentration restriction currently prescribed by section 2.1 of NI 81-102. These concerns resulted from the recent and arguably novel market conditions which have caused the weighting of certain issuers in certain indices to rise substantially above 10 percent. The concentration restriction in section 2.1 of NI 81-102 prevents index mutual funds from replicating the performance of their target indices. Generally, index mutual funds meet their stated investment objective by purchasing or gaining exposure to the securities of the issuers in their target index in the same proportion as such securities are reflected in such index.

As a result of applications for discretionary relief made by certain index mutual funds, the CSA granted those funds exemptions from the concentration restriction applicable to mutual funds (at that time, section 2.01 (a) of National Policy Statement No. 39), subject to a restriction that limited such funds to a 15 percent concentration restriction. By late fall 1999, it became apparent that certain index funds needed additional relief.

The Investment Funds Institute of Canada ("IFIC") wrote to the Chair of the Ontario Securities Commission in December 1999 outlining the concerns of its members.

As a result of considering IFIC's letter the CSA agreed to proceed to propose these amendments to NI 81-102. In the interim, upon the application of affected index mutual funds, the CSA further increased the concentration restriction for those mutual funds from the previously approved 15 percent concentration restriction to 25 percent.

In the course of deciding to propose an elimination of the concentration restriction for index mutual funds, the CSA considered the equivalent of the concentration restriction rule in other regulatory regimes such as the United States, Hong

Kong, and Europe.¹ In all cases, although the concentration restriction has been or is proposed to be lessened for index mutual funds in those jurisdictions, it has not been eliminated in its entirety. The CSA considered alternatives to the elimination of the concentration restriction for index mutual funds as discussed later in this Notice under “Alternatives Considered”.

IFIC urged the CSA to do away with the concentration restriction for all mutual funds, and not just index mutual funds. The CSA is proposing to eliminate the concentration restriction only for index mutual funds for the following reasons:

- The CSA are of the view that tracking an appropriate market index is an acceptable proxy for the concentration restriction. There is no other widely accepted and disclosed proxy for actively managed funds.
- Managers of actively managed funds have alternative investment strategies available to them and are responsible for following these investment strategies in seeking to achieve a fund’s objective. For example, although the 10 percent restriction limits how much an actively managed mutual fund can overweight a given issuer, it does not limit the extent to which such a fund can overweight a market sector or a group of issuers whose stock prices are correlated.
- Only in the context of index mutual funds can it be argued that the 10 percent restriction prevents a manager from pursuing the fundamental investment objective of the mutual fund, i.e. tracking the performance of a specified index.

The proposed amendments to NI 81-102 define “index mutual fund” as a mutual fund that has adopted fundamental investment objectives that require it to:

- hold securities that are included in a permitted index or indices in substantially the same proportion as those securities are reflected in that permitted index or indices; and

¹ For example, the Hong Kong Securities and Futures Commission (“SFC”) imposes a 10 percent diversification rule similar to NI 81-102. To date the SFC has granted discretionary exemptions from that rule but only to index mutual funds. The SFC has not imposed any upper limit for index tracking funds in their exemptions, provided that the weightings of the individual stocks within the fund track those of the fund’s target index. The Securities and Exchange Commission in the United States allows a “diversified” mutual fund to invest up to 25 percent of its assets in a single issuer, however the SEC also requires that the remaining 75 percent of the fund’s assets be invested such that no one holding constitutes more than 5 percent of the fund’s assets. Mutual funds must ensure, at least quarterly, that they are in compliance with these restrictions. Mutual funds established under the UCITS Directives of the European Commission must abide by restrictions less flexible than NI 81-102 (a 5 percent “ongoing”, rather than “purchase”, concentration restriction). These restrictions are proposed to be lessened for index mutual funds, however index mutual funds will still be subject to a restriction of 35 percent of all assets invested in any one issuer should the proposals be adopted by the member countries.

- invest in a manner that causes the mutual fund to replicate the performance of that permitted index or indices.

The proposed amendments to NI 81-102 exempt index mutual funds (as so defined) from the concentration restriction contained in section 2.1 of NI 81-102. The relatively recent increase in the weighting of some issuers in certain indices to well in excess of 10 percent provided an impetus to the CSA to propose this change. The CSA wish to allow an index mutual fund to pursue its fundamental investment objective of tracking the composition (and therefore the performance) of a specified index or indices, provided adequate disclosure is given to investors of this objective. An index mutual fund will be permitted to rely on the exception to the 10 percent concentration restriction if it:

- provides specific disclosure in its simplified prospectus as set out in the proposed amendments to Form 81-101F1;
- provides 60 days advance notice to security holders before first relying on the exception; and
- includes the word “index” in its name.

The proposed amendments to Form 81-101F1 are designed to give investors sufficient notice and information about the fundamental investment objectives of index mutual funds and the risks inherent with such objectives where the concentration restrictions applicable to all mutual funds are not followed.

In addition, the CSA propose a related amendment to Form 81-101F1 which will require all mutual funds, and not just index mutual funds, to disclose the risks of a high concentration of portfolio assets in any one issuer. The proposed disclosure requirement will require a mutual fund to disclose additional risks where, at any time during the previous 12 month period before the date of its simplified prospectus, the mutual fund held more than 10 percent of its net assets in securities of any one issuer.

Management Expense Ratio Amendments

The proposed amendments to NI 81-102 would require a mutual fund to disclose its management expense ratio (“MER”) for a “rolling” 12 month period in media other than a simplified prospectus, annual information form or annual financial statements. Currently, a mutual fund can disclose its MER only if the MER is calculated as of a completed financial year. Incidental changes are also proposed to the existing MER provisions to accommodate the proposed “rolling” 12 month MER.

The proposed amendments to 81-102CP also clarify how a mutual fund should determine its “total expenses” for the purposes of the MER calculation where income taxes and withholding taxes are payable by that mutual fund.

Other Amendments

The proposed amendments to 81-102CP provide the CSA’s views on what type of instrument, agreement or security will generally be considered by them to be a “specified derivative” for the purposes of section 2.1 of NI 81-102.

The proposed amendments to Form 81-101F1 and to Form 81-101F2 address packaging and disclosure requirements for the simplified prospectus and annual information form of a mutual fund offering multiple classes or series of securities.

The proposed amendments also implement a number of miscellaneous amendments to the Rules and the Forms that the CSA consider appropriate at this time.

Section Numbering of Proposed Amendments

The CSA have already proposed amendments to NI 81-102, 81-102CP and Forms 81-101F1 and 81-101F2 to, among other things, permit mutual funds to enter into securities lending, repurchase and reverse repurchase agreements. Those proposed amendments were published for comment in January 2000² and the comment period expired on April 30, 2000. The CSA expect that those amendments will be in force before the amendments contemplated by the current proposed amendments. The numbering of section references in the proposed amendments to the Rules and Forms and in this Notice, assumes that the “securities lending/repo amendments” are already in force and takes into account numbering changes made by those January amendments.

Summary of Proposed Amendments to National Instrument 81-102

This section describes the amendments proposed to be made to NI 81-102. Section references, unless otherwise noted, are sections or proposed sections of NI 81-102.

Section 1.1

The existing definition of “index mutual fund” contained in NI 81-102 will be deleted and replaced with the new proposed definition of “index mutual fund”. The new definition uses a new defined term “permitted index”, in place of the previous term “specified widely quoted market index”. The amendment also clarifies that an “index mutual fund” may have more than one “permitted index”.

The term “permitted index” is defined as an index which is widely quoted and readily available to the public and hence not one that is obscure and only known by, or accessible to, the investment community or a sector thereof. In addition, such index may not be one that is administered by an organization that is affiliated with the mutual fund, its manager, its portfolio adviser or principal distributor, unless the index is widely recognized and used.

The changes to the term “index mutual fund” are proposed in order to ensure sufficient certainty in determining which mutual funds may rely on the proposed exemptions from the concentration restrictions.

Section 1.3

Section 1.3 of NI 81-102 is proposed to be amended by the addition of subsection (3), which is an interpretative provision providing that a “simplified prospectus” includes a “prospectus”, a “preliminary simplified prospectus” includes a

“preliminary prospectus” and a “*pro forma* simplified prospectus” includes a “*pro forma* prospectus”. A number of other incidental amendments are proposed in light of this interpretive provision. This proposed amendment is designed to correct inconsistencies in the use of the terms “prospectus” and “simplified prospectus” in NI 81-102 and does not change the scope of NI 81-102.

Section 2.1

Section 2.1 is proposed to be amended with the addition of subsection (5) which would allow an index mutual fund to exceed the 10 percent concentration restriction if required to allow the index mutual fund to follow its fundamental investment objective. In order to rely on this exception the name of the index mutual fund must include the word “index”. The simplified prospectus of the index mutual fund must also include specified mandated disclosure. As well, the index mutual fund must provide 60 days advance written notice to existing security holders before it begins to rely on the exception (unless the simplified prospectus has contained the mandated disclosure since inception).

As noted above in this Notice, the CSA are of the view that it is appropriate to treat index mutual funds differently from other mutual funds with respect to the concentration restriction since the fundamental investment objective of index mutual funds is to track the performance of a specified index. The CSA believe that the investor protection provided by the 10 percent concentration restriction could be adequately replaced by proposed amendments to Form 81-101F1 requiring enhanced disclosure of investment objectives and the risks associated with any investment in excess of the 10 percent concentration restriction, as well as the requirement for 60 days notice in advance of relying on the exception.

Since investors in existing index mutual funds would have acquired their index mutual funds at a time when the fund could not go beyond the 10 percent concentration restriction, the CSA believe it necessary for index mutual funds to inform investors of their intentions to rely on the exception provided in the proposed amendments. Accordingly, all index mutual funds that propose to rely on the exception must give investors 60 days advance notice and give them the information required by section 2.1 so that the investors can make an informed decision on whether they wish to remain invested in these index mutual funds. The CSA propose this notice requirement for all index mutual funds, including those index mutual funds that have received discretionary relief under National Policy Statement No. 39 or NI 81-102 to go beyond the 10 percent restriction to up to 25 percent in any one issuer.

Section 5.5

Section 5.5 is proposed to be amended to permit the same procedures for securities regulatory approvals under Part 5 of NI 81-102 as are permitted for exemptions under section 19 of NI 81-102. These amendments will permit decisions to be made regarding Part 5 approvals by appropriate staff of the CSA and not only by the securities regulatory authorities (generally the securities commissions) of each province and territory of Canada.

² In Ontario, at (2000) 23 OSCB (Supp.) 135

Section 6.3

It is proposed that the word “subsidiary” be replaced with the word “affiliate” in paragraph 3(b) of section 6.3 in order to provide for the consistent use of terminology throughout NI 81-102.

Section 9.4

Subparagraph 9.4(4)(a) is proposed to be amended to delete the words “immediately before the close of business”. The CSA understand that these words have been relied on to support an interpretation that a purchase order can be completed up to the end of business on a trade date plus four business days. The CSA did not intend for this interpretation and the proposed amendment is intended to clarify this issue. Any purchase not settled by the end of business on “T+3” must be redeemed immediately thereafter under the forced settlement rules of NI 81-102.

Section 15.4

It is proposed that subsection 15.4(12) be deleted. This amendment is consistent with the proposed amendment to section 1.3 concerning the use of the term “simplified prospectus” throughout NI 81-102.

Section 15.6

Section 15.6 imposes a restriction on performance data disclosure by young funds. Currently NI 81-102 does not allow such disclosure until the mutual fund has offered securities for at least “one completed financial year”. Subparagraph 15.6(1)(a)(i) is proposed to be amended to clarify that a mutual fund or asset allocation service must first have offered securities under a simplified prospectus in a jurisdiction for 12 consecutive months before including performance data in a sales communication.

Section 16.1

Section 16.1 is proposed to be amended to require a mutual fund to disclose an MER in its simplified prospectus, annual information form or annual financial statements that is calculated in accordance with section 16.1 for its most recently completed financial year. Subsection 16.1(2) requires a mutual fund that wishes to disclose its MER in media other than a simplified prospectus, annual information form or annual financial statements to calculate and disclose an MER based on expenses incurred during the most recent twelve month period i.e. a “rolling” 12 month MER. Proposed new subparagraphs 16.1(2) and 16.1(3) provide the formula for the calculation of the “rolling” 12 month MER.

The words “before income taxes” have been added after the words “total expenses” to clarify that income taxes are not required to be included in determining a mutual fund’s MER.

A new subsection is proposed to allow a mutual fund to disclose its MER to a service provider that will arrange for public dissemination of the MER without the mutual fund having to disclose in notes to the MER disclosure whether the mutual fund has waived management fees or that management fees were paid directly by investors during the period for which the MER was calculated, as currently required

by the subsections 16.1(2) and (3) of NI 81-102. The CSA point out in the proposed amendments to 81-102CP that they expect that the mutual fund or the service providers will provide the public with the information contemplated by the note requirements of subsections 16.1(2) and (3) in a clear and understandable manner.

Section 16.2

Section 16.2, which provides a formula for the calculation of total expenses for a fund of funds, is proposed to be amended so that such calculation is also applicable to the determination of the “rolling” 12 month MER as proposed in new subparagraphs 16.1(2) and 16.1(3).

Summary of Proposed Amendments to Companion Policy 81-102CP

This section describes the amendments proposed to be made to 81-102CP. Section references, unless otherwise notes, are sections or proposed sections of 81-102CP.

Section 2.16

Subsection 2.16(2) is proposed to be amended to reflect the views of the CSA that mutual funds should not enter into derivatives or derivative-like transactions in order to circumvent the concentration restriction in section 2.1 of NI 81-102. The CSA is concerned that mutual funds not engage in transactions to do indirectly through derivatives, what they are not permitted to do directly.

Section 3.2

This proposed section is new and discusses the views of the CSA with respect to funds which do not fall within the definition of “index mutual fund”, but that have a portion of their assets invested according to a permitted index. Mutual funds that are not “index mutual funds”, but that wish to seek an exemption from the concentration restrictions for substantive portions of their net assets that are invested according to a permitted index may make such an application. The section also discusses the views of the CSA with respect to the need for securityholder approval if an index mutual fund changes its “permitted index”.

Section 13.2

Subsection 13.2(5) is proposed to be added to clarify that the words “inception of the mutual fund” as they relate to the disclosure of a mutual fund’s standard performance data in a sales communication and in a report to security holders (subsections 15.8(2) and (3)), refers to the beginning of the distribution of the securities of the mutual fund under a simplified prospectus, and not to any previous time in which the mutual fund may have existed but did not offer its securities under a simplified prospectus.

Section 14.1

Section 14.1 is proposed to be amended to reflect the proposed changes to Part 16 of NI 81-102 and clarify the factors that are required to be taken into consideration when calculating “total expenses” for the purposes of calculating MER.

Summary of Proposed Amendments to National Instrument 81-101

This section describes the amendments proposed to be made to NI 81-101. Section references, unless otherwise noted, are sections or proposed sections of NI 81-101.

Section 1.1

The definition of the term “commodity pool” in section 1.1 is proposed to be amended so that it will have the meaning ascribed to that term in proposed National Instrument 81-104 Commodity Pools.³

The definition of “material contract” is also proposed to be amended by the addition of the words “for a mutual fund”. The CSA view this amendment as a clarification amendment only.

Subparagraphs 2.3(1)(b)(i), 2.3(2)(a)(i), 2.3(3)(a)(i), 2.3(4)(a)(i) and 2.3(5)(a)(i)

The subparagraphs noted above presently refer to material contracts “made by” a mutual fund and the proposed amendments would delete that term and substitute the word “of”. These changes, as well as the amendment to the definition of “material contract” are intended to clarify that the material contracts of mutual funds that are required to be filed are those listed in the annual information form of the mutual fund under the requirements of Form 81-101F2 regardless of whether those contracts are actually **made by** the mutual fund, or by the manager or other relevant entity. The CSA view this amendment as a clarification amendment only.

Subsection 2.3(6)

This is a new provision which provides that a material contract with the portfolio adviser or portfolio advisers of the mutual fund filed pursuant to section 2.3 of NI 81-102 may be filed in an edited form so that commercial or financial information remains confidential if the disclosure of such information could reasonably be expected to significantly prejudice the competitive position of a party to the contract or interfere significantly with negotiations involving the parties to the contract. The CSA have received comments of this nature and argue that the benefits of disclosing such information are outweighed by the adverse consequences of such disclosure for fund managers and portfolio advisers.

Summary of Proposed Amendments to 81-101CP

Subsection 2.6(2)

This is a new provision which discusses the proposed new subsection 2.3(6) of NI 81-102. It sets out the view of the CSA that fees, expenses and non-competition clauses contained in portfolio advisory agreements would be the type of information that could be kept confidential. Essential terms of the contract related to the services provided by the portfolio adviser could

not be kept confidential. These would include provisions relating to the term and termination of the contract.

Summary of Proposed Amendments to Forms 81-101F1 and 81-101F2

This part of this Notice describes the amendments proposed to be made to Forms 81-101F1 and 81-101F2. Section references, unless otherwise noted, are item numbers of those forms.

Form 81-101F1

General Instructions

Subsection (2) of the “General Instructions” is proposed to be amended to correspond to the proposed new subsection 1.3(3) of NI 81-102. This subsection is consistent with section 1.3 of NI 81-101 which provides that certain types of mutual funds cannot use a simplified prospectus.

Subsection (21) is proposed to be added to the “General Instructions” to indicate that a mutual fund that has more than one class or series has the option of treating each class or series as a separate mutual fund and preparing a separate simplified prospectus for each class or series, or combining the disclosure of one or more of the classes or series in one simplified prospectus. If a mutual fund chooses to combine classes or series in one simplified prospectus, separate disclosure in response to each Item in the Form must be provided for each class or series unless the responses would be identical for each class or series.

Item 1 of Part A

Items 1.1(2) and 1.2(2) are proposed to be amended to require that, for both single and multiple simplified prospectuses, if a mutual fund has more than one class or series of securities, the name of those classes or series covered by the simplified prospectus must be named on the front cover of the simplified prospectus.

Item 6 of Part B

Item 6(5) is proposed to be added to require that an index mutual fund disclose specific information as part of its fundamental investment objectives such as the name and nature of its target permitted index or indices, the name of any security that represented more than 10 percent of the target permitted index or indices for the 12 month period immediately preceding the date of the simplified prospectus, the maximum percentage of the index or indices that such security represented in that 12 month period, and the percentage that such security represented as at the most recent date for which that information was available prior to the date of the simplified prospectus.

Item 9 of Part B

Item 9 is proposed to be amended by the addition of subsections (5) and (6).

Subsection (5) applies to index mutual funds. An index mutual fund will be required to disclose the potential risks associated with having its assets invested in one or more issuers beyond

³ Proposed National Instrument 81-104 Commodity Pools was re-published for a second 60 day comment period on June 2, 2000. In Ontario, at (2000) 23 OSCB 3855. It is expected to come into force prior to, or concurrently with, these proposed amendments to the Rules and the Forms.

the 10 percent concentration limit prescribed by section 2.1 of NI 81-102.

Subsection (6) applies to all mutual funds. Any mutual fund that had holdings of an issuer beyond the 10 percent concentration restriction at any time during the 12 months preceding the date of the simplified prospectus will be required to disclose that fact and include specific disclosure of the possible or actual risks associated with that investment. The CSA are of the view that this disclosure is necessary for all mutual funds, having regard to the fact that the 10 percent concentration restriction is a purchase test only. NI 81-102 does not require a mutual fund to reduce its holdings in any one issuer once it goes beyond the 10 percent restriction, for whatever reason due to market fluctuations. The CSA believe, however, the risks inherent in a less diversified portfolio are equally important to an actively managed mutual fund as for an index mutual fund.

Item 11.1 of Part B

Subsection (8) of Item 11.1 is new and clarifies that the requirement to provide performance data "since the inception of the mutual fund" refers to the time when the fund first began distributing securities under a simplified prospectus.

Item 13.2 of Part B

Clause 13.2(2)(c) is proposed to be amended by the deletion of the words "and operating expenses" since the words are redundant. Operating expenses are required to be included in the calculation of MER for a mutual fund.

Clause 13.2 is further proposed to be amended to address situations where the MER of a mutual fund includes fees charged directly to investors, as required by subsection 16.1(3) of NI 81-102. Subsection 13.2(4) will be amended to clarify that the cross reference to fees and expenses paid directly by investors relates to those fees and expenses not included in the calculation of MER.

Form 81-101F2

General Instructions

Corresponding changes to those in Form 81-101F1 are proposed to Form 81-101F2 regarding those mutual funds that issue more than one class or series of securities.

Item 1

Corresponding changes to those in Form 81-101F1 are proposed concerning front cover disclosure of the classes or series of securities of a mutual fund covered by the annual information form.

Item 15

Item 15 is proposed to be amended by the addition of subsection (3) which would require a mutual fund that is a trust to disclose all amounts paid and expenses reimbursed during the most recently completed financial year of the mutual fund, for the services rendered by the trustee(s) of the mutual fund. This will clarify the original intention and is consistent with the

title of this Item which refers to the remuneration of directors, officers and trustees of a mutual fund.

Authority for Proposed Amendments (Ontario)

In those jurisdictions in which the proposed amendments to NI 81-102 and NI 81-101 have been adopted or made as rules or regulations, the securities legislation in each of those jurisdictions provides the securities regulatory authority with rule-making or regulation-making authority.

In Ontario, the following provisions of the *Securities Act* (Ontario) (the "Act") provide the Ontario Securities Commission ("OSC") with authority to make the proposed amendments to NI 81-102 and NI 81-101. 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)16 of the Act authorizes the OSC to make rules varying the application of the Act to establish procedures for or requirements in respect of the preparation and filing of preliminary prospectuses and prospectuses, including requirements in respect of distribution of securities by means of a prospectus incorporating other documents by reference and requirements in respect of distribution of securities by means of a simplified prospectus. 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 considered maintaining a concentration restriction for index mutual funds, albeit beyond the current 10 percent concentration limit in section 2.1 of NI 81-102. The CSA determined to publish for comment the proposed amendments which do not have any concentration restriction for mutual funds since they decided that index mutual funds should be permitted to follow their fundamental investment objectives (that is, tracking the performance of an index) without restriction. The proposed amendments represent the CSA's views on an appropriate regulatory response which balances the needs and particular characteristics of index mutual funds with the investor protection concerns that arise when mutual funds are not fully diversified.

The CSA are aware that there are some indices in which one issuer makes up a very significant percentage of the index. One example that has been provided is the MSCI Finland Index. Nokia has comprised as much as 75 percent of that index. Another issuer has exceeded 10 percent of that index so that those two companies together have comprised more than 85 percent of that index. The CSA believe that the combination of the proposed amendments relating to the

concentration restriction for index mutual funds and the increased disclosure requirements will provide sufficient protection to investors from the risks inherent in investing in index mutual funds tracking such indices.

Comments on any alternatives to the CSA's proposed response to the issues surrounding index mutual funds can be provided during the comment period.

Related Instruments

The proposed amendments relate to NI 81-102, 81-102CP, NI 81-101, 81-101CP, Form 81-101F1 and Form 81-101F2.

Unpublished Materials

In proposing the amendments to NI 81-102, 81-102CP, NI 81-101, 81-101CP, Form 81-101F1 and Form 81-101F2, the CSA have not relied on any significant unpublished study, report, decision or other written materials.

Anticipated Costs and Benefits

The proposed amendments to NI 81-102, 81-102CP, NI 81-101, 81-101CP, Form 81-101F1 and Form 81-101F2 to enable index mutual funds to adhere to their stated fundamental investment objective may bring upon improved performance for index mutual funds which will consequently benefit investors. Conversely, index mutual funds that are no longer subject to any concentration restriction may suffer greater losses than when their exposure to any one issuer was limited to 10 percent of their net assets. While the removal of the concentration restriction for index mutual funds does lead to increased risk, such risk and related potential consequences on the mutual fund will be disclosed to investors.

The index mutual fund proposed amendments are expected to reduce the costs to index mutual funds in ensuring compliance with the concentration restrictions by allowing them to focus on tracking their target permitted index.

The proposed amendments relating to index mutual funds will require these funds to amend their simplified prospectus to include the required disclosure and send a 60-day advance notice to security holders before they are entitled to rely on the relief. Although there will be costs associated with these requirements, the CSA believe that they are more than offset by the need to give investors advance notice of the changes to their index mutual fund.

The requirement to calculate MER for a "rolling" 12 month period in addition to the current requirement that the calculation be based on a completed financial year may require mutual funds to incur additional costs. However, investors are expected to benefit from more current and accurate figures.

The requirement to make front page disclosure of classes or series of units of mutual funds, together with the additional disclosure clarifications relating to these mutual funds, are not expected to result in any additional material cost. Investors will benefit from the clearer disclosure.

Regulations to be Revoked or Amended

In Ontario, the proposed amendments do not require any regulations to be revoked or amended.

Comments

Interested parties are invited to make written submissions with respect to the proposed amendments. Submissions received by September 14, 2000 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
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario M5H 3S8
jstevenson@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
claudestpierre@cvmq.com

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 of 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:

Noreen Bent
Senior Legal Counsel
British Columbia Securities Commission
(604) 899-6741
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Proposed Amendments

The text of the proposed amendments to NI 81-101, 81-101CP, NI 81-102, 81-102CP and Forms 81-101F1 and 81-101F2 follow, together with footnotes that are not part of the proposed amendments, but have been included to provide background and explanation.

DATED: June 16, 2000

**AMENDMENT TO
NATIONAL INSTRUMENT 81-102
MUTUAL FUNDS¹**

PART 1 AMENDMENTS

1.1 Amendments

(1) National Instrument 81-102 Mutual Funds is amended by

(a) the deletion of the definition of "index mutual fund" in section 1.1 and the substitution of the following:

"index mutual fund" means a mutual fund that has adopted fundamental investment objectives that require the mutual fund to

(a) hold the securities that are included in a permitted index of the mutual fund or permitted indices in substantially the same proportion as those securities are reflected in that permitted index or those permitted indices, or

1 This instrument will amend National Instrument 81-102 ("NI81-102"). The purpose of this amending document is to make a number of changes that the Canadian Securities Administrators consider appropriate at this time following the coming into force of NI81-102 on February 1, 2000. This amending instrument addresses some issues that have been brought to the attention of the CSA following the implementation of NI81-102.

This amending instrument is being published concurrently with proposed amendments to the Companion Policy to NI81-102, which also are being included in order to address some issues that have come to the attention of the CSA in connection with the Companion Policy.

In addition, this amending instrument is being published concurrently with proposed amendments to National Instrument 81-101 Mutual Fund Prospectus Disclosure ("NI81-101"), Form 81-101F1 Contents of Simplified Prospectus and Form 81-101F2 Contents of Annual Information Form. That amending instrument amends disclosure requirements contained in NI81-101 and those forms.

For a detailed discussion of the proposals contained in this amending instrument, see the Notice that is published with this Instrument.

The CSA have already proposed amendments to NI81-102, the Companion Policy to NI81-102 and Forms 81-101F1 and 81-101F2 to, among other things, permit mutual funds to enter into securities lending, repurchase and reverse repurchase agreements. Those proposed amendments were published for comment in January 2000 and the comment period expired on April 30, 2000. The CSA expects that those amendments will be in force before the amendments contemplated by this instrument. The numbering of section references in this instrument assumes that the "securities lending/repo amendments" are already in force and takes into account numbering changes made by those amendments.

(b) invest in a manner that causes the mutual fund to replicate the performance of that permitted index or those permitted indices;" and

(b) the addition of the following definition to section 1.1, after the definition of "permitted gold certificate":

"permitted index" means, in relation to a mutual fund, a widely quoted market index that is

(a) administered by an organization that is not affiliated with any of the mutual fund, its manager, its portfolio adviser or its principal distributor, or

(b) widely recognized and used;".

(2) National Instrument 81-102 is amended by

(a) the addition of the following as subsection 1.3(3):

"(3) In this Instrument, a "simplified prospectus" includes a "prospectus", a "preliminary simplified prospectus" includes a "preliminary prospectus" and a "pro forma simplified prospectus" includes a "pro forma prospectus"; and

(b) the deletion of item 1 of paragraph (b) of the definition of "sales communication", and the renumbering of existing items 2 through 6 of that paragraph as items 1 through 5;

(c) the deletion of the words "prospectus or" in each of paragraph 1.2(a), paragraph 8.1(a), paragraph 17.3(2)(a) and paragraph 20.4(b);

(d) the addition of the word "simplified" immediately before the word "prospectus" in paragraph 1.2(b); and

(e) the deletion of the words "preliminary prospectus or" and "prospectus or" in subsection 15.4(9).

(3) Section 2.1 of National Instrument 81-102 Mutual Funds is amended by the addition of the following as subsections 2.1(5), (6) and (7):

"(5) Despite subsection (1), an index mutual fund, the name of which includes the word "index", may purchase a security, enter into a specified derivatives transaction or purchase index participation units if required to allow the index mutual fund to satisfy its fundamental investment objectives.

(6) A mutual fund shall not rely on the relief provided by subsection (5) unless

- (a) its simplified prospectus contains the disclosure contemplated by subsection (5) of Item 9 of Part B of Form 81-101F1 Contents of a Simplified Prospectus; and
 - (b) the mutual fund has provided to its securityholders, not less than 60 days before it first relies on the relief provided by subsection (5), written notice that discloses that it may, from time to time, rely on that relief and that contains the disclosure contemplated by subsection (5) of Item 9 of Part B of Form 81-101F1.
- (7) A mutual fund is not required to provide the notice referred to in paragraph (6)(b) if each simplified prospectus of the mutual fund since its inception contains the disclosure referred to in paragraph (6)(a)."
- (4) National Instrument 81-102 is amended by
- (a) the addition of the words "or regulator" immediately after the words "securities regulatory authority" in subsection 5.5(1); and
 - (b) the addition of the following as subsection 5.5(3):
 - "(3) Despite subsection (1), in Ontario only the regulator may grant an approval referred to in subsection (1)."
- (5) National Instrument 81-102 is amended by the substitution of the word "affiliate" for the word "subsidiary" in paragraph 3(b) of section 6.3.
- (6) National Instrument 81-102 is amended by the deletion of the words "immediately before the close of business" in paragraph 9.4(4)(a).
- (7) National Instrument 81-102 is amended by the deletion of subsection 15.4(12).
- (8) National Instrument 81-102 is amended by the deletion of subparagraph 15.6(1)(a)(i) and the substitution of the following:
- "(i) the mutual fund has offered securities under a simplified prospectus in a jurisdiction for 12 consecutive months, or the asset allocation service has been operated for at least 12 consecutive 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 12 consecutive months, or".
- (9) National Instrument 81-102 is amended by the deletion of subsection 16.1(1) and the substitution of the following:
- "(1) A mutual fund may disclose, in a simplified prospectus, annual information form or annual financial statements, 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, before income taxes, for the financial year, as shown on its income statement,

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."
- (10) National Instrument 81-102 is amended by the addition of the following as subsections 16.1(2) and (3):
- "(2) A mutual fund may disclose, other than in a simplified prospectus, annual information form or annual financial statements, its management expense ratio only if the management expense ratio is calculated for the 12 month period referred to in subsection (3) and if it is calculated by
 - (a) dividing
 - (i) the total expenses of the mutual fund, before income taxes, for the 12 month period,

by
 - (ii) the average net asset value of the mutual fund for the 12 month period, 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 12 month period 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 12 month period on which the net asset value of the mutual fund has been calculated; and
- (b) multiplying the result obtained under paragraph (a) by 100.
- (3) When a management expense ratio for a mutual fund is calculated under subsection (2),
- (a) the mutual fund shall calculate and allocate expenses in the 12 month period referred to in subsection (2) in a manner consistent with the calculation and allocation of expenses for the income statement that forms part of the annual financial statements of the mutual fund; and
 - (b) the 12 month period referred to in subsection (2) shall end
 - (i) on the last day of a calendar month,
 - (ii) if the management expense ratio is presented in an advertisement, not more than 45 days before the date of the appearance or use of the management expense ratio in the advertisement in which it is included, and
 - (iii) if the management expense ratio is presented or disclosed in a document or communication other than an advertisement, not more than three months before the date of first presentation or publication of the document or communication."
- (11) National Instrument 81-102 is amended by renumbering subsections 16.1(2) and (3) as subsections 16.1(4) and (5), respectively.
- (12) National Instrument 81-102 is amended by the addition of the following as subsection 16.1(6):
- "(6) The requirements to provide note disclosure contained in subsections (4) and (5) do not apply when a mutual fund provides its management expense ratio to a service provider that will arrange for public dissemination of the management expense ratio, if the mutual fund indicates, as applicable, that management fees have been waived or that management fees were paid directly by investors during the period for which the management expense ratio was calculated."
- (13) National Instrument 81-102 is amended by the renumbering of subsections 16.1(4), (5), (6), (7) and (8) as subsections 16.1 (7), (8), (9), (10) and (11), respectively.
- (14) National Instrument 81-102 is amended by the deletion of section 16.2 and the substitution of the following:
- "16.2 Fund of Funds Calculation** - For the purposes of subparagraphs 16.1(1)(a)(i) and 16.1(2)(a)(i), the total expenses of a mutual fund that invests in securities of one or more other mutual funds is equal to the sum of:
- (a) the total expenses incurred by the mutual fund that are for the period that the calculation of management expense ratio is made and that are attributable to its investment in each underlying mutual fund, as calculated by
 - (i) multiplying the total expenses of each underlying mutual fund, before income taxes, for the period, by
 - (ii) the average proportion of securities of the underlying mutual fund held by the mutual fund during the period, calculated by
 - (A) adding together the proportion of securities of the underlying mutual fund held by the mutual fund on each day in the period, and
 - (B) dividing the amount obtained under clause (A) by the number of days in the period; and
 - (b) the total expenses of the mutual fund, before income taxes, for the period."

PART 2 EFFECTIVE DATE

2.1 Effective Date - This Amendment comes into force on ! , 2000.

**AMENDMENT TO
COMPANION POLICY 81-102CP
MUTUAL FUNDS**

PART 1 AMENDMENTS

1.1 Amendments

- (1) Companion Policy 81-102CP is amended by the deletion of subsection 2.16(2), the substitution of subsection (2) below as the new subsection 2.16(2) and the addition of subsection (3) below as subsection 2.16(3):

"(2) Because of the broad ambit of the lead-in language to the definition, it is impossible to list every instrument, agreement or security that might be caught by that lead-in language but that is not considered to be a derivative in any normal commercial sense of that term. The Canadian securities regulatory authorities consider conventional floating rate debt instruments, securities of a mutual fund or commodity pool, non-redeemable securities of an investment fund, American depositary receipts and instalment receipts generally to be within this category, and generally will not treat those instruments as specified derivatives in administering the Instrument.

(3) However, the Canadian securities regulatory authorities note that these general exclusions may not be applicable in cases in which a mutual fund invests in one of the vehicles described in subsection (2) with the result that the mutual fund obtains or increases exposure to a particular underlying interest in excess of the limit set out in section 2.1 of the Instrument. In such circumstances, the Canadian securities regulatory authorities are likely to consider that instrument a specified derivative under the Instrument.

- (2) Companion Policy 81-102CP is amended by the addition of the following as subsection 13.2(5):

"(5) Subsections 15.8(2) and (3) of the Instrument require disclosure of standard performance data of a mutual fund, in some circumstances, from "the inception of the mutual fund". It is noted that paragraph 15.6(1)(d) generally prohibits disclosure of performance data for a period that is before the time when the mutual fund offered its securities under a simplified prospectus or before an asset allocation service commenced operation. Also, Instruction (1) to Item 5 of Part B of Form 81-101F1 Contents of Simplified Prospectus requires disclosure of the date on which a mutual fund's securities first became available to the public as the date on which the mutual

fund "started". Therefore, consistent with these provisions, the words "inception of the mutual fund" in subsections 15.8(2) and (3) should be read as referring to the beginning of the distribution of the securities of the mutual fund under a simplified prospectus of the mutual fund, and not from any previous time in which the mutual fund may have existed but did not offer its securities under a simplified prospectus."

- (3) Companion Policy 81-102CP is amended by the addition of the following as section 3.2, and the consequent renumbering of existing sections 3.2, 3.3, 3.4, 3.5 and 3.6 as sections 3.3, 3.4, 3.5, 3.6 and 3.7, respectively:

"3.2 Index Mutual Funds

- (1) An "index mutual fund" is defined in section 1.1 of the Instrument as a mutual fund that has adopted fundamental investment objectives that require it to either

(a) hold the securities that are included in a permitted index or permitted indices of the mutual fund in substantially the same proportion as those securities are reflected in that permitted index or permitted indices; or

(b) invest in a manner that causes the mutual fund to replicate the performance of that permitted index or those permitted indices.

(2) This definition includes only mutual funds whose entire portfolio is invested in accordance with one or more permitted indices. The CSA recognizes that there may be mutual funds that invest part of their portfolio in accordance with a permitted index or indices, with a remaining part of the portfolio being actively managed. Those mutual funds cannot avail themselves of the relief provided by subsection 2.1(5) of the Instrument, which provides relief from the "10 percent rule" contained in subsection 2.1(1) of the Instrument, because they are not "index mutual funds". The CSA acknowledge that there may be circumstances in which the principles behind the relief contained in subsection 2.1(5) of the Instrument is also applicable to "partially-indexed" mutual funds. Therefore, the CSA will consider applications from those types of mutual funds for relief analogous to that provided by subsection 2.1(5) of the Instrument.

(3) It is noted that the manager of an index mutual fund may make a decision to base the investments of the mutual fund on a different permitted index than the permitted index previously used. This decision might

be made for investment reasons or because that index no longer satisfies the definition of "permitted index" in the Instrument. It is noted that this decision by the manager will be considered by the Canadian securities regulatory authorities generally to constitute a change of fundamental investment objectives, thereby requiring securityholder approval under paragraph 5.1(c) of the Instrument. In addition, this decision would also constitute a significant change for the mutual fund, thereby requiring an amendment to the simplified prospectus of the mutual fund and the issuing of a press release under section 5.10 of the Instrument."

- (4) Companion Policy 81-102CP is amended by the deletion of section 14.1 and the substitution of the following:

"14.1 Calculation of Management Expense Ratio

- (1) Part 16 of the Instrument sets out the method to be used by a mutual fund in calculating its management expense ratio. The requirements contained in Part 16 are applicable in all circumstances in which a mutual fund calculates and discloses a management expense ratio. Subsection 16.1(1) applies to disclosure in a simplified prospectus, annual information form or audited annual financial statements. Subsection 16.1(2) applies to all other media through which disclosure could be made.
- (2) Subsections 16.1(1) and (2) require the mutual fund to use its "total expenses" before income taxes for the relevant period as the basis for the calculation of management expense ratio. Total expenses before income taxes will include interest charges and taxes of virtually all types, including sales taxes, GST and capital taxes, payable by the mutual fund. Income taxes, of course, would not be included in a calculation of total expenses before income taxes. In addition, Canadian GAAP would permit a mutual fund to deduct withholding taxes from the income to which they apply; therefore, withholding taxes would not be included as part of "total expenses".
- (3) Brokerage charges are not considered to be part of total expenses as they are included in the cost of purchasing, or netted out of the proceeds from selling, portfolio assets.

- (4) Subsection 16.1(6) of the Instrument makes reference to a mutual fund indicating, when providing management expense ratio information to a service provider that will arrange for public dissemination of the management expense ratio, whether management fees were waived or paid directly by investors during the relevant period. It is expected that the service providers will include this information in any disclosure of management expense ratio to the public in a manner that is clear and easily understandable by investors. Service providers may use symbols to inform the public of the different elements of a management expense ratio. If symbols are used, they should be accompanied by an explanatory legend."

PART 2 EFFECTIVE DATE

- 2.1 Effective Date** - This Amendment comes into force on ! , 2000.

**NATIONAL INSTRUMENT 81-101
MUTUAL FUND PROSPECTUS DISCLOSURE
AMENDMENTS TO
NATIONAL INSTRUMENT 81-101
MUTUAL FUND PROSPECTUS DISCLOSURE
FORM 81-101F1
CONTENTS OF SIMPLIFIED PROSPECTUS
AND
FORM 81-101F2
CONTENTS OF ANNUAL INFORMATION FORM**

PART 1 AMENDMENTS TO NATIONAL INSTRUMENT 81-101

1.1 Amendments to National Instrument 81-101

- (1) National Instrument 81-101 is amended by
- (a) the deletion of the definition of "commodity pool" in section 1.1 and the substitution of the following:

"commodity pool" has the meaning ascribed to that term in National Instrument 81-104 Commodity Pools;" and
 - (b) the deletion of the definition of "material contract" in section 1.1 and the substitution of the following:

"material contract" means, for a mutual fund, a contract listed in the annual information form of the mutual fund in response to Item 16 of Form 81-101F2 Contents of Annual Information Form;"
- (2) National Instrument 81-101 is amended by the deletion of the words "made by" and the substitution of the word "of" in subparagraphs 2.3(1)(b)(i), 2.3(2)(a)(i), 2.3(3)(a)(i), 2.3(4)(a)(i) and 2.3(5)(a)(i).
- (3) National Instrument 81-101 is amended by the addition of the following as subsection 2.3(6):
- "(6) Despite any other provision of this section, a mutual fund may delete commercial or financial information from the version of an agreement of the mutual fund, its manager or trustee with a portfolio adviser or portfolio advisers of the mutual fund filed as contemplated by this section if the disclosure of that information could reasonably be expected to
- (a) prejudice significantly the competitive position of a party to the agreement; or
 - (b) interfere significantly with negotiations in which parties to the agreement are involved."

PART 2 AMENDMENTS TO FORM 81-101F1

2.1 Amendments to Form 81-101F1

- (1) The "General Instructions" of Form 81-101F1 are amended by the addition of the following sentence at the end of subsection (2):
- "However, subsection 1.3(3) of National Instrument 81-102 does not apply to this Form."*
- (2) The "General Instructions" of Form 81-101F1 are amended by the addition of the following immediately after subsection (20):
- "Multi-Class Mutual Funds*
- (21) A mutual fund that has more than one class or series may treat each class or series as a separate mutual fund, for purposes of this Form, or may combine disclosure of one or more of the classes or series in one simplified prospectus. If disclosure pertaining to more than one class or series is combined in one simplified prospectus, separate disclosure in response to each item in this Form must be provided for each class or series unless the responses would be identical for each class or series."*
- (3) Item 1 of Part A of Form 81-101F1 is amended by
- (a) the deletion of subsection 1.1(2) and the substitution of the following:

"(2) Indicate on the front cover the name of the mutual fund to which the simplified prospectus pertains. If the mutual fund has more than one class or series of securities, indicate the name of each of those classes or series covered in the simplified prospectus."; and
 - (b) the deletion of subsection 1.2(2) and the substitution of the following:

"(2) Indicate on the front cover the names of the mutual funds and, at the option of the mutual funds, the name of the mutual fund family, to which the document pertains. If the mutual fund has more than one class or series of securities, indicate the name of each of those classes or series covered in the simplified prospectus."
- (4) Item 6 of Part B of Form 81-101F1 is amended by the addition of the following as subsection (5):
- "(5) For an index mutual fund,
- (a) disclose the name or names of the permitted index or permitted indices on

which the investments of the index mutual fund are based,

- (b) briefly describe the nature of that permitted index or those permitted indices,
- (c) for the 12 month period immediately preceding the date of the simplified prospectus,
 - (i) indicate whether one or more securities represented more than 10 percent of that permitted index or those permitted indices,
 - (ii) identify that security or securities, and
 - (iii) disclose the maximum percentage of the permitted index or permitted indices that that security or those securities represented in the 12 month period, and
- (d) disclose the percentage that the security or securities referred to in paragraph (c) represented at the most recent date for which that information is available."

- (5) Item 9 of Part B of Form 81-101F1 is amended by the addition of the following as subsections (5) and (6):

"(5) For an index mutual fund, disclose that the mutual fund may, in basing its investment decisions on one or more permitted indices, have more of its net assets invested in one or more issuers than is usually permitted for mutual funds, and disclose the risks associated with that fact, including the possible effect of that fact on the liquidity and diversification of the mutual fund, its ability to satisfy redemption requests and on the volatility of the mutual fund.

(6) If at any time during the 12 month period immediately preceding the date of the simplified prospectus, more than 10 percent of the net assets of a mutual fund were invested in the securities of an issuer, disclose this fact and disclose the risks associated with that fact, including the possible or actual effect of that fact on the liquidity and diversification of the mutual fund, its ability to satisfy redemption requests and on the volatility of the mutual fund."¹

¹ Subsection (6) has been added to require a mutual fund to provide disclosure if at any time in the 12 months immediately preceding the date of the simplified prospectus more than 10 percent of its net assets were

- (6) Item 11.1 of Part B of Form 81-101F1 is amended by

- (a) the addition of the following as subsection (8):

"(8) A reference to "the inception of a mutual fund" in Item 11 refers to the time at which the mutual fund first began distributing its securities under a simplified prospectus."; and

- (b) the deletion of subparagraph 11.3(3)(b)(iii).

- (7) Item 13.2 of Part B of Form 81-101F1 is amended by

- (a) the deletion of the words "and operating expenses" in paragraph 13.2(2)(c); and

- (b) the addition of the following as paragraph 13.2(4):

If the management expense ratio of the mutual fund is composed, in part, of fees charged directly to investors, include disclosure of that fact. The management expense ratio used in calculating the disclosure to be provided under this Item should be the management expense ratio that includes these fees directly charged to investors; that is, the management expense ratio calculated in accordance with the general rules of Part 16 of National Instrument 81-102; and

- (c) the renumbering of subsection 13.2(4) as subsection 13.2(5), and the addition of the words "which are not included in the calculation of management expense ratio" at the end of that subsection.

invested in the securities of an issuer. The CSA note that this provision may apply to mutual funds that are availing themselves of discretionary relief that permits them to exceed the normal 10 percent limit, to index mutual funds that are relying on subsection 2.1(5) of National Instrument 81-102, and to any other mutual fund whose portfolio, as the result of market movements, has had a security represent more than 10 percent of the net assets of the mutual fund.

PART 3 AMENDMENTS TO FORM 81-101F2

3.1 Amendments to Form 81-101F2

- (1) The "General Instructions" of Form 81-101F2 are amended by the addition of the following sentence at the end of subsection (2):

"However, subsection 1.3(3) of National Instrument 81-102 does not apply to this Form."

- (2) The "General Instructions" of Form 81-101F2 are amended by the addition of the following immediately after subsection (13):

"Multi-Class Mutual Funds

(14) A mutual fund that has more than one class or series may treat each class or series as a separate mutual fund, for purposes of this Form, or may combine disclosure of one or more of the classes or series in one annual information form."

- (3) Item 1 of Form 81-101F2 is amended by

- (a) the deletion of subsection 1.1(2) and the substitution of the following:

"(2) Indicate on the front cover the name of the mutual fund to which the annual information form pertains. If the mutual fund has more than one class or series of securities, indicate the name of each of those classes or series covered in the annual information form."; and

- (b) the deletion of subsection 1.2(2) and the substitution of the following:

"(2) Indicate on the front cover the names of the mutual funds and, at the option of the mutual funds, the name of the mutual fund family, to which the document pertains. If the mutual fund has more than one class or series of securities, indicate the name of each of those classes or series covered in the document."

- (4) Item 15 of Form 81-101F2 is amended by the addition of the following as subsection (3):

"(3) For a mutual fund that is a trust, describe the arrangements, including the amounts paid and expenses reimbursed, under which compensation was paid or payable by the mutual fund during the most recently completed financial year of the mutual fund, for the services of the trustee or trustees of the mutual fund."

PART 4 EFFECTIVE DATE

- 4.1 Effective Date** - This Amendment comes into force on ! , 2000.

**AMENDMENT TO
COMPANION POLICY 81-101CP
MUTUAL FUND PROSPECTUS DISCLOSURE**

PART 1 AMENDMENTS

1.1 Amendments

(1) Companion Policy 81-101CP is amended by the substitution of the reference to "section 2.2" in section 2.5 with a reference to "section 2.3".

(2) Companion Policy 81-101CP is amended by the deletion of section 2.6 and the substitution of the following:

"(1) Section 2.3 of the Instrument and other Canadian securities legislation require supporting documents to be filed with a simplified prospectus and annual information form and amendments. A list of documents required is set out in an Appendix to National Policy 43-201 Mutual Reliance System for Prospectus and Initial AIFs.

(2) Subsection 2.3(6) of the Instrument permits the filing of versions of certain material contracts from which certain commercial or financial information has been deleted in order to be kept confidential. The Canadian securities regulatory authorities are of the view that information such as fees and expenses and non-competition clauses is the type of information that could be kept confidential under this provision. In these cases, the benefits of disclosing that information to the public are outweighed by the potentially adverse consequences of disclosure for mutual fund managers and portfolio advisers. However, the basic terms of these agreements must be included in the versions that are filed. These terms would include the provisions relating to the term and termination of the agreements and the rights and responsibilities of the parties to the agreements."

PART 2 EFFECTIVE DATE

2.1 Effective Date - This Amendment comes into force on ! , 2000.