# Chapter 5

# Rules and Policies

## 5.1 Rules and Policies

### 5.1.1 NI 81-102, 81-102CP Mutual Funds, NI 81-101& 81-101CP Mutual Fund Prospectus Disclosure

**NOTICE OF RULES AND POLICIES MADE UNDER THE SECURITIES ACT**

**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 TO**
**FORM 81-101F1**
**CONTENTS OF SIMPLIFIED PROSPECTUS**

**AND TO**
**FORM 81-101F2**
**CONTENTS OF ANNUAL INFORMATION FORM**

**Notice of Rules and Policy**

The Commission has, under section 143 of the *Securities Act* (Ontario) (the "Act"), made rules (collectively, the "Rule Amendments") that amend the following instruments (the "Existing Rules"):

1. National Instrument 81-101 Mutual Fund Prospectus Disclosure (NI 81-101),

2. Form 81-101F1 Contents of Simplified Prospectus (Form 81-101FI),

3. Form 81-101F2 Contents of Annual Information Form (Form 81-101F2), and

4. National Instrument 81-102 Mutual Funds (NI 81-102).

The Commission also has, under section 143.8 of the Act, adopted policies (collectively, the "Policy Amendments") that amend the following policies of the Commission (the "Existing Policies"):

1. Companion Policy 81-101CP to National Instrument 81-101 Mutual Fund Prospectus Disclosure (CP81-101); and

2. Companion Policy 81-102CP to National Instrument 81-102 Mutual Funds (CP81-102).

The Rule Amendments and the material required by the Act to be delivered to the Minister of Finance were delivered on February 16, 2001.

If the Minister does not approve the Rule Amendments, reject the Rule Amendments or return them to the Commission for further consideration by May 2, 2001, or if the Minister approves the Rule Amendments, the Rule Amendments will come into force on May 2, 2001. The date that the Rule Amendments come into force is referred to in this Notice as the effective date of the Rule Amendments. The Policy Amendments will come into force on the effective date of the Rule Amendments.

In this Notice, the Rule Amendments and the Policy Amendments will be referred to collectively, as the Amendments.

The Amendments are initiatives of the Canadian Securities Administrators ("CSA"). The Rule Amendments have been, or are expected to be, adopted as rules in each of British Columbia, Alberta, Manitoba, Ontario and Nova Scotia, a Commission regulation in Saskatchewan, and policies in all other jurisdictions represented by the CSA. The Policy Amendments have been, or are expected to be, implemented as policies in all of the jurisdictions represented by the CSA.

**Background**
The CSA published drafts of the Amendments for comment in two separate Notices of Proposed Amendments, published in Ontario on:

- January 28, 2000[1] (the "January Draft Amendments"); and

- June 16, 2000[2] (the "June Draft Amendments").

The January Draft Amendments dealt primarily with the CSA's proposal to permit mutual funds to enter into securities lending, repurchase and reverse repurchase transactions. The June Draft Amendments proposed changes to permit index mutual funds to better meet their investment objectives, but also proposed changes to the calculation of the management expense ratio of mutual funds, amongst other housekeeping changes.

The Notices of Proposed Amendments published with the January Draft Amendments and the June Draft Amendments

[1] (2000) 23 OSCB (Supp.) 133.

[2] (2000) 23 OSCB 4195.

provide background for the Amendments and describe the changes proposed to be made to the Existing Rules and the Existing Policies and the reasons for such changes.

The comment periods for the January Draft Amendments and the June Draft Amendments ended on April 30, 2000 and September 14, 2000, respectively. The CSA received a number of submissions on each of the January Draft Amendments and the June Draft Amendments. The CSA have considered the comments provided in these submissions and their decisions regarding these comments are reflected in the Amendments. Changes have been made from the January Draft Amendments and the June Draft Amendments in response to comments received.

The CSA are of the view that none of the changes made from the January Draft Amendments and the June Draft Amendments are material within the meaning of securities legislation. Accordingly the Amendments are not subject to a further comment period.

Since the CSA are not making any material changes from the January Draft Amendments or the June Draft Amendments, these two rule and policy amendments have been combined into the Amendments. The Amendments should be read with the Existing Rules and the Existing Policies, as amended.

Appendix A to this Notice lists the commentators on each of the January Draft Amendments and the June Draft Amendments. Appendix B provides a summary of the comments received on the January Draft Amendments and the response of the CSA to those comments. Appendix C provides this information for the June Draft Amendments.

This Notice summarizes the changes to the January Draft Amendments and the June Draft Amendments made in response to comments received and as a result of further consideration of the applicable proposed rules and policies by the CSA.

**Substance and Purpose of the Amendments**

The purpose of the Amendments is to:

- allow mutual funds to enter into securities lending, repurchase and reverse repurchase transactions on a basis that the CSA believe is appropriate to both ensure investor protection and permit mutual funds to realize the potential benefits of these transactions for their securityholders;

- permit index mutual funds to better achieve their investment objectives by allowing them to track their target indices without concentration limits, provided certain disclosure requirements are adhered to; and

- make various housekeeping amendments to the Existing Rules and the Existing Policies to address issues that were brought to the attention of the CSA when they were finalizing the Existing Rules and the Existing Policies in late 1999 and since those rules and policies came into force on February 1, 2000.

The Notices of Proposed Amendments published with the January Draft Amendments and the June Draft Amendments contain a complete description of the substance and purpose of the Amendments.

**Transitional Matters**

The Investment Funds Institute of Canada has asked the CSA, on behalf of its members, whether the CSA would object if mutual funds gave the notices required by the Amendments to permit those mutual funds to engage in securities lending transactions, repurchase agreements and reverse repurchase agreements, after the date the CSA have made the Amendments, but before they become effective. Similar questions have been asked on behalf of index mutual funds wishing to take advantage of the concentration restriction exemptions provided in the Amendments once the Amendments come into force.

The CSA note that the Amendments do not prescribe that the required notices be given only once the Amendments become effective. If this were the result, the CSA note that mutual funds would be obliged to wait 60 days before engaging in these transactions following the coming into force of the Amendments.

Provided the content of the notices conform with the requirements set out in the Amendments and investors are informed that a mutual fund will engage in these transactions only if and when the Amendments come into force, the CSA will consider the notices properly given if given before the coming into force of the Amendments. Since the coming into force of the Amendments is dependent, in Ontario and British Columbia, on government approval, the CSA recommend that the notices clarify this point.

The CSA also will not object to mutual funds wishing to amend their prospectuses to provide the required disclosure, provided clear disclosure is given of the status of (i) the funds' ability to engage in these transactions and (ii) the coming into force of the Amendments.

**Summary of Changes to the Amendments from the January Draft Amendments and June Draft Amendments**

This section describes changes made in the Amendments from the January Draft Amendments and the June Draft Amendments except that 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 January Draft Amendments and the June Draft Amendments, reference should be made to the Notices published with those proposed amendments.

**Rule Amendment to NI 81-102**

*Section 1.1 - Definitions*

"*permitted index*"

The June Draft Amendments proposed a new definition of "permitted index" in connection with the proposed rules relating to index mutual funds. The CSA have amended this definition from the June Draft Amendments by deleting the requirement that a permitted index be one that is "widely quoted". Instead,

the definition now provides that a permitted index must be one that is either (a) both administered by an organization that is not affiliated with any of the mutual fund, its manager, its portfolio adviser or its principal distributor and available to persons or companies other than the mutual fund, or (b) one that is widely recognized and used. This change was made in response to concerns surrounding the potential ambiguity of the words "widely quoted". The CSA are of the view that an index which is widely recognized and used, but which may not be widely quoted by the media, should not be prevented from qualifying as a "permitted index".

*"qualified security"*

The January Draft Amendments proposed a new definition of "qualified security" in connection with the securities lending, repurchase and reverse repurchase transaction rule amendments. The CSA have amended this definition from the January Draft Amendments. The CSA agree with commentators that commercial paper and debt of Canadian financial institutions where the issuer or guarantor of such securities has an approved credit rating can constitute acceptable collateral for securities lending. Firstly, this change will permit mutual funds to accept collateral that is currently permitted as eligible collateral in the guidelines for securities lending for pension plans and life insurance companies (the "OSFI Guidelines") developed by the Office of the Superintendent of Financial Institutions ("OSFI")[3]. The CSA are of the view that the collateral for these transactions remain limited to securities which are sufficiently liquid and secure while being consistent with current practices for institutional lenders in Canada. Secondly, the change will also allow mutual funds more flexibility in how the cash collateral, or sale proceeds from a repurchase transaction, can be reinvested, since such reinvestment can only be in qualified securities. Thirdly, the change will allow more flexibility in the securities which may be purchased by a mutual fund under a reverse repurchase transaction.

*Section 2.1 - Concentration Restriction*

The June Draft Amendments proposed new subsections (5), (6) and (7) of section 2.1 to provide an exemption from the concentration restrictions for index mutual funds, as defined by the June Draft Amendments.

Subsection (6) has been amended from the June Draft Amendments. To clarify that an index mutual fund can only rely on the relief provided by subsection (5) if it includes the disclosure required by subsection (5) of Item 6, as well as the disclosure required by subsection (5) of Item 9, both of Part B to Form 81-101F1. Subsection (6) of section 2.1 as drafted in the June Draft Amendments did not specifically refer to subsection (5) of Item 6. This was an oversight since the June Draft Amendments clearly proposed that this disclosure be included in the simplified prospectus of an index mutual fund.

*Section 2.12 - Securities Loans*

The January Draft Amendments proposed a new section 2.12 which contained the conditions to be satisfied by a mutual fund in order for it to enter into a securities lending transaction as lender.

Three changes have been made to section 2.12 from the January Draft Amendments.

Firstly, paragraph 6 of subsection 2.12(1) has been amended to permit specified irrevocable letters of credit as acceptable collateral for a securities lending transaction. Letters of credit must be issued by a Canadian financial institution with an approved credit rating as defined in NI 81-102. Letters of credit issued by the counterparty, or an affiliate of the counterparty, of the mutual fund in the transaction will not be acceptable collateral. The CSA understand that letters of credit are eligible collateral under the OSFI Guidelines and for mutual funds in the United States for securities lending transactions. The CSA's views on the prudent use of letters of credit as collateral have been added in subsection 3.7(4) of the Policy Amendments relating to CP81-102.

Secondly, paragraph 12 of subsection 2.12(1) has been amended to clarify the aggregate lending/repurchase transaction limit. The CSA have simplified this limit to be 50 percent of the total assets of a mutual fund (*without* including the collateral) in response to some apparent confusion on the calculation methodology contained in the January Draft Amendments. The January Draft Amendments followed the model for U.S. mutual funds whereby mutual funds are permitted to lend up to 33 - 1/3 percent of total assets including the collateral received from the borrower. The new limit of 50 percent without counting the collateral received is substantively similar to the 33 - 1/3 percent restriction in the U.S. model, but the CSA consider that the revised limit is easier to understand.

Thirdly, clause 2.12(2)(a) has been amended to permit a mutual fund to reinvest any cash collateral received in qualified securities with a term to maturity no longer than 90 days. The January Draft Amendments essentially limited reinvestment of cash collateral to overnight investments. After reviewing the comments received on this issue, the CSA are of the view that this restriction was not commercially practicable. The Amendments allow lending agents to invest any cash collateral on a portfolio basis within the term to maturity restriction. The CSA believe that this change will allow for investment diversification while continuing to restrict investments to secure, liquid and short-term instruments.

Similarly, clause 2.12(2)(b) has been amended to allow a mutual fund to invest cash collateral received from securities lending transactions, in reverse repurchase transactions as permitted by section 2.14. Under clause 2.12(2)(b) of the January Draft Amendments, a mutual fund was limited to reinvesting its cash collateral in overnight reverse repurchase transactions. This result was not intended by the CSA.

[3] OSFI Guidelines Pensions B-4 Securities Lending - Pension Plans (February 1992) and OSFI Guidelines Life Insurance Companies B-4 Securities Lending (February 1997).

*Section 2.13 - Repurchase Transactions*

The January Draft Amendments proposed a new section 2.13 which contained the conditions to be satisfied by a mutual fund in order for it to enter into a repurchase transaction as lender.

Three changes have been made to section 2.13 from the January Draft Amendments.

Firstly, paragraph 10 of subsection 2.13(1) has been amended to permit repurchase transactions with a maximum term of 30 days. After reviewing the comments, the CSA are of the view that the maximum term of five business days proposed in the January Draft Amendments was overly restrictive and the amendment is more reflective of commercial realities for these transactions. This change will allow mutual funds to reduce the administrative costs of entering into new repurchase transactions on a weekly basis.

Secondly, paragraph 11 of subsection 2.13(1) has been amended to clarify the aggregate lending/repurchase limit in a manner identical to that described above in respect of section 2.12.

Thirdly, clause 2.13(2)(a) has been amended to permit a mutual fund to reinvest cash sale proceeds in qualified securities with a maximum term to maturity of 30 days. This change mirrors the change to paragraph 10 of subsection 2.13(1) which permits a mutual fund to enter into a repurchase transaction with a term of up to 30 days. A mutual fund will have the added flexibility to invest the cash sales proceeds from a repurchase transaction in 30 day debt instruments which may be more liquid, provide better returns to the fund and provide for additional diversification.

Similarly, clause 2.13(2)(b) has been amended to remove the requirement that reverse repurchase transactions entered into with sales proceeds must have "a term to maturity no longer than the term of the repurchase transaction". As with the change to clause 2.12(2)(b), a lending agent is permitted to manage the reinvested cash, subject to the restrictions that any reverse repurchase transaction must be permitted by section 2.14.

*Section 2.14 - Reverse Repurchase Transactions*

The January Draft Amendments proposed a new section 2.14 which contained the conditions to be satisfied by a mutual fund in order for it to enter into a reverse repurchase transaction.

Section 2.14 has been changed in two ways from the January Draft Amendments.

Paragraph 3 of subsection 2.14(1) has been amended to delete the restriction on the term to maturity of the qualified securities purchased by the mutual fund under a reverse repurchase transaction. The CSA are of the view that the current restrictions, including: (i) the maximum term of the reverse repurchase transaction; (ii) the over-collateralization requirement; (iii) the daily marking to market of collateral and (iv) the definition of qualified securities adequately address the risks that this restriction was intended to deal with.

Paragraph 9 of subsection 2.14(1) has been amended to increase the maximum term of a permitted reverse repurchase transaction to 30 days (from five business days). As discussed above in the context of repurchase agreements, the CSA are of the view that the maximum term of five business days in the January Draft Amendments was overly restrictive.

*Section 2.15 - Agent for Securities Lending, Repurchase and Reverse Repurchase Transactions*

The January Draft Amendments proposed a new section 2.15 which contained the requirements relating to the use of an agent by a mutual fund to administer its securities lending, repurchase and reverse repurchase transactions.

Subsection 2.15(4) of the January Draft Amendments has been deleted, as have requirements that the manager of a mutual fund have reasonable grounds for believing that the mutual fund's custodian or sub-custodian is competent to act as an agent. The CSA have deleted these provisions since in their view the requirements did not add substantively to the existing legal framework for mutual fund managers in appointing agents for mutual funds. A discussion of the CSA's views regarding the appointment of lending agents has been added to subsection 3.7(12) of the Policy Amendments to CP81-102.

*Section 2.16 - Controls and Records*

The January Draft Amendments proposed a new section 2.16 which imposed reporting and review requirements on both the agent and the manager of a mutual fund.

Clause 2.16(2)(c) is new. The CSA have added this provision to highlight the need for agreed upon collateral diversification standards when running a securities lending program. Collateral diversification standards help to minimize a mutual fund's exposure to any one issuer's securities in the event of a borrower default where the mutual fund is required to realize on the collateral received from that borrower.

*Section 2.17 - Commencement of Securities Lending, Repurchase and Reverse Repurchase Transactions by a Mutual Fund*

Subsection 2.17(2) is new. This subsection clarifies that mutual funds that have entered into reverse repurchase transactions prior to the effective date of the Amendments pursuant to decisions of the securities regulatory authorities are not required to provide notice to securityholders of their intention to continue to enter into such transactions after the effective date of the Amendments. The CSA consider that these mutual funds have given their securityholders adequate notice of their reverse repurchase transactions practices.

*Part 5 - Fundamental Changes - Sections 5.5, 5.6 and 5.9*

The CSA proposed to amend section 5.5 in the June Draft Amendments through the addition of subsection (3) to permit the same procedures for securities regulatory approvals under Part 5 of NI 81-102 as are permitted for exemptions under section 19. In finalizing the Rule Amendments, the CSA noted that other sections in Part 5 needed to reflect this decision and accordingly the words "or regulator" have been added to sections 5.5, 5.6 and 5.9 where appropriate.

*Section 6.8 - Custodial Provisions relating to Derivatives and Securities Lending, Repurchase and Reverse Repurchase Agreements*

The CSA have changed the name of this section to better reflect its contents.

The CSA proposed an amendment to subsection 6.8(3) in the January Draft Amendments. In response to the comments received and further consideration of this provision by the CSA, the CSA have not made this proposed amendment final and subsection 6.8(3) remains unamended. The CSA are satisfied that the safeguards currently built into Part 6 are adequate to protect the interests of security holders of mutual funds using over-the-counter derivatives to accomplish their investment objectives.

Subsection 6.8(5) is new. The CSA have added this subsection in response to comments, to allow a mutual fund to deliver its portfolio assets to a counterparty pursuant to a securities lending, repurchase or reverse repurchase transaction. Subsection 6.8(5) will permit this delivery to occur so long as the collateral, cash proceeds or purchased securities delivered by the counterparty are held under the custodianship of the custodian (or sub-custodian) as provided for by Part 6.

*Section 15.6 - Performance Data - General Requirements*

The June Draft Amendments proposed a clarification to section 15.6 relating to "young mutual funds" and the date that the applicable one year period ends. The CSA have further amended subparagraph 15.6(a)(i) to clarify that no sales communication pertaining to a mutual fund shall contain performance data unless the mutual fund has "distributed" (the June Draft Amendments used the word "offered") securities under a simplified prospectus in a jurisdiction for 12 consecutive months. The CSA consider this word to be a more readily understandable term that is consistent with applicable securities legislation.

*Section 15.14 - Sales Communications - Multi-Class Mutual Funds*

This section is new and re-orders rules proposed in the January Draft Amendments to reflect the increase in mutual funds offering multiple classes of securities that are referable to the same portfolio of assets. Proposed subsections 15.6(2) and (3) have been moved to form a separate new section 15.14 dealing with sales communications for multi-class funds. No substantive changes have been made to section 15.14 from the amendments proposed in the January Draft Amendments, although two clarifying changes have been made.

The CSA have clarified that these rules apply to mutual funds that distribute different classes or series of securities that are referable to the same portfolio of assets. In addition, the CSA have clarified that the requirement to provide performance data in a particular sales communication for each class or series relates only to each class or series that is referred to in the sales communication and not to all classes or series of the mutual fund that are in existence.

The CSA note that they are continuing to consider the issues raised by multi-class mutual funds as they relate to the presentation of performance data and may propose additional rules in future proposed amendments to NI 81-102.

*Section 16.1 - Calculation of Management Expense Ratio*

In the June Draft Amendments, the CSA proposed a concept of a rolling 12 month management expense ratio to be calculated by mutual funds wishing to make public their management expense ratios, other than in financial statements and prospectuses. The CSA received conflicting comments in respect of this proposal; commentators were approximately equally divided either in favour or not in favour of this amendment. The CSA proposed this amendment largely in response to industry submissions following the coming into force of NI 81-102. Since no industry consensus appears to be present concerning the utility and practicality of this proposal, the CSA have decided not to proceed with the draft amendments for new subsections 16.1 (2) and (3). Accordingly mutual funds are governed by the existing rules contained in NI 81-102 regarding the calculation and presentation of management expense ratios, except that section 16.3, as proposed in the January Draft Amendments, has been made final as have the amendments described below proposed in the June Draft Amendments.

Subsection 14.1(5) of the Policy Amendments relating to CP81-102 is new and reflects the CSA's concern that mutual funds comply with section 16.1 in calculating and disseminating their management expense ratios.

The CSA have made final the proposed amendments contained in the June Draft Amendments to section 16.1 regarding the non-inclusion of income taxes in calculating management expense ratios and the requirements to provide note disclosure when a mutual fund provides its management expense ratio to the public media service providers.

*Section 16.2 - Fund of Funds Calculation*

Since the CSA have not proceeded with their proposal for a rolling 12 month management expense ratio, the changes proposed in the June Draft Amendments to section 16.2 which provides a formula for the calculation of total expenses for a fund of funds, have similarly been dropped from the Amendments.

The CSA have finalized subsections 16.2(2) and (3) which were proposed in the January Draft Amendments. These subsections have not been amended from the January Draft Amendments.

The CSA have added a new subsection (4) to section 16.2 to address a technical problem raised by a commentator in respect of the calculation of the management expense ratio for a top fund where management fees are rebated by an underlying fund to that top fund that invests in such underlying fund. The CSA have clarified that management fee rebates may be deducted from total expenses of the underlying fund if the rebate is made for the purpose of avoiding duplication of fees between the two mutual funds.

**Policy Amendment to CP81-102**

*Section 2.13 - "purchase"*

The CSA proposed a new paragraph 5 for subsection 2.13(2) in the January Draft Amendments to clarify the application of the definition of "purchase" in the context of securities lending transactions. The CSA have finalized paragraph 5 by adding subparagraph (b), which reflects the CSA's response to comments received on the practical application of paragraph 5 as proposed in the January Draft Amendments. Paragraph 5 now accommodates the practical necessity for a mutual fund to have a reasonable period of time to sell any collateral that it becomes legally entitled to dispose of due to default of the counterparty, before that asset is considered a "purchase" for the purposes of section 2.1 of NI 81-102.

*Section 3.7 - Securities Lending, Repurchase and Reverse Repurchase Transactions*

The CSA proposed a new section 3.6 in the January Draft Amendments to give the CSA's views on certain matters relating to securities lending, repurchase and reverse repurchase transactions. Section 3.6 in the January Draft Amendments has been renumbered to section 3.7.

Several clarifying amendments have been made in the Policy Amendments relating to CP81-102 in response to comments received by the CSA.

Firstly, the words "having regard to the level of risk for the mutual fund in the transaction" have been added to the end of the second sentence of subsection 3.7(2). The CSA are of the view that a mutual fund and its lending agent should evaluate, among other prudent matters, the risks of a securities lending, repurchase and reverse repurchase transaction to the mutual fund in determining the appropriate level of over-collateralization as required by sections 2.12, 2.13 and 2.14 of the Rule Amendments.

Secondly, the CSA have added subsection 3.7(4). This subsection provides the CSA's views on the prudent use of letters of credit as collateral for securities lending transactions. Letters of credit should be irrevocable and the mutual fund should have the ability to draw down the full value of the loan upon default of the borrower. This subsection is a companion policy to new paragraph 6(d) of subsection 2.12(1) described above in connection with the Rule Amendments to NI 81-102.

Thirdly, the CSA have added subsection 3.7(6). This subsection clarifies the application of the terms "delivery" and "holding" of securities or collateral in the context of securities held by a lending agent for a mutual fund. The CSA recognize securities lending agents' industry practice of pooling collateral that is received from one borrower for several securities lending/repurchase transactions clients. Such pooling of collateral will not, of itself, violate the Rule Amendments.

Fourth, the CSA have added subsections 3.7(7) and (8). Both subsections are related and recognize industry practice that collateral requirements are calculated at the end of business on one day and any additional collateral delivered by borrowers on the next business day. Subsection 3.7(8) clarifies that a securities lending agent is permitted to use its valuation principles and practices when carrying out the requisite daily marking to market calculations.

Fifth, the CSA have added subsection 3.7(11). This subsection recognizes that the standard of care applicable to a securities lending agent applies to all the functions performed under a securities lending program for a mutual fund client, including the responsibility to reinvest cash collateral and proceeds of sale from repurchase transactions.

Sixth, the CSA have added subsection 3.7(12). This subsection clarifies that a securities lending agent must be properly appointed as a custodian or a sub-custodian in accordance with section 6.1 of NI 81-102. As custodian or sub-custodian, the securities lending agent must satisfy all the applicable requirements of Part 6 in carrying out its responsibilities.

Seventh, the CSA have amended clauses 3.7(13)(e) and (f) [in the January Draft Amendments, clauses 3.7 (7)(e) and (f)]. The amendments to clause (e) are to clarify the CSA's views that managers and mutual funds should provide securities lending agents with parameters regarding minimum requirements for diversification of collateral, as well as the amount of the collateralization. The amendments to clause (f) now recommend that managers and mutual funds provide direction and applicable parameters to lending agents on the lending agent's reinvestment of cash collateral to ensure that proper levels of liquidity of such reinvested collateral are maintained at all times.

*Section 13.2 - Other Provisions*

The CSA proposed subsection 13.2(5) in the June Draft Amendments and have finalized it without amendment.

The CSA have made three additions to section 13.2 of CP81-102 to articulate the CSA's views on the applicability of rules regarding sales communications to the new multi-class structures established by mutual funds since the coming into force of NI 81-102. As described above, the CSA's proposed rules in the January Draft Amendments are now contained in section 15.14 of the Rule Amendments. The three changes made by the CSA in the Policy Amendments relate to section 15.14 of the Rule Amendments to NI 81-102.

Subsection 13.2(6) is new. This subsection clarifies that the creation of a new class or series of security of a mutual fund that is referable to the same portfolio of assets does not constitute the creation of a new mutual fund and therefore does not subject the mutual fund to the restrictions of paragraph 15.6(a) of NI 81-102 which provides that no performance data is to be provided for a mutual fund if it has distributed its securities for less than 12 consecutive months.

Subsection 13.2(7) is new. This subsection clarifies that although section 15.14 of NI 81-102 does not deal directly with asset allocation services, the CSA recognize that it is possible that asset allocation services could offer multiple classes, and recommends that any sales communications for those services comply with the principles of section 15.14 to ensure that those sales communications are not misleading.

Subsection 13.2(8) is new. This subsection sets out the CSA's views that the use of hypothetical or *pro forma* performance data for new classes of securities of a multi-class mutual fund would generally be misleading.

*Section 14.1 - Calculation of Management Expense Ratio*

Subsection 14.1(5) is new. Given the CSA's decision not to proceed with the implementation of a rule that would require mutual funds to disclose their 12 month "rolling" management expense ratios in media other than prospectus documents and annual financial statements, subsection 14.1(5) reminds industry participants that all management expense ratios provided to service providers for public dissemination can only be the latest available management expense ratios as calculated in accordance with Part 16 of NI 81-102.

**Rule Amendments to NI 81-101**

*Section 1.1 Definitions*

*"commodity pool"*

Since the CSA have made the Amendments before finalizing National Instrument 81-104 Commodity Pools, the CSA have not finalized the amendments to the definition of commodity pool at this time, as they proposed in the June Draft Amendments.

**Rule Amendments to Form 81-101F1**

*General Instructions*

The CSA proposed instruction (21) in the June Draft Amendments in response to the renewed focus of Canadian mutual funds on offering multiple classes of securities referable to the same portfolio of assets. Instruction (21) has been finalized, with the clarification that it was intended to apply to those multi-class mutual funds whose classes are referable to the same portfolio. The CSA have added instruction (22) to the General Instructions to remind industry participants that classes or series of a mutual fund, where each class or series of a class of securities of the mutual fund is referable to a separate portfolio of assets, are considered to be separate mutual funds as provided in section 1.3 of NI 81-102.

*Item 9 of Part B - Risks*

The CSA proposed amendments to Item 9 of Part B in connection with the index fund amendments proposed in the June Draft Amendments. The CSA have finalized these amendments in the Rule Amendments with three changes made in response to comments received on the June Draft Amendments.

Firstly, subsection (6) of Item 9 now reflects that section 2.1 of NI 81-102 exempts mutual funds from the concentration restrictions in section 2.1 when they invest in government securities (as defined) or in securities issued by clearing corporations. A mutual fund investing in these securities is not required to provide the disclosure required by subsection (6) of Item 9 in respect of those investments.

Secondly, subsection (6) has been amended to clarify more precisely than did the June Draft Amendments, the nature of the disclosure that must be given by mutual funds investing more than 10 percent of their net assets in securities of any one issuer. Where subsection (6) requires disclosure, the mutual fund must disclose the name of the applicable issuer and the maximum percentage of the net assets of the mutual fund that the securities of that issuer represented during the applicable 12 month period.

Thirdly, the CSA have included new Instruction (6) to Item 9 of Part B. This Instruction clarifies that, in providing the disclosure required by subsection (6) of Item 9, a mutual fund is not required to provide particulars or provide a summary of each and every occurrence where more than 10 percent of its net assets were invested in the securities of an issuer in the past 12 months.

**Rule Amendments to Form 81-101F2**

*General Instructions*

The CSA amended or added instructions (14) and (15) to the General Instructions, as applicable, for the same reasons as are described above in connection with the General Instructions for Form 81-101F1.

**Text of the Amendments**

The text of the Amendments follow.

February 16, 2001.

**APPENDIX A**

**LIST OF COMMENTATORS**
**ON**
**THE JANUARY DRAFT AMENDMENTS**
**AND**
**THE JUNE DRAFT AMENDMENTS**

On January 28, 2000, the CSA released for public comment the January Draft Amendments. During the comment period, which ended on April 30, 2000, the CSA received twenty-three letters from the following parties:

1. AIC Group of Funds
2. The Association of Global Custodians (an informal coalition of nine United States banks that act, directly or through affiliates, as global custodians or sub-custodians)
3. Barclays Global Investors Canada Limited
4. CIBC Mellon Global Securities Services Company
5. Desjardins Trust/Fiducie Desjardins
6. Elliott & Page Limited
7. Fidelity Investment Canada Limited
8. Global Strategy Financial Inc.
9. John E. Hall
10. Investment Dealers Association of Canada
11. The Investment Funds Institute of Canada
12. Investors Group Inc.
13. Kirkpatrick & Lockhart LLP, on behalf of Morgan Stanley & Co. Incorporated
14. McMillan Binch
15. Osler, Hoskin & Harcourt LLP
16. PaineWebber Global Portfolio Lending, a division of PaineWebber Incorporated
17. Royal Bank of Canada
18. Royal Bank Investment Management Inc.
19. Royal Trust Corporation of Canada
20. Scotia Securities Inc.
21. State Street Bank and Trust Company
22. Stikeman Elliott, on behalf of TAL Global Asset Management Inc.
23. TD Asset Management Inc.

On June 16, 2000, the CSA released for public comment the June Draft Amendments. During the comment period, which ended on September 14, 2000, the CSA received five letters from the following parties:

1. C.I. Mutual Funds Inc.
2. Fraser Milner Casgrain
3. The Investment Funds Institute of Canada
4. Royal Mutual Funds Inc. and Royal Bank Investment Management Inc.
5. TD Quantitative Capital, a division of TD Asset Management Inc.

The CSA have considered all comments provided by the above commentators and have made the changes described in this Notice largely in response to those comments. The specific comments provided, together with the CSA's responses to those comments, are summarized in the following two appendices to this Notice. The CSA thank all commentators for their thoughtful review of the proposed rules and policies and for providing their written comments.

Copies of all comment letters may be viewed at Micromedia Limited, 20 Victoria Street, Toronto, Ontario (416) 312-5211 or 1- (800) 387-2689; at the British Columbia Securities Commission, P.O. Box 10142, Pacific Centre, 701 West Georgia Street, Vancouver, British Columbia (604) 899-6500; at the Alberta Securities Commission, 10025 Jasper Avenue, Edmonton, Alberta (780) 427-5201; and at the Commission des valeurs mobilières du Québec, Stock Exchange Tower, 800 Victoria Square, 22nd floor, Montréal, Québec (514) 940-2150.

**APPENDIX B**

**SUMMARY OF COMMENTS RECEIVED ON THE JANUARY DRAFT AMENDMENTS ("THE SECURITIES LENDING AMENDMENTS") AND RESPONSES OF THE CANADIAN SECURITIES ADMINISTRATORS**

**GENERAL COMMENTS**

Commentators were generally supportive of the January Draft Amendments, particularly as they related to securities lending, repurchase and reverse repurchase transactions. The majority of comments dealt with the proposed securities lending/repurchase regime for mutual funds, although several comments were received in respect of the proposed amendment to subsection 6.8(3) of NI 81-102.

Both the Investment Dealers Association of Canada and The Investment Funds Institute of Canada, on behalf of their members, provided support for the securities lending amendments. The IDA summarized their views:

> "We commend the CSA for the overhaul of regulatory framework relating to mutual funds and we believe that by moving forward with the proposal to remove the restrictions currently in force will be beneficial to the liquidity of the capital markets and will increase returns to mutual fund unitholders. ... the changes will provide mutual funds with short term investment options that are more in line with pension funds and insurance companies. Allowing mutual funds use of the securities lending and repo markets will result in increased revenues for mutual funds, and thus mutual fund unitholders, and increase trading activity (liquidity) to the benefit of all participants in the Canadian capital markets."

IFIC described the proposed regime as "a very positive step for the industry". Another industry commentator noted that "in general, the Proposal's regulatory requirements and limitations are both prudent and consistent with sound industry practice", although this industry commentator was quite opposed to the requirements for a mandatory use of a securities lending agent.

Both the IDA and IFIC suggested that the industry and the CSA should agree to review the regime following at least a year's experience in working with the new rules to determine if changes should be made. The IDA, in particular, offered the expertise of its Securities Lending Committee for this purpose. The CSA agree that this review of the regime once some practical experience has been gained would be useful and encourage both the IDA and IFIC, and individual fund companies, lending agents and custodians to provide the CSA with their submissions once the Rule Amendments have been in force for at least twelve completed months.

The CSA asked several specific questions in the Notice accompanying the release of the January Draft Amendments and received the answers noted below to those questions:

1. Should the CSA allow irrevocable letters of credit or other specified financial instruments to be accepted as collateral for securities lending/repurchase transactions by mutual funds?

***Answer and CSA Response:***

Commentators responding to this question unanimously endorsed the addition of irrevocable letters of credit, on specified conditions, as well as commercial paper, bankers acceptances and "widely traded debt". Most commentators noted that these financial instruments were widely accepted in the institutional lending industry and posed no increased risk to mutual funds. As discussed more throughly below, the CSA have changed the January Draft Amendments to permit mutual funds to accept irrevocable letters of credit, bankers acceptances and commercial paper, on the conditions set out in the Rule Amendments.

2. Does the condition that securities lending and repurchase transactions must be "securities lending arrangements" under the *Income Tax Act* (Canada) pose unnecessary restrictions on mutual funds wishing to engage in these transactions?

***Answer and CSA Response:***

Commentators answering this question suggested that this was an important and necessary condition to ensure that securities lending/repurchase transactions for mutual funds were carried out in a standard and certain fashion. The CSA have not removed this condition.

3. Do the proposed rules articulate appropriate term restrictions for securities lending/repurchase transactions? Are they too restrictive?

***Answer and CSA Response:***

Most commentators noted that the securities lending provisions were drafted correctly, but that the term requirements for repurchase and reverse repurchase transactions should be extended, since the terms proposed did not reflect industry practice, although commentators varied on the suggested length of the appropriate term. The CSA have not changed the securities lending provisions, but have amended the term restrictions for repurchase and reverse repurchase transactions from five business days to 30 days. Most commentators indicated that the risks to a mutual fund would not be substantially increased through this change.

4. Are the proposed rules on reinvestment of cash collateral too restrictive – should some level of mismatch be permitted?

***Answer and CSA Response:***

Most commentators noted that mutual funds should be permitted to reinvest cash collateral in longer term instruments and that the level of mismatch inherent in such longer terms was both in accordance with prudent industry practice and did not expose mutual funds to greater risks. The CSA have accepted these comments and have amended the applicable provisions to provide that cash collateral can be reinvested in

qualified securities having a term to maturity no greater than 90 days and that sale proceeds can be reinvested in qualified securities having a term to maturity no greater than 30 days.

5. Should the aggregate volume limit for mutual funds lending securities or sold pursuant to repurchase transactions be separate limits? If so, why. In addition, should the lending/repurchase regime impose limits on transactions with any one counterparty?

***Answer and CSA Response:***

Some commentators expressed concern about the clarity of the volume limit as drafted and some commentators suggested that either no limit was necessary or that separate limits should be permitted. No commentator was of the view that limits on transactions with counterparties were necessary given the other applicable controls and rules and current industry practices. Limits on transaction with individual counterparties should be left to the discretion of individual mutual funds and their managers. The CSA have amended the drafting of the volume limit, but have retained it as a aggregate limit for both types of transactions. No counterparty limit has been imposed.

6. Does the 102 percent over-collateralization requirement, when coupled with the requirement to supplement that collateral where warranted, reflect industry practices?

***Answer and CSA Response:***

Commentators were strongly in favour of the requirements as drafted in the January Draft Amendments. Most commentators indicated their support for the flexible "best practices" approach articulated in the proposed January Draft Amendments. The CSA have not amended this provision.

7. Will any of the restrictions proposed for securities lending/repurchase transactions unduly reduce the potential for revenues for mutual funds?

***Answer and CSA Response:***

Although most commentators did not specifically address this question, most commentators noted that the limitations on collateral, the terms of repurchase and reverse repurchase transactions and the restrictions on the reinvestment of cash collateral and sales proceeds were unduly restrictive, particularly in relation to industry practices and the risks associated with these transactions. As noted, the CSA have amended the January Draft Amendments in response to these comments.

**SPECIFIC COMMENTS**

**1. Definition of "cash cover"**

One commentator requested that the definition of "cash cover" be expanded to include debt instruments with a remaining term to maturity of five years or less. This change would allow a bond fund to lengthen the duration of its bond holdings by using futures contracts without having to sell some of its bond holdings to meet cash cover requirements in NI 81-102. Similarly, this change would allow a bond fund to manage country risk in a similar manner. This same commentator also made suggestions for changes to the definition of "synthetic cash".

***CSA Response:***
The CSA do not agree that the "cash cover" or "synthetic cash" definitions and requirements should be expanded at this time to accommodate these specific requests. The CSA note that this comment was not in response to the January Draft Amendments, but was made by the commentator desiring additional flexibility for its mutual funds. The CSA note further that mutual funds wishing additional flexibility have the option of applying for exemptive relief, provided they can provide the CSA with appropriate reasons for the exemption and submissions on why the mutual fund would not be subject to additional risks having regard to the purpose of the cash cover requirements set out in NI 81-102.

**2. Definition of "purchase"**

The January Draft Amendments provided that when a mutual fund becomes legally entitled to dispose of the collateral, such an occurrence is a "purchase" for the purposes of the investment restriction tests in NI 81-102. One commentator recommended that mutual funds be given a reasonable period of time to dispose of the collateral prior to the collateral becoming an asset of the mutual fund for the purposes of the investment restrictions.

***CSA Response*:**

The CSA acknowledge this comment and have clarified the application of the definition of "purchase" in the Policy Amendments to CP81-102. Paragraph 5(b) of subsection 2.13(2) of the Policy Amendments to CP81-102 reflects the CSA's views in response to this comment.

**3. Definition of "qualified securities"**

Many commentators recommended that the list of eligible collateral be expanded to include any or all of the following assets: widely-traded corporate debt, commercial paper, bankers' acceptances, letters of credit and guarantees, high quality common and preferred shares, deposit notes and agency debt. The commentators argued that without a broader list of eligible collateral, mutual funds would be at a competitive disadvantage with other Canadian institutional lenders, such as life insurance companies, financial institutions and pension plans, as provided for in the OSFI Guidelines. Another concern was raised that the current list of eligible collateral would place increased strains on the limited quantities of government securities currently in the market.

***CSA Response:***

The CSA have expanded the list of eligible collateral to include commercial paper, bankers' acceptances and irrevocable letters of credits, all on the conditions and specifications contained in the Rule Amendments to NI 81-102. The list of eligible collateral is now more consistent with the list of eligible collateral provided for in the OSFI Guidelines. Also these additions are consistent with the collateral that can be accepted by U.S. mutual funds for securities lending transactions.

The definition of "qualified security" and paragraph 6(d) of subsection 2.12(1) of the Rule Amendments to NI 81-102 have been amended to reflect the CSA's response to these comments. Subsection 3.7(4) of the Policy Amendments to CP81-102 provides the CSA's views on the use of irrevocable letters of credit as collateral.

**4. Over-collateralization requirement**

Commentators were supportive of the over-collateralization requirements in the January Draft Amendments, although two commentators suggested that 105 percent over-collateralization was appropriate, primarily to be consistent with the OSFI Guidelines. A higher margin of safety would increase the feasibility of a broader array of collateral. Two other commentators suggested that a 102 percent *initial* over-collateralization requirement with a maintenance margin of 100 percent would provide a sufficient buffer against price and market volatility.

***CSA Response*:**

The CSA have not made any changes to the applicable requirements, other than to emphasize in the Policy Amendments (subsection 3.7(2) of the Policy Amendments to CP81-102) that mutual funds should look at the level of risk for the transaction in determining appropriate levels of collateral. The CSA believe that the current over-collateralization requirements are consistent with the OSFI Guidelines. The Amendments require a mutual fund to take at least 102 percent of the value of the securities sold or lent in a particular transaction. The Policy Amendments clarify that a mutual fund must take additional collateral when best market practices so dictate. Similarly, the OSFI Guidelines require lenders to take the amount of collateral which reflect the best practices in the local market.

**5. Daily marking to market**

One commentator raised concerns over which valuation principles should be used to make the required daily mark to market calculation of collateral and securities sold or lent: those of the mutual fund or those of the lending agent. Another commentator suggested the requirements in the January Draft Amendments were not consistent with industry practice to carry out the mark to market calculation at the end of a business day and require that additional collateral be delivered during the following day.

***CSA Response*:**

The CSA acknowledge both comments and have provided their views in the Policy Amendments to CP81-102. The Policy Amendments state that a mutual fund may use the valuation principles of their lending agent. Also, the Policy Amendments confirm that delivery of additional collateral by the end of the next business day, in accordance with current market practices, does not violate the Instrument.

Subsection 3.7(7) and (8) of the Policy Amendments to CP81-102 contain the applicable CSA views given in response to these comments.

**6. Term of repurchase and reverse repurchase transactions**

Many commentators recommended that the maximum term of a permitted repurchase or reverse repurchase transaction be lengthened. The recommended time periods varied. Some commentators felt that 30 days would be sufficient, while others proposed allowing for transactions of up to a year. The limit in the January Draft Amendments of five business days would create unnecessary administrative costs and would leave mutual funds with few options. As a result of this restriction, mutual funds would be limited to investing the proceeds of repurchase transactions in overnight investments. Overnight investments have lower yields and do not allow for appropriate diversification of investments. By extending the permitted term to 30 days or more, both of these concerns would be addressed.

***CSA Response:***

The CSA have extended the maximum term for permitted repurchase and reverse repurchase transactions to 30 days. The CSA believe that this change will allow mutual funds to reduce the administrative costs of renewing repurchase transactions after each five business day period when a mutual fund has no immediate intention to recall the securities. Also, mutual funds will be able to invest the cash proceeds as they believe is prudent in qualified securities with a term to maturity of up to 30 days. This added flexibility will permit a mutual fund to earn more yield and allow for increased diversification of its investments.

Paragraph 10 of subsection 2.13(1) and paragraph 9 of subsection 2.14(1) of the Rule Amendments to NI 81-102 reflect the CSA's decision.

**7. Reinvestment of cash collateral or sale proceeds**

Most commentators viewed the restrictions on reinvestment of cash collateral or sale proceeds as too restrictive. Commentators suggested that the January Draft Amendments would create a significant disincentive against accepting cash collateral or entering into repurchase transactions. Commentators recommended that cash reinvestment be examined from an investment portfolio basis, as opposed to a loan-by-loan basis. An example was given of U.S. mutual funds which effect their cash collateral reinvestment through collective investment vehicles, such as money market funds. Lending agents are capable of co-ordinating the reinvestment of cash collateral of their clients to ensure that proper levels of liquidity are maintained at all times.

***CSA Response:***

The CSA have provided for a portfolio approach to cash reinvestment. Specific parameters are set out in the Rule Amendments for repurchase transactions that cash proceeds must be invested in qualified securities with a remaining term to maturity of 30 days or less. For securities lending transactions, cash collateral may be invested in qualified securities with a remaining term to maturity of 90 days or less. The additional 60 days for cash collateral received from securities lending transactions recognizes that these transactions are open loans with no fixed terms. The lending agent in consultation with the mutual fund manages the cash

collateral within the specified investment restrictions so as to maintain an adequate level of liquidity at all times.

Subsection 2.12(2) of the Rule Amendments to NI 81-102 sets out the changed rules for securities lending transactions, subsection 2.13(2) sets out the changed rules for repurchase transactions.

**8. Aggregate lending and repurchase transaction limit**

Commentators were generally supportive of the proposed volume limit of 33 1/3 percent of total assets of the mutual fund, including the collateral received, although some confusion was expressed on how the limit would be applied. The consistency to the regulatory restrictions applicable to U.S. mutual funds for securities lending was seen as appropriate. A few commentators suggested the overall limit should be raised to 50 percent of the total assets of the mutual fund. One commentator proposed that the percentage should be broken out by asset class (for example, 33 percent of total assets for equities and 75 percent for bonds). A few commentators suggested that the current limit was overly restrictive and that exposure of 75 to 100 percent of total assets could be justified.

***CSA Response*:**

The CSA have amended, and simplified, the applicable volume limit. The Rule Amendments now impose an aggregate limit of 50 percent of the total assets of the mutual fund, excluding the collateral or sales proceeds received under the transaction. The CSA note that this revised test is not a substantive change from the limit proposed under the January Draft Amendments and are of the view, echoed by some commentators, that the volume limit is appropriate at this time, particularly having regard to the limitations on U.S. mutual funds.

Paragraph 12 of subsection 2.12(1) of the Rule Amendments to NI 81-102 sets out the changed rules for securities lending transactions and paragraph 11 of subsection 2.13(1) sets out the changed rules for repurchase transactions.

**9. Term to maturity restriction on securities purchased under a reverse repurchase transaction**

Several commentators questioned the rationale for limiting the term to maturity of securities that a mutual fund may purchase under a reverse repurchase transaction. The limitation on the term of securities purchased under a reverse repurchase transaction is not reflective of how the reverse repurchase market works and will limit the ability of mutual funds to enter into these transactions. The risk which this restriction is attempting to address, is more suitably dealt with by the over-collateralization requirements, daily marking-to-market and the term of the reverse repurchase transaction.

***CSA Response*:**

The CSA agree with the comments and have not carried forward the restriction previously contained in paragraph 3 of subsection 2.14(1) of the January Draft Amendments to NI 81-102. Any risks to a mutual fund inherent with reverse repurchase transactions are better dealt with the over-collateralization requirement, the daily marking to market requirements and the term limit on the reverse repurchase transaction.

**10. Mandatory use of an agent for securities lending and repurchase transactions**

Some commentators agreed that the mandatory use of a lending agent was appropriate given the infrastructure and systems required to operate a securities lending program. Custodial lenders devote substantial resources to operational systems, legal and tax advice and program efficiency. Other commentators suggested that the operational risks associated with repurchase transactions did not warrant the mandatory use of a lending agent. One commentator noted that the effect of this provision would be to “create a virtual monopoly in the Canadian fund industry for custodian lending agents”.

One commentator suggested that some mutual fund managers have experience in direct lending and the use of an agent will result in additional costs without any incremental benefit. A mutual fund manager’s fiduciary responsibilities should be sufficient to prevent a manager from engaging in an activity on behalf of its mutual funds for which it is not sufficiently expert. Another commentator suggested that the need for appropriate controls and systems could be addressed by using a single principal borrower that has proprietary lending systems and operational expertise.

Commentators opposed to this requirement generally noted that its effect will be to increase costs to mutual funds, while only incrementally minimizing risk. Several commentators urged the CSA to re-examine this requirement, if they decided to retain it, following practical experience with the new regime.

Several commentators suggested that the requirements in subsection 2.15(4) proposed by the January Draft Amendments precluded the use of a a third party lending agent unless the fund’s custodian was believed to be incompetent at performing this function.

***CSA Response*:**

The CSA have not changed the requirements to engage an agent to carry out securities lending and repurchase transactions on behalf of mutual funds. Operating a securities lending and repurchase transaction program requires significant operational safeguards and a level of expertise and experience beyond the current scope of most mutual fund managers. A prudent securities lender operating a securities lending program must have safeguards to ensure daily marking to market calculations, collection of collateral and distributions, diversification of collateral and maintenance of credit standards on borrowers. A securities lender must also have access and in-depth knowledge of the market for a specific security that the mutual fund intends to lend. The CSA are of the view that to ensure the appropriate protection of the investors, at present, all mutual funds must use a lending agent for securities lending and repurchase transactions. The CSA have made an exception for reverse repurchase transactions, since the CSA view reverse repurchase transactions as a cash reinvestment tool where special expertise and control systems are more widespread and the practices are more developed within the Canadian mutual fund industry.

As noted above, the CSA will welcome submissions on this point, amongst others, following practical experience with the rules.

The CSA note the comments in respect of the drafting contained in subsection 2.15(4) of the January Draft Amendments, and have deleted much of the provisions commented upon. A third party may act as a lending agent for a mutual fund so long as the agent is appointed as a sub-custodian of the mutual fund regardless of the mutual fund's views of its custodian's ability to perform this function.

Subsection 2.15(3) of the Rule Amendments to NI 81-102 contains the amended rules. The CSA have included a discussion of their views on this issue to subsection 3.7(12) of Policy Amendments to CP81-102.

**11. Advance Notice to Mutual Fund Securityholders**

One commentator suggested that the 60 days advance notice requirement to securityholders of mutual funds intending to enter into securities lending and repurchase transactions should not be required as commencing a program is not analogous to the commencement of the use of derivatives or other risk increasing strategies. In the alternative, the commentator argued that those currently engaging in reverse repurchase transactions should not be required to give a notice to continue in such investment activities.

***CSA Response*:**

The CSA believe that securityholders of a mutual fund should receive notice of the mutual fund's intention to enter into securities lending, repurchase or reverse repurchase transactions, since these transactions could have an impact both on the risks to the mutual fund and its potential revenues. However, the Rule Amendments clarify that for those mutual funds which currently enter into these transactions pursuant to exemptive relief decisions no notice is required to continue in those activities.

Subsection 2.17(2) of the Rule Amendments to NI 81-102 has been added to address the situation for those mutual funds that have exemptive relief to enter into reverse repurchase transactions.

**12. Lending to Related Parties**

One commentator provided views on the application of the self-dealing prohibitions proposed in section 4.2 of the January Draft Amendments to NI 81-102. The commentator noted that mutual funds sponsored by financial institutions should be able to lend securities to related parties, particularly their affiliated investment dealers or transfer agents and periodic reviews controls to ensure market rates on arm's length transactions should be imposed in place of the prohibitions.

***CSA Response:***

The CSA have not amended section 4.2 in response to this comment and continue of the view that these prohibitions are necessary for mutual funds at this time. Any change to the prohibitory regime for related party transactions will be made in conjunction with a complete review of governance and conflicts of interest related to mutual funds.

**13. Custodial Provisions as they Relate to Securities Lending and Repurchase Transactions**

One commentator pointed to several technical changes that should be made to Part 6 of NI 81-102 to properly implement the securities lending and repurchase transaction regime.

***CSA Response*:**

The CSA have amended Part 6 in the manner noted above in the Notice to reflect the comments received.

**14. Proposed changes to subsection 6.8(3) of NI 81-102**

Many commentators argued that the proposed amendment to subsection 6.8(3) of NI 81-102 included with the January Draft Amendments would cause serious problems for many mutual funds which use over-the-counter forward contracts with one counterparty. In particular, this change would hamper the current structure of many RSP clone funds which had been structured in good faith on the current subsection 6.8(3). The proposed change would increase the cost of these forward contracts and may endanger the viability of these funds. The commentators explained that the current safeguards in Part 6 of NI 81-102 adequately protect a mutual fund's credit exposure under such forward derivative contracts, in three ways: (1) the counterparty must maintain an approved credit rating; (2) the mark-to-market exposure cannot exceed 10 percent of the fund's assets over a 30 day period; and (3) subsection 6.8(4) of NI 81-102 ensures that the records show the mutual fund as beneficial owner of those assets. One commentator noted that a pledge of collateral by a mutual fund does not expose the mutual fund to the credit risk of the counterparty and the risks of credit exposure to a counterparty have been adequately dealt with elsewhere in NI 81-102.

***CSA Response*:**

The CSA have not finalized the proposed amendment to subsection 6.8(3). The CSA are satisfied that the current safeguards which are currently built into NI 81-102 adequately protect the interests of securityholders of mutual funds which extensively use over-the-counter derivatives.

**15. Sales Communications for Multi-Class Mutual Funds**

Two commentators pointed out a technical deficiency in the drafting of proposed paragraph 15.6(2)(b) in the January Draft Amendments in that the rule could be interpreted to require all sales communications where performance data for one class is given, and the sales communications is designed to cover only that class, to provide the performance data for all classes. The commentators suggested the inclusion of the words "referred to in the sales communication" to make the intent of this section clear.

***CSA Response*:**

The CSA have amended section 15.14 of the Rule Amendments to NI 81-102 to clarify the meaning of this rule and have incorporated the drafting suggestion of the commentator.

**16. Calculation of Management Expense Ratio**

A commentator pointed out the need for clarity in the application of the rules regarding calculation of management expense ratios for those fund of funds, where the underlying funds rebate to the top fund management fees paid by the top fund, so as to ensure no duplication of management fees.

A second commentator noted that the task of re-stating management expense ratios for the past five years as required by the new management expense ratio calculation mandated by NI 81-102 to be too onerous and accordingly should not be required.

***CSA Response*:**

The CSA have added subsection 16.2(4) to the Rule Amendments to NI 81-102 to clarify the application of the applicable rules in response to the first comment.

The CSA note that in response to the second comment, that section 16.3 of the Rule Amendments to NI 81-102 clarifies the need for mutual funds to calculate management expense ratios in accordance with NI 81-102 for financial periods ending after February 1, 2000. The CSA further note that CSA staff published CSA Staff Notice 81-306 Disclosure by Mutual Funds of Changes in Calculation of Management Expense Ratio to clarify staff's views. Staff have been addressing issues related to management expense ratios on a fund by fund basis since February 1, 2000 and note general industry compliance with the matters addressed in that notice.

**17. Accounting issues**

One commentator recommended that repurchase transactions be treated as off balance sheet items in order to conform with the balance sheet treatment of securities loans. Since the lending agent is not acting as the portfolio manager for a mutual fund, these transactions should be treated as being off the balance sheet. Note disclosure to the financial statements could adequately describe the transactions. Another commentator asked for guidance on how revenue received by a securities lending program should be treated.

***CSA Response:***

The CSA believe that generally accepted accounting principles in Canada (GAAP) apply in determining the accounting treatment for these transactions. Under GAAP, a repurchase transaction is a sale and must be disclosed as such on the balance sheet of the applicable mutual fund. This treatment is consistent with the accounting used by U.S. mutual funds. With respect to guidance on how revenues should be treated, subsections 14.3(4), 14.4(4) and 14.5(4) of the Policy Amendments to CP81-102 require that income from securities lending, repurchase and reverse repurchase transactions be presented as revenue and not as a deduction from expenses. No changes to the rules proposed in the January Draft Amendments have been made.

**APPENDIX C**

**SUMMARY OF COMMENTS RECEIVED ON THE JUNE DRAFT AMENDMENTS ("THE INDEX FUND AMENDMENTS") AND RESPONSES OF THE CANADIAN SECURITIES ADMINISTRATORS**

**GENERAL COMMENTS**

Four of the five commentators provided comments on specific provisions contained in the June Draft Amendments relating to the proposed changes designed to permit index mutual funds to better meet their investment objectives. One commentator focussed exclusively, and the other commentators also commented, on the rolling 12 month management expense ratio proposed in the June Draft Amendments.

All commentators were supportive of the proposed regime to permit mutual funds to better meet their investment objectives; one commentator commended the CSA for recognizing the "special nature of index mutual funds and the importance of meeting their fundamental investment objectives".

**SPECIFIC COMMENTS**

**1. Definition of "index mutual fund"**

One commentator proposed that the words "attempt to" ought to be inserted before the word "replicate" in the definition of index mutual fund in order to clarify that a mutual fund would still be considered an index fund if it attempts to replicate an index but does not identically replicate that index at all times.

Another commentator queried whether the definition of "index mutual fund" would include index mutual funds that track multiple indices. This commentator also asked whether the definition would include a fund that is invested in other index mutual funds (i.e. a fund of funds), and if so, whether an additional subparagraph should be added to the definition of "index mutual fund" to state that an index mutual fund means a mutual fund that has adopted fundamental investment objectives that require the mutual fund to invest in other "index mutual funds" as defined in that section.

***CSA Response:***

The CSA are of the view that the definition of "index mutual fund" is adequate and that no change is required in response to the comments received. In particular, with respect to the second comment, the CSA believe that the definition of "index mutual fund" is sufficiently broad enough as drafted to include index mutual funds that track multiple indices, as well as index mutual funds that are invested in other index mutual funds.

**2. Definition of "permitted index"**

Two commentators expressed concerns with the potential ambiguity of the requirement that the "permitted index" be one that is "widely quoted". For example, does this term mean widely quoted in the media or by money managers? Commentators proposed that the words "widely quoted" be

deleted from the definition, since the most important consideration should be whether the index is administered by a non-affiliate ((a) of the definition) and is widely recognized and used ((b) of the definition), not whether it is widely quoted.

Another commentator suggested that clear parameters should be established around what would constitute a "widely recognized and used" index.

***CSA Response:***

The CSA have deleted the words "widely quoted" from the definition of index fund in response to the comments. The definition now provides that a "permitted index" must be either one that is (a) both administered by an organization that is not affiliated with any of the mutual fund, its manager, its portfolio advisor or its principal distributor, and one that is available to persons or companies other than the mutual fund, or (b) one that is widely recognized and used.

The CSA do not believe that it is necessary to expand on the meaning of the phrase "widely recognized and used".

**3. Mandatory use of the word "index" in the name of the mutual fund**

One commentator asked that the requirement to include the word "index" in the name of the index mutual fund should be removed since the disclosure already provided in the fundamental investment objective is adequate.

***CSA Response*:**

The CSA believe that investors are entitled to a clear and unambiguous indication that an index mutual fund is in fact an index fund that avails itself of exemptions from the customary rules applicable to other mutual funds. The CSA are of the view that the best way to provide this information is for the mutual fund to include the word "index" in its name. Index mutual funds not wishing to include this word in their name will not be able to utilize the exemption from the concentration restriction that is provided for in the Rule Amendments. No changes from the proposed rules in the June Draft Amendments have been made.

**4. Mandatory Advance Notice to Securityholders**

Two commentators suggested that index mutual funds that already benefit from an exemption which allows them to track their permitted index and invest up to 25 percent in any one issuer should not have to send out a 60 day notice to their securityholders given that their prospectuses have already been amended to disclose the exemption. The obligation for such funds to provide the 60 day notice would impose an additional and unjustifiable cost on these funds. Further, one commentator asked whether an index mutual fund that already benefits from an exemption from the concentration restriction would have to cease availing itself of the concentration relief during the 60 days notice period.

***CSA Response:***

The CSA confirm that an index mutual fund is required to provide 60 day written notice to its securityholders of its intention to rely on the exemption from the concentration restriction provided by subsection 2.1(5) of the Rule Amendments to NI 81-102, regardless of whether such mutual fund has obtained prior relief from the concentration restriction. However those index mutual funds whose prospectuses have since their inception contained the investment objective and risk disclosure referred to in subsection (5) of Item 6 and subsection (5) of Item 9 of Part B of Form 81-101F1 do not have to give advance notice.

The CSA note that they consider it very important that investors, both new and existing, understand the nature of an index mutual fund and how it differs from a conventional mutual fund that is subject to investment restrictions, including the concentration restriction. For this reason, the CSA have retained the notice requirement, however, index mutual funds should review this Notice under the heading "Transitional Matters" for the CSA's views on giving notices to securityholders before the effective date of the Rule Amendments.

**5. Performance Data - General Requirements**

One commentator proposed that the words "offered securities under a simplified prospectus in a jurisdiction for 12 consecutive months" as used in proposed subparagraph 15.6(a)(i), be clarified to mean the date on which the fund or its manager actually made the securities available to the public, regardless of when the receipt for the prospectus was issued. It is often the case that mutual funds do not make their units publicly available until several months after the receipt has been issued.

***CSA Response:***

Subparagraph 15.6(a)(i) of the Rule Amendments to NI 81-102 has been amended to clarify that no sales communication pertaining to a mutual fund shall contain performance data unless the mutual fund has "distributed" (rather than "offered") securities under a simplified prospectus in a jurisdiction for 12 consecutive months.

**6. 12 Month Rolling Management Expense Ratio**

All commentators provided their views on the proposal contained in the June Draft Amendments to require a 12 month "rolling" management expense ratio in media other than the prospectuses and annual financial statements. No one consensus view as to the utility of a rolling management expense ratio was expressed in the comments.

Two commentators noted that a rolling management expense ratio, as proposed to be calculated, would not reflect any management decisions to change the expenses charged to a fund on a go-forward basis. For example, the manager of a fund may change the management fee and/or introduce a cap on the management fee, but these decisions would not be immediately reflected in published ratios. The impact would be that the publicly reported management expense ratios would not reflect the actual costs incurred by securityholders until the end of a 12 month rolling period.

One commentator suggested that the timing of large expenses could significantly impact the management expense ratio calculated on a rolling 12-month basis. For example, if the rolling period happened to capture two prospectus renewals, those costs would have a significant impact on the stated ratio.

This could distort the management expense ratio for that period and could be misleading unless explained through detailed note disclosure.

Another commentator expressed the opinion that the 12 month rolling average is a historical measure of management expense ratio which, being an average measure, does not provide sufficient information as to the level of current fees being charged, and is therefore not useful for prospective investors, and of limited use for existing investors. This commentator further submitted that a historical 12 month rolling management expense ratio for those funds with increasing expenses will understate current fee levels, while for funds with decreasing expenses, the rolling management expense ratio will overstate current fee levels.

Finally, two commentators expressed concerns relating to mutual funds structured as funds of funds, where the underlying funds are mutual funds managed by parties unrelated to the manager of the top fund, may not be able to meet the month-end deadline for calculation of the rolling management expense ratio. Delayed reporting of updated management expense ratios could lead to securityholder confusion.

Commentators provided several recommendations as to acceptable substitutes for the proposed 12 month rolling management expense ratio:

- retain the current management expense ratio calculation and disclosure requirements, but permit a management expense ratio of a mutual fund to be recalculated if expense decisions are made that would materially impact the management expense ratio if taken into account;

- if the 12 month rolling management expense ratio is retained, it should be restricted to the publication of management expense ratios in non-mandatory media, so that semi-annual statements would be excluded from the rolling calculation and would include management expense ratios calculated on the basis outlined in section 16.1 of NI 81-102. Funds wishing to publish 12 month rolling management expense ratios in non-mandatory media could continue to do so;

- rather than using a 12-month rolling average, a current-month management expense ratio annualized (but not compounded) for a 12 months period would be more appropriate. Such a prospective management expense ratio would be based on the most recent month and could serve as supplementary information to the historical audited management expense ratio shown in the simplified prospectus, annual information form and annual financial statements. Audit verification should be required for both values and that notes as to the calculation of both ratios could be provided to avoid confusion between the two numbers.

***CSA Response*:**

The CSA note that their proposal for a rolling 12 month management expense ratio outlined in the June Draft Amendments was the result of industry submissions on the practical implications of section 16.1 of NI 81-102, particularly given the practices of industry participants in providing management expense ratios in non standardized formats to public media service providers. Section 16.1 of NI 81-102 requires management expense ratios to be calculated based only on annual audited financial data and does not permit any other calculation or dissemination of management expense ratios.

The CSA continue of the view that a management expense ratio for a mutual fund is a useful figure for investors, both new and existing, and one standard method of calculation should be adhered to by the industry. The commentators have suggested to the CSA that there is no industry consensus on the correct calculation of management expense ratios, other than one based on the historical annual audited financial statements. The CSA have accordingly decided not to proceed at this time with their proposal for a rolling 12 month management expense ratio as proposed in the June Draft Amendments. The CSA are concerned that industry participants do not continue the practice of providing management expense ratios, particularly to media service providers, calculated in ways that are not in compliance with section 16.1 of NI 81-102, and have therefore included an explicit statement to this effect in subsection 14.1(5) in the Policy Amendments to CP 81-102. Once an industry consensus has been developed, the CSA will consider further whether it is advisable to amend section 16.1 of NI 81-102.

**7. Calculation of Management Expense Ratio**

One commentator suggested that capital taxes should be excluded from the calculation of "total expenses" in the same manner that income taxes and foreign withholding taxes have been excluded. Capital taxes are not consumption taxes like GST that are directly related to expenses and capital taxes are only chargeable based on the level of capital as at the tax year-end of a mutual fund. Including capital taxes in the calculation of management expense ratios distorts the ratios. Given that capital taxes are only charged on corporate funds, it would make sense for comparability of management expense ratios among other mutual funds that capital taxes be excluded, much like income taxes.

***CSA Response*:**

The CSA have not made any changes in response to this comment. The CSA's views on the appropriate accounting treatment of capital taxes in determining the "total expenses before income taxes" for a mutual fund are set out in subsection 14.1(2) of the Policy Amendments to CP81-102. These views have not changed from the June Draft Amendments.

**8. Risk disclosure**

One commentator suggested that the proposed required disclosure regarding the impact of an increased concentration in any one issuer on the fund's liquidity should not be required. Those securities that are likely to exceed the prescribed 10 percent concentration limit are typically among the most liquid and have the largest trading volumes.

In addition, two commentators expressed concerns regarding the requirement to disclose occurrences during the 12 month period preceding the date of the simplified prospectus of a

mutual fund where more than 10 percent of the fund's net assets were invested in the securities of an issuer and asked what the CSA expect this disclosure to include. In particular, they queried as to whether each and every instance where the 10 percent limit had been exceeded in the past 12 months would have to be disclosed. They suggested that, if so, a better approach would be to require disclosure based on how long the mutual fund has held the position in excess of 10 percent, or alternatively require this disclosure based on the numbers available as at any month end during the preceding 12 month period.

***CSA Response*:**

The CSA have not changed the Rule Amendments to NI 81-101 to accommodate the first comment. The CSA are of the view that disclosure of the potential impact of exceeding the concentration restriction on the fund's liquidity must be disclosed and do not agree with the commentator's assertion that in all cases the subject securities will be large and liquid.

In response to the second comment, the CSA have amended paragraph (6) to Item 9 of Form 81-101F1 to clarify what disclosure must be provided. In addition, instruction (6) to Item 9 of Part B of Form 81-101F1 has been added to clarify that it is not necessary to provide particulars or a summary of each and every occurrence where the concentration restriction was exceeded by a mutual fund in the 12 months preceding the date of the simplified prospectus. Rather, the CSA believe it sufficient for a mutual fund to disclose only that at a time during the 12 month period referred to, the 10 percent concentration restriction was exceeded by the fund.

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

**PART 1 AMENDMENTS**

**1.1 Amendments**

(1) Section 1.1 of National Instrument 81-102 Mutual Funds is amended by

(a) the addition of the following as paragraphs 5 and 6 of the definition of "cash cover":

"5. Securities purchased by the mutual fund in a reverse repurchase transaction under section 2.14, to the extent of the cash paid for those securities by the mutual fund.

6. Commercial paper that has a term to maturity of 365 days or less and an approved credit rating and that was issued by a person or company other than a government or permitted supranational agency.";

(b) the deletion of the definition of "index mutual fund" 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 or permitted indices of the mutual fund in substantially the same proportion as those securities are reflected in that permitted index or those 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";

(c) the addition of the following definition:

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

(a) both

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

(ii) available to persons or companies other than the mutual fund, or

(b) widely recognized and used;";

(d) the addition of the following definition:

" “qualified security” means

(a) an evidence of indebtedness that is issued, or fully and unconditionally guaranteed as to principal and interest, by

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

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

(iii) a Canadian financial institution 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, or

(b) commercial paper that has a term to maturity of 365 days or less and an approved credit rating and that was issued by a person or company other than a government or permitted supranational agency;" and

(e) 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.

(2) National Instrument 81-102 is amended by the renumbering of section 1.3 as subsection 1.3(1), and by the addition of the following as subsections 1.3(2) and (3):

"(2) A mutual fund that renews or extends a securities lending, repurchase or reverse repurchase transaction is entering into a securities lending, repurchase or reverse repurchase agreement for the purposes of section 2.12, 2.13 or 2.14.

(3) In this Instrument, a reference to a "simplified prospectus" includes a prospectus, a reference to a "preliminary simplified prospectus" includes a preliminary prospectus and a reference to a "*pro forma* simplified prospectus" includes a *pro forma* prospectus.”.

(3) National Instrument 81-102 is amended by

(a) 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);

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

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

(4) 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) An index mutual fund shall not rely on the relief provided by subsection (5) unless

(a) its simplified prospectus contains the disclosure referred to in subsection (5) of Item 6 and subsection (5) of Item 9 of Part B of Form 81-101F1 Contents of Simplified Prospectus; and

(b) the index mutual fund has provided to its securityholders written notice given not less than 60 days before it first relies on the relief provided by subsection (5), that discloses that it may, from time to time, rely on that relief and that contains the disclosure referred to in paragraph (a).

(7) Paragraph (6)(b) does not apply if each simplified prospectus of the index mutual fund since its inception contains the disclosure referred to in paragraph (6)(a).”.

(5) National Instrument 81-102 is amended by the deletion of subsections 2.7(1) and (2) and the substitution of the following:

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

(a) in the case of an option, swap or forward contract, 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, debt-like security, 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, debt-like security, 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 debt-like security, swap or forward contract, or the credit rating of the equivalent debt of the writer or guarantor of the option, debt-like security, swap or contract, falls below the level of approved credit rating while the option, debt-like security, 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, debt-like security, swap or contract in an orderly and timely fashion.".

(6) National Instrument 81-102 is amended by the addition of the following as section 2.12:

"**2.12 Securities Loans**

(1) Despite any other provision of this Instrument, a mutual fund may enter into a securities lending transaction as lender if the following conditions are satisfied for the transaction:

1. The transaction is administered and supervised in the manner required by sections 2.15 and 2.16.

2. The transaction is made under a written agreement that implements the requirements of this section.

3. Securities are loaned by the mutual fund in exchange for collateral.

4. The securities transferred, either by the mutual fund or to the mutual fund as collateral, as part of the transaction are immediately available for good delivery under applicable legislation.

5. The collateral to be delivered to the mutual fund at the beginning of the transaction

(a) is received by the mutual fund either before or at the same time as it delivers the loaned securities; and

(b) has a market value equal to at least 102 percent of the market value of the loaned securities.

6. The collateral to be delivered to the mutual fund is one or more of

(a) cash;

(b) qualified securities;

(c) securities that are immediately convertible into, or exchangeable for, securities of the same issuer, class or type, and the same term, if applicable, as the securities that are being loaned by the mutual fund, and in at least the same number as those loaned by the mutual fund; or

(d) irrevocable letters of credit issued by a Canadian financial institution that is not the counterparty, or an affiliate of the counterparty, of the mutual fund in the transaction, if evidences of indebtedness of the Canadian financial institution that are rated as short term debt by an approved credit rating organization have an approved credit rating.

7. The collateral and loaned securities are marked to market on each business day, and the amount of collateral in the possession of the mutual fund is adjusted on each business day to ensure that the market value of collateral maintained by the mutual fund in connection with the transaction is at least 102 percent of the market value of the loaned securities.

8. If an event of default by a borrower occurs, the mutual fund, in addition to any other remedy available under the agreement or applicable law, has the right under the agreement to retain and dispose of the collateral to the extent necessary to satisfy its claims under the agreement.

9. The borrower is required to pay promptly to the mutual fund amounts equal to and as compensation for all dividends and interest paid, and all distributions made, on the loaned

securities during the term of the transaction.

10. The transaction is a "securities lending arrangement" under section 260 of the ITA.

11. The mutual fund is entitled to terminate the transaction at any time and recall the loaned securities within the normal and customary settlement period for securities lending transactions in the market in which the securities are lent.

12. Immediately after the mutual fund enters into the transaction, the aggregate market value of all securities loaned by the mutual fund in securities lending transactions and not yet returned to it or sold by the mutual fund in repurchase transactions under section 2.13 and not yet repurchased does not exceed 50 percent of the total assets of the mutual fund, and for such purposes collateral held by the mutual fund for the loaned securities and cash held by the mutual fund for the sold securities shall not be included in total assets.

(2) A mutual fund may hold all cash delivered to it as the collateral in a securities lending transaction or may use the cash to purchase

(a) qualified securities having a remaining term to maturity no longer than 90 days;

(b) securities under a reverse repurchase agreement permitted by section 2.14; or

(c) a combination of the securities referred to in paragraphs (a) and (b).

(3) A mutual fund, during the term of a securities lending transaction, shall hold all, and shall not invest or dispose of any, non-cash collateral delivered to it as collateral in the transaction.".

(7) National Instrument 81-102 is amended by the addition of the following as section 2.13:

"**2.13 Repurchase Transactions**

(1) Despite any other provision of this Instrument, a mutual fund may enter into a repurchase transaction if the following conditions are satisfied for the transaction:

1. The transaction is administered and supervised in the manner required by sections 2.15 and 2.16.

2. The transaction is made under a written agreement that implements the requirements of this section.

3. Securities are sold for cash by the mutual fund, with the mutual fund assuming an obligation to repurchase the securities for cash.

4. The securities transferred by the mutual fund as part of the transaction are immediately available for good delivery under applicable legislation.

5. The cash to be delivered to the mutual fund at the beginning of the transaction

(a) is received by the mutual fund either before or at the same time as it delivers the sold securities; and

(b) is in an amount equal to at least 102 percent of the market value of the sold securities.

6. The sold securities are marked to market on each business day, and the amount of sale proceeds in the possession of the mutual fund is adjusted on each business day to ensure that the amount of cash maintained by the mutual fund in connection with the transaction is at least 102 percent of the market value of the sold securities.

7. If an event of default by a purchaser occurs, the mutual fund, in addition to any other remedy available under the agreement or applicable law, has the right under the agreement to retain or dispose of the sale proceeds delivered to it by the purchaser to the extent necessary to satisfy its claims under the agreement.

8. The purchaser of the securities is required to pay promptly to the mutual fund amounts equal to and as compensation for all dividends and interest paid, and all distributions made, on the sold securities during the term of the transaction.

9. The transaction is a "securities lending arrangement" under section 260 of the ITA.

10. The term of the repurchase agreement, before any extension or renewal that requires the consent of both the mutual fund and the purchaser, is not more than 30 days.

11. Immediately after the mutual fund enters into the transaction, the aggregate market value of all securities loaned by the mutual fund in securities lending transactions under section 2.12 and not yet returned to it or sold by the mutual fund in repurchase transactions and not yet repurchased does not exceed 50 percent of the total assets of the mutual fund, and for such purposes collateral held by the mutual fund for the loaned securities and the cash held by the mutual fund for the sold securities shall not be included in total assets.

(2) A mutual fund may hold cash delivered to it as consideration for sold securities in a repurchase transaction or may use the cash to purchase

(a) qualified securities having a remaining term to maturity no longer than 30 days;

(b) securities under a reverse repurchase agreement permitted by section 2.14; or

(c) a combination of the securities referred to in paragraphs (a) and (b).".

(8) National Instrument 81-102 is amended by the addition of the following as section 2.14:

"**2.14 Reverse Repurchase Transactions**

(1) Despite any other provision of this Instrument, a mutual fund may enter into a reverse repurchase transaction if the following conditions are satisfied for the transaction:

1. The transaction is administered and supervised in the manner required by sections 2.15 and 2.16.

2. The transaction is made under a written agreement that implements the requirements of this section.

3. Qualified securities are purchased for cash by the mutual fund, with the mutual fund assuming the obligation to resell them for cash.

4. The securities transferred as part of the transaction are immediately available for good delivery under applicable legislation.

5. The securities to be delivered to the mutual fund at the beginning of the transaction

(a) are received by the mutual fund either before or at the same time as it delivers the cash used by it to purchase those securities; and

(b) have a market value equal to at least 102 percent of the cash paid for the securities by the mutual fund.

6. The purchased securities are marked to market on each business day, and either the amount of cash paid for the purchased securities or the amount of purchased securities in the possession of the seller or the mutual fund is adjusted on each business day to ensure that the market value of purchased securities held by the mutual fund in connection with the transaction is not less than 102 percent of the cash paid by the mutual fund.

7. If an event of default by a seller occurs, the mutual fund, in addition to any other remedy available in the agreement or applicable law, has the right under the agreement to retain or dispose of the purchased securities delivered to it by the seller to the extent necessary to satisfy its claims under the agreement.

8. The transaction is a "securities lending arrangement" under section 260 of the ITA.

9. The term of the reverse repurchase agreement, before any extension or renewal that requires the consent of both the seller and the mutual fund, is not more than 30 days.".

(9) National Instrument 81-102 is amended by the addition of the following as section 2.15:

"**2.15 Agent for Securities Lending, Repurchase and Reverse Repurchase Transactions**

(1) The manager of a mutual fund shall appoint an agent or agents to act on behalf of the mutual fund in administering the securities lending and repurchase transactions entered into by the mutual fund.

(2) The manager of a mutual fund may appoint an agent or agents to act on behalf of the mutual fund to administer the reverse repurchase transactions entered into by the mutual fund.

(3) The custodian or a sub-custodian of the mutual fund shall be the agent appointed under subsection (1) or (2).

(4) The manager of a mutual fund shall not authorize an agent to enter into a securities lending, repurchase or, if applicable, reverse repurchase transactions on behalf of the mutual fund until the agent enters into a written agreement with the manager and the mutual fund in which

(a) the mutual fund and the manager provide instructions to the agent on the parameters to be followed in entering into the type of transactions to which the agreement pertains;

(b) the agent agrees to comply with this Instrument, accepts the standard of care referred to in subsection (5) and agrees to ensure that all transactions entered into by it on behalf of the mutual fund will comply with this Instrument; and

(c) the agent agrees to provide to the mutual fund and the manager regular, comprehensive and timely reports summarizing the mutual fund's securities lending, repurchase and reverse repurchase transactions, as applicable.

(5) An agent appointed under this section, in administering the securities lending, repurchase and, if applicable, reverse repurchase transactions of the mutual fund shall exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances.".

(10) National Instrument 81-102 is amended by the addition of the following as section 2.16:

"**2.16 Controls and Records**

(1) A mutual fund shall not enter into transactions under sections 2.12, 2.13 or 2.14 unless,

(a) for transactions to be entered into through an agent appointed under section 2.15, the manager has reasonable grounds to believe that the agent has established and maintains appropriate internal controls and procedures and records; and

(b) for reverse repurchase transactions directly entered into by the mutual fund without an agent, the manager has established and maintains appropriate internal controls, procedures and records.

(2) The internal controls, procedures and records referred to in subsection (1) shall include

(a) a list of approved borrowers, purchasers and sellers based on generally accepted creditworthiness standards;

(b) as applicable, transaction and credit limits for each counterparty; and

(c) collateral diversification standards.

(3) The manager of a mutual fund shall, on a periodic basis not less frequently than annually,

(a) review the agreements with any agent appointed under section 2.15 to determine if the agreements are in compliance with this Instrument;

(b) review the internal controls described in subsection (2) to ensure their continued adequacy and appropriateness;

(c) make reasonable enquiries as to whether the agent is administering the securities lending, repurchase or reverse repurchase transactions of the mutual fund in a competent and responsible manner, in conformity with the requirements of this Instrument and in conformity with the agreement between the agent, the manager and the mutual fund entered into under subsection 2.15(4);

(d) review the terms of any agreement between the mutual fund and an agent entered into under subsection 2.15(4) in order to determine if the instructions provided to the agent in connection with the securities lending, repurchase or reverse repurchase transactions of the mutual fund continue to be appropriate; and

(e) make or cause to be made any changes that may be necessary to ensure that

(i) the agreements with agents are in compliance with this Instrument,

(ii) the internal controls described in subsection (2) are adequate and appropriate,

(iii) the securities lending, repurchase or reverse repurchase transactions of the mutual fund are administered in the manner described in paragraph (c), and

(iv) the terms of each agreement between the mutual fund and an agent entered into under subsection 2.15(4) are appropriate.".

(11) National Instrument 81-102 is amended by the addition of the following as section 2.17:

"**2.17 Commencement of Securities Lending, Repurchase and Reverse Repurchase Transactions by a Mutual Fund**

(1) A mutual fund shall not enter into securities lending, repurchase or reverse repurchase transactions unless

(a) its simplified prospectus contains the disclosure required for mutual funds entering into those types of transactions; and

(b) the mutual fund has provided to its securityholders, not less than 60 days before it begins entering into those types of transactions, written notice that discloses its intent to begin entering into those types of transactions and the disclosure required for mutual funds entering into those types of transactions.

(2) Paragraph (1)(b) does not apply to a mutual fund that has entered into reverse repurchase agreements as permitted by a decision of the securities regulatory authority or regulator.".

(12) National Instrument 81-102 is amended by the deletion of section 4.2 and the substitution of the following:

"**4.2 Self-Dealing**

(1) A mutual fund shall not purchase a security from, sell a security to, or enter into a securities lending, repurchase or reverse repurchase transaction under section 2.12, 2.13 or 2.14 with, any of the following persons or companies:

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.

(2) Subsection (1) applies in the case of a sale of a security to, or a purchase of a security from, a mutual fund only if the person or company that would be selling to, or purchasing from, the mutual fund would be doing so as principal.".

(13) National Instrument 81-102 is amended by the deletion of subsection 4.4(5), the substitution of subsection (5) below as the new subsection (5) and the addition of subsection (6) below as subsection (6):

"(5) This section does not apply to any losses to a mutual fund or securityholder arising out of an action or inaction by

(a) a director of the mutual fund; or

(b) a custodian or sub-custodian of the mutual fund, except as set out in subsection (6).

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

(14) National Instrument 81-102 is amended by

(a) the addition of the words "or regulator" immediately after the words "securities regulatory authority" in subsections 5.5(1), 5.5(2) and 5.6(1) and section 5.9; 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)."

(15) Paragraph 6.3(3)(b) of National Instrument 81-102 is amended by striking out "subsidiary" and substituting "affiliate".

(16) National Instrument 81-102 is amended by

(a) changing the title of section 6.8 to "Custodial Provisions relating to Derivatives and Securities Lending, Repurchase and Reverse Repurchase Agreements";

(b) the deletion of subsection 6.8(4) and the substitution of the following:

"(4) The agreement by which portfolio assets of a mutual fund are deposited in accordance with subsection (1), (2) or (3) shall require the person or company holding portfolio assets of the mutual fund so deposited to ensure that its records show that that mutual fund is the beneficial owner of the portfolio assets."; and

(c) by the addition of the following as subsection 6.8(5):

"(5) A mutual fund may deliver portfolio assets to a person or company in satisfaction of its obligations under a securities lending, repurchase or reverse purchase agreement that complies with this Instrument if the collateral, cash proceeds or purchased securities that are delivered to the mutual fund in connection with the transaction are held under the custodianship of the custodian or a sub-custodian of the mutual fund in compliance with this Part.".

(17) National Instrument 81-102 is amended by the deletion of the words "immediately before the close of business" in paragraph 9.4(4)(a).

(18) National Instrument 81-102 is amended by the deletion of subsection 11.4(1) and the substitution of the following:

"(1) Sections 11.1 and 11.2 do not apply to members of The Investment Dealers Association of Canada, The Montreal Exchange, The Toronto Stock Exchange or the Canadian Venture Exchange Inc.".

(19) National Instrument 81-102 is amended by the deletion of subsection 12.1(4) and the substitution of the following:

"(4) Subsection (3) does not apply to members of The Investment Dealers Association of Canada, The Montreal Exchange, The Toronto Stock Exchange or the Canadian Venture Exchange Inc.".

(20) National Instrument 81-102 is amended by the deletion of subsection 15.4(12).

(21) National Instrument 81-102 is amended by the deletion of subparagraph 15.6(a)(i) and the substitution of the following:

"(i) the mutual fund has distributed 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 funds each of which has distributed securities under a simplified prospectus in a jurisdiction for at least 12 consecutive months, or".

(22) National Instrument 81-102 is amended by the addition of the following as section 15.14:

"**Sales Communication - Multi-Class Mutual Funds** - A sales communication for a mutual fund that distributes different classes or series of securities that are referable to the same portfolio shall not contain performance data unless the sales communication complies with the following requirements:

1. The sales communication clearly specifies the class or series of security to which any performance data contained in the sales communication relates.

2. If the sales communication refers to more than one class or series of security and provides performance data for any one class or series, the sales communication shall provide performance data for each class or series of security referred to in the sales communication and shall clearly explain the reasons for different performance data among the classes or series.

3. A sales communication for a new class or series of security and an existing class or series of security shall not contain performance data for the existing class or series unless the sales communication clearly explains any differences between the new class or series and the existing class or series that could affect performance.".

(23) Section 16.1 of National Instrument 81-102 is amended by the deletion of subparagraph (1)(a)(i) and the substitution of the following:

"(i) the total expenses of the mutual fund, before income taxes, for the financial year, as shown on its income statement,".

(24) National Instrument 81-102 is amended by the addition of the following as subsection 16.1(4):

"(4) The requirements to provide note disclosure contained in subsections (2) and (3) do not apply if 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.".

(25) National Instrument 81-102 is amended by the renumbering of existing subsections 16.1(4), (5), (6), (7) and (8) as subsections 16.1(5), (6), (7), (8) and (9), respectively.

(26) 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**

(1) For the purposes of subparagraph 16.1(1)(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.

(2) A mutual fund that has exposure to one or more other mutual funds through the use of specified derivatives in a financial year shall calculate its management expense ratio for the financial year in the manner described in subsection (1), treating each mutual fund to which it has exposure as an "underlying mutual fund" under subsection (1).

(3) Subsection (2) does not apply if the specified derivatives do not expose the mutual fund to expenses that would be incurred by a direct investment in the relevant mutual funds.

(4) Despite subsection 16.1(5), management fees rebated by an underlying fund to a mutual fund that invests in the underlying fund shall be deducted from total expenses of the underlying fund if the rebate is made for the purpose of avoiding duplication of fees between the two mutual funds.".

(27) National Instrument 81-102 is amended by the addition of the following as section 16.3:

"**16.3 Application of Section 16.1** - Section 16.1 does not apply to a mutual fund in respect of a financial year that ended before February 1, 2000 if the management expense ratio for that financial year is disclosed and calculated in accordance with securities legislation applicable to mutual funds on January 31, 2000.".

(28) National Instrument 81-102 is amended by the deletion of section 20.3 and the substitution of the following:

"**20.3 Reports to Securityholders** - This Instrument does not apply to reports to securityholders

(a) printed before February 1, 2000; or

(b) that include only financial statements that relate to financial periods that ended before February 1, 2000.".

**PART 2 EFFECTIVE DATE**

**2.1 Effective Date** - This Amendment comes into force on May 2, 2001.

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

**PART 1 AMENDMENTS**

**1.1 Amendments**

(1) Companion Policy 81-102CP is amended by the addition of the following as paragraph 5 of subsection 2.13(2):

"5. (a) The mutual fund has become legally entitled to dispose of the collateral held by it under a securities loan or repurchase agreement and to apply proceeds of realization to satisfy the obligations of the counterparty of the mutual fund under the transaction, and

(b) sufficient time has passed after the event described in paragraph (a) to enable the mutual fund to sell the collateral in a manner that maintains an orderly market and that permits the preservation of the best value for the mutual fund."

(2) 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.

(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 and 3.5 as sections 3.3, 3.4, 3.5 and 3.6, 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

(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 all or some of the investments of the mutual fund on a different permitted index than a permitted index previously used. This decision might be made for investment reasons or because that index no longer satisfies the definition of "permitted index" in the 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 addition of the following as section 3.7:

"**3.7 Securities Lending, Repurchase and Reverse Repurchase Transactions**

(1) Section 2.12, 2.13 and 2.14 of the Instrument each contains a number of conditions that must be satisfied in order that a mutual fund may enter into a securities lending, repurchase or reverse repurchase transaction in compliance with the Instrument. It is expected that, in addition to satisfying these conditions, the manager on behalf of the mutual fund, in co-ordination with an agent, will ensure that the documentation evidencing these types of transactions contains customary provisions to protect the mutual fund and to document the transaction properly. Among other things, these provisions would normally include:

(a) a definition of an "event of default" under the agreement, which would include failure to deliver cash or securities, or to promptly pay to the mutual fund amounts equal to dividends and interest paid, and distributions made, on loaned or sold securities, as required by the agreement;

(b) provisions giving non-defaulting parties rights of termination, rights to sell the collateral, rights to purchase identical securities to replace the loaned securities and legal rights of set-off in connection with their obligations if an event of default occurs; and

(c) provisions that deal with, if an event of default occurs, how the value of collateral or securities held by the non-defaulting party that is in excess of the amount owed by the defaulting party will be treated.

(2) Section 2.12, 2.13 and 2.14 of the Instrument each imposes a requirement that a mutual fund that has entered into a securities lending, repurchase or reverse repurchase transaction hold cash or securities of at least 102 percent of the market value of the securities or cash held by the mutual fund's counterparty under the transaction. It is noted that the 102 percent requirement is a minimum requirement, and that it may be appropriate for the manager of a mutual fund, or the agent acting on behalf of the mutual fund, to negotiate the holding of a greater amount of cash or securities if necessary to protect the interests of the mutual fund in a particular transaction, having regard to the level of risk for the mutual fund in the transaction. In addition, if the recognized best practices for a particular type of transaction in a particular market calls for a higher level of collateralization than 102 percent, it is expected that, absent special circumstances, the manager or the agent would ensure that its arrangements reflect the relevant best practices for that transaction.

(3) Paragraph 3 of subsection 2.12(1) of the Instrument refers to securities lending transactions in terms of securities that are "loaned" by a mutual fund in exchange for collateral. Some securities lending transactions are documented so that title to the "loaned" securities is transferred from the "lender" to the "borrower". The Canadian securities regulatory authorities do not consider this fact as sufficient to disqualify those transactions as securities loan transactions within the meaning of the Instrument, so long as the transaction is in fact substantively a loan. References throughout the Instrument to "loaned" securities, and similar references, should be read to include securities "transferred" under a securities lending transaction.

(4) Paragraph 6 of subsection 2.12(1) permits the use of irrevocable letters of credit as collateral in securities lending transactions. The Canadian securities regulatory authorities believe that, at a minimum, the prudent use of letters of credit will involve the following arrangements:

(a) the mutual fund should be allowed to draw down any amount of the letter of credit at any time by presenting its sight draft and certifying that the borrower is in default of its obligations under the securities lending agreement, and the amount capable of being drawn down would represent the current market value of the outstanding loaned securities or the amount required to cure any other borrower default; and

(b) the letter of credit should be structured so that the lender may draw down, on the date immediately preceding its expiration date, an amount equal to the current market value of all outstanding loaned securities on that date.

(5) Paragraph 9 of subsection 2.12(1) and paragraph 8 of subsection 2.13(1) of the Instrument each provides that the agreement under which a mutual fund enters into a securities lending or repurchase transaction include a provision requiring the mutual fund's counterparty to promptly pay to the mutual fund, among other things, distributions made on the securities loaned or sold in the transaction. In this context, the term "distributions" should be read broadly to include all payments or distributions of any type made on the underlying securities, including, without limitation, distributions of property, stock dividends, securities received as the result of splits, all rights to purchase additional securities and full or partial redemption proceeds. This extended meaning conforms to the meaning given the term "distributions" in several standard forms of securities loan agreements widely used in the securities lending and repurchase markets.

(6) Section 2.12, 2.13 and 2.14 of the Instrument make reference to the "delivery" and "holding" of securities or collateral by the mutual fund. The Canadian securities regulatory authorities note that these terms will include the delivery or holding by an agent for a mutual fund. In addition, the Canadian securities regulatory authorities recognize that under ordinary market practice, agents pool collateral for securities lending/repurchase clients; this pooling of itself is not considered a violation of the Instrument.

(7) Section 2.12, 2.13 and 2.14 of the Instrument require that the securities involved in a securities lending, repurchase or reverse repurchase transaction be marked to market daily and adjusted as required daily. It is recognized that market practice often involves an agent marking to market a portfolio at the end of a business day, and effecting the necessary adjustments to a portfolio on the next business day. So long as each action occurs on each business day, as required by the Instrument, this market practice is not a breach of the Instrument.

(8) As noted in subsection (7), the Instrument requires the daily marking to market of the securities involved in a securities lending, repurchase or reverse repurchase transaction. The valuation principles used in this marking to market may be those generally used by the agent acting for the mutual fund, even if those principles deviate from the principles that are used by the mutual fund in valuing its portfolio assets for the purposes of calculating net asset value.

(9) Paragraph 6 of subsection 2.13(1) of the Instrument imposes a requirement concerning the delivery of sales proceeds to the mutual fund equal to 102 per cent of the market value of the securities sold in the transaction. It is noted that accrued interest on the sold securities should be included in the calculation of the market value of those securities.

(10) Section 2.15 of the Instrument imposes the obligation on a manager of a mutual fund to appoint an agent or agents to administer its securities lending and repurchase transactions, and makes optional the ability of a manager to appoint an agent or agents to administer its reverse repurchase transactions. A manager that appoints more than one agent to carry out these functions may allocate responsibility as it considers best. For instance, it may be appropriate that one agent be responsible for domestic transactions, with one or more agents responsible for off-shore transactions. Managers should ensure that the various requirements of sections 2.15 and 2.16 of the Instrument are satisfied for all agents.

(11) It is noted that the responsibilities of an agent appointed under section 2.15 of the Instrument include all aspects of acting on behalf of a mutual fund in connection with securities lending, repurchase or reverse repurchase agreements. This includes acting in connection with the reinvestment of collateral or securities held during the life of a transaction.

(12) Subsection 2.15(3) of the Instrument requires that an agent appointed by a mutual fund to administer its securities lending, repurchase or reverse repurchase transactions shall be a custodian or sub-custodian of the mutual fund. It is noted that the provisions of Part 6 of the Instrument generally apply to the agent in connection with its activities relating to securities lending, repurchase or reverse repurchase transactions. The agent must have been appointed as custodian or sub-custodian in accordance with section 6.1, and must satisfy the other requirements of Part 6 in carrying out its responsibilities.

(13) Subsection 2.15(5) of the Instrument provides that the manager of a mutual fund shall not authorize an agent to enter into securities lending, repurchase or, if applicable, reverse repurchase transactions on behalf of the mutual fund unless there is a written agreement between the agent, the manager and the mutual fund that deals with certain prescribed matters. Subsection (5) requires that the manager and the

mutual fund, in the agreement, provide instructions to the agent on the parameters to be followed in entering into the type of transaction to which the agreement pertains. The parameters would normally include:

(a) details on the types of transactions that may be entered into by the mutual fund;

(b) types of portfolio assets of the mutual fund to be used in the transaction;

(c) specification of maximum transaction size, or aggregate amount of assets that may be committed to transactions at any one time;

(d) specification of permitted counterparties;

(e) any specific requirements regarding collateralization, including minimum requirements as to amount and diversification of collateralization, and details on the nature of the collateral that may be accepted by the mutual fund;

(f) directions and an outline of responsibilities for the reinvestment of cash collateral received by the mutual fund under the program to ensure that proper levels of liquidity are maintained at all times; and

(g) duties and obligations on the agent to take action to obtain payment by a borrower of any amounts owed by the borrower.

(14) The definition of "cash cover" contained in section 1.1 of the Instrument requires that the portfolio assets used for cash cover not be "allocated for specific purposes". Securities loaned by a mutual fund in a securities lending transaction have been allocated for specific purposes and therefore cannot be used as cash cover by the mutual fund for its specified derivatives obligations.

(15) A mutual fund sometimes needs to vote securities held by it in order to protect its interests in connection with corporate transactions or developments relating to the issuers of the securities. The manager and the portfolio adviser of a mutual fund, or the agent of the mutual fund administering a securities lending program on behalf of the mutual fund, should monitor corporate developments relating to securities that are loaned by the mutual fund in securities lending transactions, and take all necessary steps to ensure that the mutual fund can exercise a right to vote the securities when necessary. This may be done by way of a termination of a securities lending transaction and recall of loaned securities, as described in paragraph 11 of subsection 2.12(1) of the Instrument.

(16) As part of the prudent management of a securities lending, repurchase or reverse repurchase program, managers of mutual funds, together with their agents, should ensure that transfers of securities in connection with those programs are effected in a secure manner over an organized market or settlement system. For foreign securities, this may entail ensuring that securities are cleared through central depositories. Mutual funds and their agents should pay close attention to settlement arrangements when entering into securities lending, repurchase and reverse repurchase transactions.".

(5) Companion Policy 81-102CP is amended by the addition of the following as section 5.2:
"**Securities Lending, Repurchase and Reverse Repurchase Transactions**

(1) As described in section 5.1, section 4.4 of the Instrument is designed to ensure that the manager of a mutual fund is responsible for any loss that arises out of the failure of it, and of any person or company retained by it or the mutual fund to discharge any of the manager's responsibilities to the mutual fund, to satisfy the standard of care referred to in that section.

(2) The retention by a manager of an agent under section 2.15 of the Instrument to administer the mutual fund's securities lending, repurchase or reverse repurchase transactions does not relieve the manager from ultimate responsibility for the administration of those transactions in accordance with the Instrument and in conformity with the standard of care imposed on the manager by statute and required to be imposed on the agent in the relevant agreement by subsection 2.15(6) of the Instrument.

(3) Because the agent is required to be a custodian or sub-custodian of the mutual fund, its activities, as custodian or sub-custodian, are not within the responsibility of the manager of the mutual fund, as provided for in subsection 4.4(5) of the Instrument. However, the activities of the agent, in its role as administering the mutual funds' securities lending, repurchase or reverse repurchase transactions, are within the ultimate responsibility of the manager,

as provided for in subsection 4.4(6) of the Instrument."

(6) Companion Policy 81-102CP is amended by the addition of the following as subsections 13.2(5),(6), (7) and (8):

"(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(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.

(6) Paragraph 15.6(a) of the Instrument contains a prohibition against the inclusion of performance data for a mutual fund that has been distributing securities for less than 12 consecutive months. The creation of a new class or series of security of an existing mutual fund does not constitute the creation of a new mutual fund and therefore does not subject the mutual fund to the restrictions of paragraph 15.6(a) unless the new class or series is referable to a new portfolio of assets.

(7) Section 15.14 of the Instrument contains the rules relating to sales communications for multi-class mutual funds. Those rules are applicable to a mutual fund that has more than one class of securities that are referable to the same portfolio of assets. Section 15.14 does not deal directly with asset allocation services. It is possible that asset allocation services could offer multiple "classes"; the Canadian securities regulatory authorities recommend that any sales communications for those services generally respect the principles of section 15.14 in order to ensure that those sales communications not be misleading.

(8) The Canadian securities regulatory authorities believe that the use of hypothetical or *pro forma* performance data for new classes of securities of a multi-class mutual fund would generally be misleading.".

(7) 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.

(2) Subsection 16.1(1) requires a 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(4) 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.

(5) Mutual funds are reminded to ensure that any management expense ratio provided to

a service provider for public dissemination should be only the management expense ratio calculated as required by the Instrument.".

(8) Part 14 of Companion Policy 82-102CP is amended by

(a) the change of the title of the part to "Financial Disclosure Matters";

(b) the addition of the following as section 14.2:

"**14.2 Financial Statement Requirements in Securities Lending, Repurchase and Reverse Repurchase Transactions** - Mutual funds are required to follow Canadian GAAP in preparing financial statements, as supplemented as applicable by the requirements of other applicable securities legislation. The Canadian securities regulatory authorities wish to provide their views on the appropriate application of Canadian GAAP in circumstances where mutual funds enter into securities lending, repurchase and reverse repurchase transactions. Sections 14.3, 14.4 and 14.5 reflect the views of the Canadian securities regulatory authorities as to the steps those mutual funds should take in order to ensure that their financial statements comply with Canadian GAAP.";

(c) the addition of the following as section 14.3:

"**14.3 Financial Statement Requirements Concerning Securities Lending Transactions**

(1) A mutual fund, 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, should

(a) disclose the aggregate dollar value of securities that were lent in the securities lending transactions of the mutual fund that remain outstanding as at the date of the statement; and

(b) disclose the type and aggregate amount of collateral received by the mutual fund under securities lending transactions of the mutual fund that remain outstanding as at the date of the statement.

(2) A balance sheet of a mutual fund that has received cash collateral in a securities lending transaction that remains outstanding as of the date of the balance sheet should fairly present

(a) the cash collateral received by it as an asset; and

(b) the obligation to repay the cash collateral as a liability.

(3) The asset and liability referred to in subsection (2) should be shown as separate line items in the balance sheet.

(4) An income statement of a mutual fund should fairly present income from securities lending transactions as revenue and not as deductions from expenses.";

(d) the addition of the following as section 14.4:

"**14.4 Financial Statement Requirements Concerning Repurchase Transactions**

(1) A mutual fund, 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, should, for each repurchase transaction of the mutual fund that remains outstanding as at the date of the statement, disclose the date of the transaction, the expiration date of the transaction, the name of the counterparty of the mutual fund, the nature and market value of the securities sold by the mutual fund, the amount of cash received, the repurchase price to be paid by the mutual fund and the market value of the sold securities as at the date of the statement.

(2) A balance sheet of a mutual fund that has entered into a repurchase transaction that remains outstanding as of the date of the balance sheet should fairly present the obligation of the mutual fund to repay the collateral as a liability.

(3) The liability referred to in subsection (2) should be shown as

a separate line item in the balance sheet.

(4) An income statement of a mutual fund should fairly present income from the use of the cash received on repurchase transactions as revenue and not to offset expenses incurred in connection with the repurchase transaction."; and

(e) the addition of the following as section 14.5:

"**14.5 Financial Statement Requirements Concerning Reverse Repurchase Transactions**

(1) A mutual fund, 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, should for each reverse repurchase transaction of the mutual fund that remains outstanding as at the date of the statement, disclose the date of the transaction, the expiration date of the transaction, the name of the counterparty of the mutual fund, the total dollar amount paid by the mutual fund, the nature and value or principal amount of the securities received by the mutual fund and the market value of the purchased securities as at the date of the statement.

(2) A balance sheet of a mutual fund that has entered into a reverse repurchase transaction that remains outstanding as of the date of the balance sheet should fairly present the reverse repurchase agreement relating to the transaction as an asset at market value.

(3) The asset referred to in subsection (2) should be shown as a separate line item in the balance sheet.

(4) An income statement of a mutual fund should fairly present income from reverse repurchase transactions as revenue and not as deductions from expenses.".

**PART 2 EFFECTIVE DATE**

**2.1 Effective Date** - This Amendment comes into force on May 2, 2001.

**NATIONAL INSTRUMENT 81-101**
**MUTUAL FUND PROSPECTUS DISCLOSURE**
**AMENDMENTS TO**
**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 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 copy of an agreement of the mutual fund, its manager or trustee with a portfolio adviser or portfolio advisers of the mutual fund filed under 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 that are referable to the same portfolio 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.*

*(22) As provided in National Instrument 81-102, a 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. Those principles are applicable to National Instrument 81-101 and this Form."*.

(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 of the permitted index that the security or securities referred to in paragraph (c) represented at the most recent date for which that information is available.".

(5) Item 7 of Part B of Form 81-101F1 is amended by the addition of the following as subsection (8):

"(8) If the mutual fund intends to enter into securities lending, repurchase or reverse repurchase transactions under sections 2.12, 2.13 or 2.14 of National Instrument 81-102

(a) state that the mutual fund may enter into securities lending, repurchase or reverse repurchase transactions; and

(b) briefly describe

(i) how those transactions are or will be entered into in conjunction with other strategies and investments of the mutual fund to achieve the mutual fund's investment objectives;

(ii) the types of those transactions to be entered into and give a brief description of the nature of each type, and

(iii) the limits of the mutual fund's entering into of those transactions.".

(6) Item 9 of Part B of Form 81-101F1 is amended by

(a) the addition of the following as subsections (5), (6) and (7):

"(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, other than a government security or a security issued by a clearing corporation, disclose

(a) the name of the issuer and the securities;

(b) the maximum percentage of the net assets of the mutual fund that securities of that issuer represented during the 12 month period; and

(c) disclose the risks associated with these matters, 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.

(7) If the mutual fund is to enter into securities lending, repurchase or reverse repurchase transactions, describe the risks associated with the mutual fund entering into those transactions.";

(b) the addition of the following as Instruction (6):

*"In responding to subsection (6) above, it is necessary to disclose only that at a time during the 12 month period referred to, more than 10 percent of the net assets of the mutual fund were invested in the securities of an issuer. Other than the maximum percentage required to be disclosed under paragraph (6)(b), the mutual fund is not required to provide particulars or a summary of any such occurrences."*.

(7) 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).

(8) 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 subsection (4):

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

**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 that are referable to the same portfolio 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. If disclosure pertaining to more than one class or series is combined in one annual information form, 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.*

*(15) As provided in National Instrument 81-102, a section, party, 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. Those principles are applicable to National Instrument 81-101 and this 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 12 of Form 81-101F2 is amended by the addition of the following as subsections (4) and (5):

"(4) If the mutual fund intends to enter into securities lending, repurchase or reverse repurchase transactions, describe the policies and practices of the mutual fund to manage the risks associated with those transactions.

(5) In the disclosure provided under subsection (4), include disclosure of

(a) the involvement of an agent to administer the transactions on behalf of the mutual fund, and the details of the instructions provided by the mutual fund to the agent under the agreement between the mutual fund and the agent;

(b) whether there are written policies and procedures in place that set out the objectives and goals for securities lending, repurchase transactions or reverse repurchase transactions, and the risk management procedures applicable to the mutual fund's entering into of those transactions;

(c) who is responsible for setting and reviewing the agreement referred to in paragraph (a) and the policies and procedures referred to in paragraph (b), how often the policies and procedures are reviewed, and the extent and nature of the involvement of the board of directors or trustee in the risk management process;

(d) whether there are limits or other controls in place on the entering into of those transactions by the mutual fund and who is responsible for authorizing those limits or other controls on those transactions;

(e) whether there are individuals or groups that monitor the risks independent of those who enter into those transactions on behalf of the mutual fund; and

(f) whether risk measurement procedures or simulations are used to test the portfolio under stress conditions.".

(5) 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**

**Effective Date** - This Amendment comes into force on May 2, 2001.

**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 certain material contracts from which certain commercial or financial information was 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 contracts 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 May 2, 2001.