

**NOTICE OF  
PROPOSED AMENDMENTS TO  
  
NATIONAL INSTRUMENT 81-102  
MUTUAL FUNDS  
  
AND TO  
  
NATIONAL INSTRUMENT 81-106  
INVESTMENT FUND CONTINUOUS DISCLOSURE  
  
AND RELATED CONSEQUENTIAL AMENDMENTS**

## **Introduction**

The Canadian Securities Administrators (the CSA or we) are publishing for comment proposals that would modify the current regulatory framework for mutual funds contained in National Instrument 81-102 *Mutual Funds* (NI 81-102 or the Instrument).

The proposed amendments (the Amendments) would codify exemptive relief that we have frequently granted to mutual funds from requirements in NI 81-102, create additional operational requirements for money market funds, update various provisions and remove provisions that are no longer relevant.

We are also proposing substantive amendments to National Instrument 81-106 Investment Fund Continuous Disclosure (NI 81-106). These amendments codify exemptive relief we have frequently granted to investment funds from requirements in NI 81-106.

Finally, we are also publishing for comment related consequential amendments to the following:

- Companion Policy 81-102CP – *To National Instrument 81-102 Mutual Funds* (81-102CP);
- National Instrument 41-101 *General Prospectus Requirements* (NI 41-101) and its related Form 41-101F2 *Information Required in an Investment Fund Prospectus* (Form 41-101F2);
- National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (NI 81-101) and its related Forms 81-101F1 *Contents of Simplified Prospectus* (Form 81-101F1) and 81-101F2 *Contents of Annual Information Form* (Form 81-101F2).

## **Background**

The CSA is currently reviewing the product regulation of conventional mutual funds and other investment funds with a view to modernizing it. The following types of prospectus

qualified investment funds are within the scope of this project: (i) conventional mutual funds, (ii) exchange-traded mutual funds and (iii) non-redeemable investment funds.

NI 81-102 imposes product regulation requirements for all publicly offered investment funds that fall within the definition of “mutual fund” contained in Canadian securities legislation. Aside from certain focussed amendments, NI 81-102 has not had an overall update since it came into force. During this time there have been many changes in the nature and types of investment funds offered for sale to retail investors in the Canadian marketplace and to the evolution of regulatory approaches to mutual funds in other major markets. To accommodate these changes, the CSA has for the last few years been frequently granting certain relief.

### **Phase 1**

The first phase of this project, which consists of the Amendments, would codify exemptive relief that we frequently grant to mutual funds under NI 81-102 and to other investment funds from other investment fund rules. The Amendments cover the following:

- (i) exchange-traded mutual funds;
- (ii) investments in other mutual funds;
- (iii) short selling;
- (iv) derivatives;
- (v) money market funds;
- (vi) mutual fund dealers;
- (vii) mutual fund ratings;
- (viii) drafting changes;
- (ix) continuous disclosure requirements.

We anticipate that the Amendments would replace a patchwork of exemptive relief orders with a set of uniform requirements applicable to all mutual funds and, in the case of the continuous disclosure requirements, all investment funds.

### **Phase 2**

In the second phase of this project we will consider whether there are any market efficiency, fairness or investor protection issues that arise out of the differing regulatory regimes that apply to different types of investment funds and other competing retail investment products and whether NI 81-102 should be amended to address these issues. NI 81-102 currently applies only to mutual funds. We will assess whether there are any significant problems with the current approach to investment fund product regulation and assess what solutions might be appropriate to address them. Potential outcomes of this analysis may include:

- (i) no changes to current investment fund product regulation,
- (ii) new base level product regulation for all investment funds, or

- (iii) less prescriptive product regulation for conventional mutual funds and exchange-traded mutual funds.

When completed, the Phase 2 review may result in one or more amendment proposals.

## **Summary and Purpose of the Amendments to National Instrument 81-102**

### **(i) Exchange-Traded Mutual Funds**

Since we adopted NI 81-102 there has been a significant increase in the number and types of exchange-traded mutual funds available in the Canadian marketplace. NI 81-102 did not contemplate the various structures used by exchange-traded mutual funds and most of these funds have received exemptive relief from a number of its requirements.

There are two types of exchange-traded mutual funds for which we have frequently given relief, namely, exchange-traded mutual funds in continuous distribution and exchange-traded mutual funds not in continuous distribution, which include fixed portfolio exchange-traded mutual funds.

#### Amendments Relating to all Exchange-Traded Mutual Funds

##### *Record Date*

We propose amending Part 14 of NI 81-102 to require exchange-traded mutual funds to establish record dates that determine the right of a securityholder to receive a dividend or distribution in accordance with the rules of the exchange that the mutual fund is listed on.

#### Amendments Relating to Exchange-Traded Mutual Funds in Continuous Distribution

Exchange-traded mutual funds in continuous distribution are generally bought and sold by retail investors in a manner that is substantially different than purchases and redemptions of conventional mutual funds. Retail investors typically buy and sell these funds in the secondary market through the exchange. Primary distribution of these funds is generally limited to designated brokers. These designated brokers then make the securities of the funds available in the secondary market.

##### *Payment for Purchases and Redemptions*

In recognition of the different purchase and redemption process utilized by exchange-traded mutual funds in continuous distribution, we are proposing amendments to subsections 9.4(2) and 10.4(3). The change to subsection 9.4(2) would permit mutual funds to receive a combination of cash and securities as payment for the purchase of mutual fund securities. The parallel amendment to subsection 10.4(3) would permit mutual funds to pay redemption proceeds in a combination of cash and portfolio assets. We would continue to require that the fund obtain the prior written consent of the securityholder to the delivery of portfolio assets as redemption proceeds.

### *Determination of Redemption Price*

Retail investors seeking to dispose of securities of exchange-traded mutual funds in continuous distribution do not normally redeem their holdings as they would with a conventional mutual fund. Retail investors are more likely to sell their securities in the secondary market through the exchange. Redemptions of exchange-traded mutual funds in continuous distribution are typically only made by designated brokers. A designated broker will typically purchase fund securities in the secondary market and redeem these securities in large quantities set by the manager of the mutual fund known as a manager-prescribed number of units.

We propose to amend section 10.3 to permit exchange-traded mutual funds in continuous distribution to pay a redemption price that is based on the closing price of the fund's securities on the stock exchange in the case of redemptions of less than a manager-prescribed number of units of the fund. This would result in most securityholders who wish to redeem their securities selling the securities in the secondary market through the exchange. We think this would minimize the need for a fund to hold more cash than they otherwise think is necessary to meet their investment objectives, solely to fund redemptions.

### Amendments Relating to Exchange-Traded Mutual Funds Not in Continuous Distribution

We are proposing a number of amendments that would apply to exchange-traded mutual funds that are not in continuous distribution. These amendments would provide additional flexibility to this type of exchange-traded mutual fund relating to borrowing, reimbursing organizational costs and the requirements on the redemption of securities.

#### *Borrowing*

We propose to amend section 2.6 to allow exchange-traded mutual funds not in continuous distribution to borrow cash or provide a security interest over its portfolio assets to finance the acquisition of its portfolio securities. The fund must repay its borrowing on the completion of its initial public offering.

Many exchange-traded mutual funds not in continuous distribution establish short-term credit facilities to fund the purchase of portfolio assets before completing the fund's initial public offering. As a term of these short-term credit facilities, the fund will often be required to pledge these portfolio assets to the lender as collateral for the amounts borrowed under the facility. These facilities enable the fund to purchase portfolio assets before completing the fund's initial public offering and allow the fund to partially or fully invest in the securities described in the fund's investment objectives or strategies at that time.

#### *Organizational Costs*

We propose to amend section 3.3 to create an exemption for exchange-traded mutual funds not in continuous distribution from the prohibition of the reimbursement of organizational costs. Conventional mutual funds are prohibited from reimbursing their manager or promoters for or funding their organizational costs on the basis that these

costs would be prejudicial to the initial investors in the mutual fund. This is not the case in a one time offering where all the securities of the mutual fund are sold to investors on the closing of the offering and not through continuous distribution.

#### *Determination and Payment of Redemption Price*

In addition to the amendment to section 10.3 discussed above, we propose another amendment to section 10.3 to allow exchange-traded mutual funds not in continuous distribution to redeem securities at a price that is less than the net asset value of the security determined on a date specified in the prospectus or, if applicable, the annual information form of the exchange-traded mutual fund.

While exchange-traded mutual funds not in continuous distribution are required to calculate their net asset value as frequently as other mutual funds, they typically only permit redemptions based on net asset value no more frequently than once per month. This amendment allows these funds to pay redemption proceeds based on the fund's net asset value on a specified valuation date following the redemption request and to pay redemption proceeds that are less than the fund's net asset value per unit. We have previously granted this relief to these funds because the primary source of liquidity for investors in these funds is the trading on the exchange, and not the redemption feature of the fund.

We propose amendments to section 10.4 to allow an exchange-traded mutual fund not in continuous distribution to pay the proceeds of a redemption order more than three days after the valuation date on which the redemption price was established. The redemption payment date must be disclosed in the prospectus or, if applicable, the annual information form of the exchange-traded mutual fund not in continuous distribution. This type of fund typically has one day in each month designated as the day on which it pays the proceeds of redemptions. This date is often 10 days following the valuation date on which the fund determined the redemption price.

#### Amendments Relating to Fixed Portfolio Exchange-Traded Mutual Funds

Fixed portfolio exchange-traded mutual funds are exchange-traded mutual funds not in continuous distribution whose investment objectives include holding and maintaining a specified fixed portfolio of publicly listed equity securities of one or more issuers that are disclosed in its prospectus. These equity securities are not traded throughout the life of the fund, except in limited circumstances disclosed in the fixed portfolio fund's prospectus. A common example of a fixed portfolio exchange-traded mutual fund would be a split share corporation that holds a portfolio consisting of the equity securities of one or more issuers for a fixed period of time.

#### *Concentration Restriction*

We propose to amend section 2.1 to create an exemption from the concentration restriction for purchases of equity securities by a fixed portfolio exchange-traded mutual fund in accordance with its investment objectives. We have added this exemption in recognition of the fact that these funds typically make concentrated investments. The

issuers in which a fixed portfolio exchange-traded mutual fund invests would be disclosed in the fund's prospectus along with disclosure in the prospectus or annual information form about concentration risk.

## **(ii) Investments in Other Mutual Funds**

### *Definition of Index Participation Unit*

We propose to expand a mutual fund's ability to invest in index participation units issued by a mutual fund by amending the definition of "index participation unit" in the Instrument to include index participation units traded on a stock exchange in the United Kingdom in addition to those traded on a stock exchange in Canada or the United States.

### *Investment Restriction Amendments*

We propose to amend subsection 2.5(2) to allow mutual funds to purchase and hold securities of another mutual fund provided that the other mutual fund is subject to NI 81-102, offers or has offered securities under a simplified prospectus in accordance with NI 81-101 and is a reporting issuer in the local jurisdiction. This amendment avoids a top fund from having to divest of its investments in an underlying fund if the underlying fund ceases distributions under a prospectus but otherwise remains a reporting issuer.

The amendments to paragraph 2.5(2)(c) require that both the top and underlying funds be reporting issuers in a local jurisdiction. Accordingly, a top fund and the bottom funds in which it invests must be reporting issuers in the same jurisdictions. This prevents underlying funds from indirectly offering their securities in a jurisdiction in which they have not directly become reporting issuers.

We propose to make a related change to the existing exemptions from the concentration and control restrictions for funds-of-funds in subsections 2.1(2) and 2.2(1.1) as reliance on these exemptions is currently premised on the securities of the underlying fund being offered under a current prospectus. The amendment would allow a top fund to rely on the exemptions from the concentration and control restrictions provided its investments in underlying funds are made in compliance with section 2.5 of the Instrument.

We propose to amend the exception in paragraph 2.5(4)(a) which currently allows a multi-layered fund structure that is made up of a mutual fund investing in an RSP clone fund. As the RSP clone fund has become obsolete since the removal of the foreign content restriction under tax rules, the multi-layered fund exception in paragraph 2.5(4)(a) is being modified to apply going forward where a mutual fund invests in a "clone fund". We have defined "clone fund" to mean a mutual fund that has adopted a fundamental investment objective to link its performance to the performance of another mutual fund. This change to paragraph 2.5(4)(a) codifies past exemptive relief permitting certain mutual funds to invest in funds-of-funds that are similarly structured to RSP clone funds and equally transparent.

On a related note, we are proposing to amend subsection 10.6(1) to allow a clone fund to suspend redemptions when the other mutual fund to which the clone fund has linked its fundamental investment objectives has suspended redemptions.

Finally, a proposed amendment to subsection 2.5(5) would recognize that the prohibition in paragraph 2.5(2)(e) against a mutual fund paying sales and redemption fees in connection with the purchase or sale of securities of a related mutual fund does not apply to prohibit the mutual fund from paying applicable brokerage commissions on the purchase or sale of index participation units issued by a related mutual fund.

### **(iii) Short Selling**

#### *Short Sales*

We propose to amend Part 2 of NI 81-102 to codify the exemptive relief that we have frequently granted to allow mutual funds to engage in limited short selling of securities subject to certain conditions.

To do so, we have added section 2.6.1 Short Sales which would permit a mutual fund to sell securities short subject to compliance with certain conditions, including a cap on short selling of 20% of the mutual fund's net asset value. Total exposure to any one issuer that could be achieved through short selling would be limited to 5% of the net asset value of the mutual fund. Each of these limits would be determined as at the time the mutual fund sells a security short. The mutual fund would also be required to hold cash cover in an amount, including mutual fund assets deposited with the borrowing agent as security, that is at least 150% of the aggregate market value of all securities sold short by the mutual fund on a daily marked to market basis. Long/short strategies would not be permitted as the proceeds of short sales received by the mutual fund may not be used to enter into long positions in securities other than cash cover.

#### *Borrowing Agent*

Section 2.6.1 would require that, at the time of the short sale transaction, the mutual fund have borrowed or arranged to borrow from a "borrowing agent" the securities intended to be sold short. A custodian or sub-custodian that holds assets in connection with a short sale transaction, or a qualified dealer (discussed below) from whom the mutual fund borrows securities to effect the short sale, would qualify as a "borrowing agent" based on our proposed definition of that term.

#### *Custodial Provisions*

We propose adding section 6.8.1 Custodian Provisions Relating to Short Sales. This provision would identify and define the qualified dealers that may act as a borrowing agent in connection with a short sale transaction and the limits on exposure to a qualified dealer. A mutual fund could use a dealer as a borrowing agent for short sale transactions made in Canada if that dealer is registered as a dealer in Canada and a member of the Investment Industry Regulatory Organization of Canada (IIROC).

A mutual fund could only use a dealer as a borrowing agent for short sale transactions made outside of Canada if that dealer is a member of a stock exchange and therefore subject to regulatory audit and if that dealer has a net worth in excess of \$50 million, as determined from its most recent audited financial statements that have been made public.

#### *Notice Requirement*

We propose to amend section 2.11 to require a mutual fund to provide notice that it is commencing short selling in the same manner required for the commencement of the use of specified derivatives. We also propose to amend the prospectus forms to require the disclosure of short selling as an investment strategy. These amendments are described under the heading Related Consequential Amendments below.

#### **(iv) Derivatives**

##### *Cash Cover*

We propose amending the definition of “cash cover” in the Instrument to include:

- (i) evidences of indebtedness with a remaining term to maturity of 365 days or less and an approved credit rating;
- (ii) certain floating rate evidences of indebtedness whose interest rates reset no less frequently than every 185 days and the principal amounts of which continue to have a market value of approximately par on each rate reset;
- (iii) securities of money market mutual funds.

These proposed amendments are intended to provide mutual funds more flexibility in selecting securities for use as cash cover.

##### *Transactions in Specified Derivatives for Hedging and Non-hedging Purposes*

We propose to amend section 2.7(1) to remove the term limit on specified derivatives. Mutual funds are not limited in the term to maturity of the fixed income securities that they can invest in. As a result, mutual funds may choose to enter into derivatives that match the term to maturity of fixed income holdings. Additionally derivative positions can be offset at any time by entering into an opposing transaction.

#### **(v) Money Market Funds**

In October 2008, the CSA published a consultation paper<sup>1</sup> (the Consultation Paper) seeking comments on potential regulatory responses to the market turmoil and its impact on Canadian credit markets. Item 7 of the Consultation Paper sought comments on:

- (i) whether a specific concentration restriction for money market funds would be appropriate;
- (ii) whether to further restrict the types of investments a money market fund can make;

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<sup>1</sup> CSA Consultation Paper 11-405 – *Securities Regulatory Proposals Stemming from the 2007-08 Credit Market Turmoil and its Effect on the ABCP Market in Canada*



- (iii) whether assets such as asset-backed short-term debt are appropriate as eligible assets in the definition of “cash cover” and “qualified security”;
- (iv) whether short-term debt instruments, including asset-backed commercial paper with a specified credit rating, should be permitted to be aggregated in a statement of investment portfolio.

In addition CSA staff conducted reviews of money market fund managers focusing on portfolio holdings, valuation of portfolio securities, concentration levels, counterparty exposure and levels of redemptions.

Our proposed amendments relating to money market funds reflect the outcome of these reviews, the comments received in response to the Consultation Paper, and previously granted relief.

#### *Investment Restrictions*

We propose moving the investment restrictions applicable to money market funds out of the definitions section and into a new section 2.18 of the Instrument. The proposed amendments to the money market fund investment restrictions include:

- (i) allowing money market funds to hold securities issued by money market funds, if such investment is made in accordance with section 2.5;
- (ii) a restriction on money market funds using specified derivatives or selling securities short;
- (iii) new liquidity requirements;
- (iv) a revised dollar-weighted average term to maturity limit.

The new liquidity provisions would require a money market fund to have at least 5% of its assets in cash or readily convertible to cash within one day and 15% of its assets in cash or readily convertible to cash within one week. These requirements would better enable money market funds to meet redemption requests.

The current dollar-weighted average term to maturity limit in the definition of “money market fund” requires a money market fund to maintain a portfolio with a dollar-weighted average term to maturity limit not exceeding 90 days that is calculated on the basis that the term of a floating rate note is the period to the next rate setting of the note. We propose to maintain the current limit and to combine it with a new dollar-weighted average term to maturity limit of 120 days that is calculated based on the actual term to maturity of all securities in a money market fund portfolio including floating rate notes.

While the proposed limits may reduce the ability of money market funds to utilize floating rate notes with a long term to maturity, they would place a limit on the exposure of money market funds to the risks associated with longer terms to maturity.

We seek feedback on whether you agree or disagree with the 90 and 120-day dollar-weighted average term to maturity limits and whether there should be any limit on the exposure of a money market fund to floating rate notes. We also seek feedback on

whether the 90-day limit should be reduced to a shorter time frame as is the case in the money market funds rules approved by the United States Securities and Exchange Commission on January 27, 2010, which specify a 60-day limit.

**(vi) Mutual Fund Dealers**

We developed the Commingling Restrictions (as defined below) and the requirements for mutual fund dealers to pay interest on client deposits at a time when mutual fund dealers were not members of a self-regulatory organization and did not participate in an investor protection fund. Now that the Mutual Fund Dealers Association of Canada (MFDA) oversees mutual fund dealers and has created the Investor Protection Corporation, we think we should consider codifying relief we have frequently granted from these requirements. Although Quebec does not recognize the MFDA, similar relief was granted in the past and Quebec mutual fund dealers' activities are, or will be, governed by rules similar to those of the MFDA.

*Commingling Restrictions*

We propose to exempt principal distributors and participating dealers that are members of the MFDA, as well as mutual fund dealers in Québec, from the restrictions in paragraphs 11.1(1)(b) and 11.2(1)(b) against holding in the same trust account, cash for or from an investment in a mutual fund with cash for or from other products the dealer sells (collectively, the Commingling Restrictions). Principal distributors and participating dealers would still be required to hold client assets in a trust account and separate from their own assets. The exemption would simply enable them to hold all client assets in one trust account, and would not require a separate trust account for mutual fund-related money.

IIROC dealers are currently exempt from the Commingling Restrictions under subsection 11.4(1) of the Instrument. We propose to expand the exemption in subsection 11.4(1) to also include members of the MFDA and mutual fund dealers in Québec.

We request your feedback on the proposed exemption from the Commingling Restrictions.

*Interest Determination and Allocation*

Paragraphs 11.1(1)(a) and 11.2(1)(a) require principal distributors and participating dealers to account separately for cash received in connection with a mutual fund purchase or redemption transaction and to deposit the cash in an interest bearing trust account until such time as the cash is disbursed to the relevant persons (i.e. the mutual fund in the case of a purchase, the client in the case of a redemption). Subsections 11.1(4) and 11.2(4) require principal distributors and participating dealers to pay out the interest earned on cash held in a trust account either to the client or to each of the mutual funds to which the trust account pertains.

We understand that because the cash sits in the trust account for a very brief period of time before being disbursed, the amount of interest earned on the trust account and

remitted by a dealer is most often nominal. We further understand that costs to implement the internal controls and procedures necessary to comply with the interest determination, allocation and distribution requirements are significant relative to the amount of interest paid out.

In recognition of the administrative burden, unnecessary complexity and increased costs associated with this interest requirement, our proposed amendment to subsection 11.4(1) (discussed above) would, as is already the case for IIROC members, exempt MFDA members, as well as mutual fund dealers in Québec, from such interest requirement. We remind mutual fund dealers however that they would remain subject to any applicable rules of their self-regulatory organization pertaining to interest requirements.

We request feedback on the proposed amendments to exempt dealers from the interest requirement in Part 11 of NI 81-102.

#### *Compliance Reports*

We propose to exempt a principal distributor or participating dealer who is a member of the MFDA, or is a mutual fund dealer in Quebec, from the requirement in Part 12 of the Instrument to file a report describing their compliance with the requirements of Parts 9, 10 and 11 of the Instrument. Subsection 12.1(4) currently exempts members of IIROC from filing such a compliance report.

As we understand that the MFDA assesses its members' compliance with the sale, redemption and commingling/trust account requirements described in Parts 9, 10 and 11 of the Instrument, we consider the compliance reporting requirement for principal distributors and participating dealers under Part 12 to now be redundant to the extent such dealers would be members of the MFDA. In addition, given our proposed exemption of MFDA members and mutual fund dealers in Québec from the Commingling Restrictions (discussed above), compliance reporting on such restrictions is rendered unnecessary for those dealers. For those reasons, we propose to expand the current exemption in subsection 12.1(4) to members of the MFDA, as well as to mutual fund dealers in Québec.

#### **(vii) Mutual Fund Ratings**

##### *Mutual Fund Rating Entities*

We propose to add a new definition of “mutual fund rating entity” to the Instrument. A mutual fund rating entity is defined as an entity that rates or ranks the performance of a mutual fund through an objective methodology that is applied consistently to all mutual funds rated or ranked, is not a member of the organization of a mutual fund and whose services are not procured by the manager of a mutual fund or its affiliates.

##### *Use of Mutual Fund Ratings in Sales Communications*

We propose to amend section 15.3 to clarify how mutual funds may use performance ratings or rankings in sales communications. Mutual funds that wish to utilize ratings or rankings in sales communications would still be required to present the rating or ranking

for each period in which standard performance data is required to be given except for the period since the mutual fund's inception. It is not possible to accurately compare the performance of one mutual fund to another on a since inception basis because each fund may have a different inception date. The amendments would also permit mutual funds to provide an overall rating or ranking in addition to the ratings or rankings based on standard periods of performance.

To comply with this provision, a rating or ranking used in sales communications must be based on a published category of mutual funds that provides a reasonable basis for evaluating the performance of the mutual fund. The proposed amendment also sets out new disclosure requirements intended to ensure that ratings or rankings used in sales communications are not misleading.

### **(viii) Drafting Changes**

In addition to the amendments described above, we are also proposing certain amendments which are intended to clarify some of the drafting in NI 81-102 and to update the instrument to reflect changes in Canadian tax law and the existence of certain self-regulatory organizations.

Specifically, these amendments reflect the changes made to the tax treatment of investments in foreign property in certain registered tax-advantaged savings plans, the consolidation of the Investment Dealers Association of Canada and Market Regulation Services Inc. into IIROC and the creation of the MFDA. We have also replaced the term "simplified prospectus" wherever referenced throughout the Instrument with the general term "prospectus" in recognition of the fact that exchange-traded mutual funds governed by the Instrument use the long form prospectus.

We have also made changes to Part 5 of the Instrument to clarify when securityholder approval is required in connection with fee-related changes to a mutual fund.

## **(ix) Summary and Purpose of the Amendments to National Instrument 81-106**

### **Aggregation of Short-Term Debt**

We propose repealing subsections 3.5(4) and (5) which currently allow an investment fund to aggregate certain types of short-term debt in the fund's statement of investment portfolio.

The repeal of subsection 3.5(4) was first proposed in the Consultation Paper. The majority of comments received in connection with the Consultation Paper regarding the aggregation of short-term debt were either neutral or in favour of repealing subsection 3.5(4). CSA staff think that this amendment will increase the transparency of investment fund portfolio holdings and allow investors to better evaluate the risks associated with an investment fund's short-term debt holdings.

### **Limited Life Funds**

The CSA has frequently granted relief from certain continuous disclosure requirements to investment funds that we consider to be limited life funds such as flow-through limited partnerships. As part of these amendments, we propose to add a definition of “limited life fund” to NI 81-106. A limited life fund would be defined as an investment fund established to fulfil a specific short-term objective, whose securities are not redeemable and not listed on an exchange or quoted on an over-the-counter market. The limited life fund’s prospectus must also disclose that the manager intends to cause the fund to be terminated within 24 months of its formation.

We are proposing to create a limited exemption from the requirement under section 9.2 of the Instrument to file an annual information form for limited life funds. The rationale for this exemption stems from the short lifespan and limited liquidity of limited life funds. The annual information form is intended to assist current and prospective investors to evaluate the investment fund so that they may make informed decisions about their investment. In a typical investment fund a current securityholder would have the option to sell or redeem its holdings. Since limited life funds do not have any established secondary market or redemption rights, there is a reduced need to provide the information contained in the annual information form to investors. In addition, given the short lifespan of limited life funds, the information contained in an annual information form may not be available until shortly before the limited life fund is terminated. If a limited life fund is not terminated within the time frame disclosed in its prospectus, we propose that the fund be required to file an annual information form if it has not obtained a receipt for a prospectus during the last 24 months preceding its financial year end.

### **Calculation of Net Asset Value**

We are proposing a new requirement that investment funds must make their net asset value available to the public at no cost. This amendment will boost the transparency of fund performance and make it easier for current and prospective investors to determine the net asset value of an investment fund. We also propose a requirement that an investment fund that engages in short selling of securities must calculate its net asset value on a daily basis.

### **Related Consequential Amendments**

We are making a consequential amendment to 81-102CP. We are also making a number of consequential amendments to investment fund prospectus rules. These amendments generally create disclosure requirements that support the changes we are making to the Instrument.

#### **81-102CP Amendment**

We propose repealing subsection 3.4(1) of 81-102CP in connection with our proposed amendment to paragraph 2.5(2)(c) of NI 81-102.

### **NI 41-101 Amendments**

We propose amending Part 14 of NI 41-101 to add section 14.8.1 Custodian provisions relating to short sales. This section would mirror the requirements of proposed section 6.8.1 of NI 81-102 and would extend these requirements to investment funds subject to NI 41-101.

### **Form 41-101F2 Amendments**

We propose amending Item 6 of Form 41-101F2 to require investment funds that intend to effect short sale transactions to describe the short selling process and how the investment fund would use short sales to meet its investment objectives.

We propose amending Item 12 of Form 41-101F2 to require investment funds, as applicable, to describe the risks of entering into securities lending, repurchase or reverse repurchase transactions and short sale transactions in addition to the current requirement to describe the risks associated with the use of derivatives for non-hedging purposes.

### **Form 81-101F1 Amendments**

We propose amending Item 7 of Part B of Form 81-101F1 to require mutual funds that intend to effect short sale transactions to describe the short selling process and how the mutual fund will use short sales to meet its investment objectives.

We propose amending the risk disclosure requirement under subsection (7) of Item 9 of Part B to require disclosure of the risks associated with the mutual fund entering into short sale transactions and derivative transactions for non-hedging purposes, in addition to the current required disclosure of the risks associated with securities lending and repurchase or reverse repurchase transactions.

### **Form 81-101F2 Amendments**

We propose amending Item 7 of Form 81-101F2 to require mutual funds to describe how the net asset value of the mutual fund will be made available to the public at no cost. This amendment relates to proposed requirements for the calculation of net asset value for mutual funds in NI 81-106 that are discussed above.

We propose amending Item 12 of Form 81-101F2 to require mutual funds to disclose their policies and procedures with respect to short sales including the use of trading limits or other controls.

### **Alternatives Considered**

The alternative to the project is to leave the rules alone but continue to issue exemptive relief on a case by case basis. We however believe this alternative would be inappropriate given the cost and inefficiency of continuing to do frequent applications and the need to update our rules to reflect the changes in the nature and type of investment funds offered for sale to retail investors in the Canadian marketplace.

## **Anticipated Costs and Benefits**

### **Benefits**

The proposed codification of exemptive relief that is frequently granted to investment funds will benefit investment funds and their investors by eliminating unnecessary regulatory burdens.

Elimination of the need to file what have become ‘routine’ applications will allow certain investment funds, including exchange-traded mutual funds, to get to market without the expense and delay associated with obtaining ‘routine’ relief from the regulators. More expeditious access to market may foster greater competition among investment funds and promote the efficiency of the capital markets.

To the extent that the codification of frequently granted exemptive relief permits the use of new investment strategies for investment funds, the flexibility to use these investment strategies (subject to certain prescribed limits) may enable investment funds to better manage risk and also earn incremental returns. This may be beneficial for investors and may also foster greater competition among investment funds.

In addition, by not having to pay costs associated with these frequent applications, investment funds may save on expenses, which will be beneficial for investors who ultimately bear these costs through asset-based fees.

### **Costs**

The Amendments should not result in any costs to the investment fund industry. Rather, as discussed above, we expect that the reduced need for regulatory exemptions will result in reduced regulatory costs for investment funds.

## **Local Rule Amendments**

In connection with the implementation of the Amendments, certain securities regulatory authorities may amend local securities legislation. If these changes are necessary, they will be initiated and published by the local jurisdiction. You will find these local changes and any publication requirements of a particular jurisdiction in Annex E to this Notice published in that local jurisdiction.

## **Materials Published**

The Amendments are set out in the following annexes to this Notice:

Annex A – proposed amendments to NI 81-102 and to 81-102CP

Annex B – proposed amendments to NI 81-101, Form 81-101F1 and Form 81-101F2

Annex C – proposed amendments to NI 41-101 and Form 41-101F2

Annex D – proposed amendments to NI 81-106

## **Unpublished Materials**

In developing the Amendments, we have not relied on any significant unpublished study, report or other written materials.

## **Request for Comments**

We would like your input on the Amendments. We need to continue our open dialogue with all stakeholders if we are to achieve our regulatory objectives while balancing the interests of investors and market participants. To allow for sufficient review, we are providing you with 90 days to comment.

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. All comments will be posted on the OSC website at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

Thank you in advance for your comments.

## **Deadline for Comments**

Your comments must be submitted in writing by Friday, September 24, 2010.

Please send your comments electronically in Word, Windows format.

## **Where to Send Your Comments**

Please address your comments to all CSA members, as follows:

British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Financial Services Commission  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
New Brunswick Securities Commission  
Registrar of Securities, Prince Edward Island  
Nova Scotia Securities Commission  
Superintendent of Securities, Newfoundland and Labrador  
Superintendent of Securities, Northwest Territories  
Superintendent of Securities, Yukon Territory  
Superintendent of Securities, Nunavut

Please send your comments **only** to the addresses below. Your comments will be forwarded to the remaining CSA member jurisdictions.



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The text of the Amendments follows or can be found elsewhere on a CSA member website.

## ANNEX A

### Proposed Amendment To National Instrument 81-102 Mutual Funds

1. *National Instrument 81-102 is amended by this Instrument.*
2. *Section 1.1 is amended by:*
  - (a) *adding the following definition, after the definition of “book-based system”:*

“ “borrowing agent” means any of the following:

    - (a) a custodian or sub-custodian that holds assets in connection with a short sale transaction by a mutual fund;
    - (b) a qualified dealer from whom a mutual fund borrows securities in order to make a short sale transaction; ”;
  - (b) *replacing the definition of “cash cover” with the following:*

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

    - (a) cash;
    - (b) a cash equivalent;
    - (c) synthetic cash;
    - (d) a receivable of the mutual fund arising from the disposition of portfolio assets, net of payables arising from the acquisition of portfolio assets;
    - (e) a security purchased by the mutual fund in a reverse repurchase transaction under section 2.14, to the extent of the cash paid for the security by the mutual fund;

- (f) an evidence of indebtedness, other than cash equivalents, that has a remaining term to maturity of 365 days or less and an approved credit rating;
- (g) a floating rate evidence of indebtedness not referred to in paragraph (f) above if
  - (i) the floating interest rate of the evidence of indebtedness is reset no later than every 185 days, and
  - (ii) the evidence of indebtedness has a market value of approximately par at the time of each change in the rate to be paid to the holder of the evidence of indebtedness;
- (h) a security issued by a money market fund; ”;

(c) ***adding the following definition, after the definition of “clearing corporation option”:***

“ “clone fund” means a mutual fund that has adopted a fundamental investment objective to link its performance to the performance of another mutual fund; ”;

(d) ***adding the following definitions, after the definition of “equivalent debt”:***

“ “fixed portfolio ETF” means an exchange-traded mutual fund

- (a) that is not in continuous distribution,
- (b) whose investment objectives include holding and maintaining a fixed portfolio of publicly listed equity securities of one or more issuers that are disclosed in its prospectus, and
- (c) that trades in the equity securities referred to in paragraph (b) only in the circumstances disclosed in its prospectus;

“floating rate evidence of indebtedness” means an evidence of indebtedness that pays a floating rate of interest determined over the term of the obligation by reference to a widely accepted market benchmark interest rate and that satisfies any of the following requirements:

- (a) if it was issued by a person or company other than a government or a permitted supranational agency, has an approved credit rating;

(b) if it was issued by a government or a permitted supranational agency, has its principal and interest fully and unconditionally guaranteed by any of the following:

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

(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; ”;

**(e) adding the following definition, after the definition of “hedging”:**

“ “IIROC” means the Investment Industry Regulatory Organization of Canada; ”;

**(f) amending the definition of “index participation unit” by replacing “Canada or the United States” with “Canada, the United States or the United Kingdom”;**

**(g) adding the following definition, after the definition of “manager”:**

“ “manager-prescribed number of units” means, in relation to an exchange-traded mutual fund that is in continuous distribution, the number of units determined by the manager from time to time for the purposes of subscription orders, exchanges, redemptions or for other purposes; ”;

**(h) adding the following definition, after the definition of “member of the organization”:**

“ “MFDA” means the Mutual Fund Dealers Association of Canada; ”;

**(i) replacing the definition of “money market fund” with the following:**

“ “money market fund” means a mutual fund that invests its assets in accordance with section 2.18; ”;

**(j) adding the following definition, after the definition of “mutual fund conflict of interest reporting requirements”:**

“ “mutual fund rating entity” means an entity

(a) that rates or ranks the performance of a mutual fund through an objective methodology that is applied consistently to all mutual funds rated or ranked by it,

(b) that is not a member of the organization of a mutual fund, and

(c) whose services are not procured by the manager of a mutual fund or any of its affiliates to assign the mutual fund a rating or ranking; ”;

**(k) deleting the definition of “NI 81-107”;**

**(l) adding the following definition, after the definition of “order receipt office”:**

“ “overall rating or ranking” means a rating or ranking that is computed from performance data for a mutual fund over one or more periods of standard performance data, which at a minimum include the longest period for which the mutual fund is required under securities legislation to give standard performance data, except the period since the inception of the mutual fund; ”;

**(m) replacing the definition of “permitted supranational agency” with the following:**

“ “permitted supranational agency” means the African Development Bank, the Asian Development Bank, the Caribbean Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the International Bank for Reconstruction and Development and the International Finance Corporation; ”;

**(n) adding the following definition, after the definition of “qualified security”:**

“ “redemption payment date” means, in relation to an exchange-traded mutual fund that is not in continuous distribution, a date as specified in the prospectus or annual information form of the exchange-traded mutual fund on which redemption proceeds are paid; ”;

**(o) deleting the definition of “RSP clone fund”; and**

**(p) amending the definition of “sales communication” by striking out “simplified” wherever it occurs in paragraph (b) of the definition.**

**3. Section 1.2 is amended by striking out “simplified” wherever it occurs.**

4. *Subsection 1.3(3) is repealed.*

5. *Section 2.1 is amended by:*

(a) *replacing subsection (2) with the following:*

“ (2) Subsection (1) does not apply to the purchase of any of the following:

- (a) a government security;
- (b) a security issued by a clearing corporation;
- (c) a security issued by a mutual fund if the purchase is made in accordance with the requirements of section 2.5;
- (d) an index participation unit that is a security of a mutual fund;
- (e) an equity security where the purchase is made by a fixed portfolio ETF in accordance with its investment objectives.”;

(b) *striking out “simplified” in subsection (5), except where it occurs in the reference to “Form 81-101F1 Contents of Simplified Prospectus”.*

6. *Section 2.2 is amended by:*

(a) *replacing subsection (1.1) with the following:*

“ (1.1) Subsection (1) does not apply to the purchase of any of the following:

- (a) a security issued by a mutual fund if the purchase is made in accordance with section 2.5;
- (b) an index participation unit that is a security of a mutual fund. ”.

7. *Section 2.5 is amended by:*

(a) *replacing paragraph (2)(a) with the following:*

“ (a) the other mutual fund is subject to this Instrument and offers or has offered securities under a simplified prospectus in accordance with National Instrument 81-101 Mutual Fund Prospectus Disclosure, ”;

**(b) replacing paragraph (2)(c) with the following:**

“ (c) the mutual fund and the other mutual fund are reporting issuers in the local jurisdiction,”;

**(c) striking out “RSP” in paragraph (4)(a); and**

**(d) replacing “Paragraph (2)(f) does” in subsection (5) with “Paragraphs (2)(e) and (f) do”.**

**8. Section 2.6 is amended by:**

**(a) replacing subparagraph (a)(ii) with the following:**

“ (ii) the security interest is required to enable the mutual fund to effect a specified derivative or short sale transaction under this Instrument, is made in accordance with industry practice for that type of transaction and relates only to obligations arising under that particular transaction, ”;

**(b) adding “or” at the end of subparagraph (a)(iii);**

**(c) adding the following after subparagraph (a)(iii):**

“ (iv) in the case of an exchange-traded mutual fund that is not in continuous distribution, the transaction is to finance the acquisition of its portfolio securities and the outstanding amount of all borrowings is repaid on the closing of its initial public offering; ”; **and**

**(d) replacing paragraph (c) with the following:**

“ (c) sell securities short other than in compliance with section 2.6.1, unless permitted by section 2.7 or 2.8; ”.

**9. The following section is added after section 2.6:**

“ 2.6.1 **Short Sales** – (1) A mutual fund may sell a security short if

(a) the security sold short is sold for cash;

(b) the security sold short is not any of the following:

(i) a security that the mutual fund is otherwise not permitted to purchase at the time of the short sale transaction;



(ii) an illiquid asset;

(iii) a security of an investment fund unless the security is an index participation unit; and

(c) at the time the mutual fund sells the security short

(i) the mutual fund has borrowed or arranged to borrow from a borrowing agent the security that is to be sold under the short sale transaction;

(ii) the aggregate market value of all securities of the issuer of the securities sold short by the mutual fund does not exceed 5% of the net asset value of the mutual fund; and

(iii) the aggregate market value of all securities sold short by the mutual fund does not exceed 20% of the net asset value of the mutual fund.

(2) A mutual fund that enters into a short sale transaction must hold cash cover in an amount, including cash cover in the form of mutual fund assets deposited with borrowing agents as security in connection with short sale transactions, that is at least 150% of the aggregate market value of all securities sold short by the mutual fund on a daily marked to market basis.

(3) A mutual fund must not use the cash from a short sale transaction to enter into a long position in a security other than cash cover.”.

**10. Subsection 2.7(1) is replaced with following:**

“ **2.7 Transactions in Specified Derivatives for Hedging and Non-hedging Purposes** – (1) A mutual fund may 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 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. ”.

**11. Section 2.11 is replaced with the following:**

“ **2.11 Commencement of Use of Specified Derivatives and Short Selling by a Mutual Fund** – (1) A mutual fund that has not used specified derivatives may not begin using specified derivatives, and a mutual fund that has not sold a security short in accordance with section 2.6.1 may not sell a security short, unless

(a) its prospectus contains the disclosure required for a mutual fund engaging in the intended activity; and

(b) the mutual fund has provided to its securityholders, not less than 60 days before it begins the activity, written notice that it may engage in the intended activity and the disclosure required for mutual funds engaging in the intended activity.

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

**12. Section 2.17 is amended by striking out “simplified” wherever it occurs.**

**13. The following section is added after section 2.17:**

**“ 2.18 Money Market Fund –** (1) A mutual fund must not describe itself as a “money market fund” in its prospectus, a continuous disclosure document or a sales communication unless

(a) it has all of its assets invested in any of the following:

(i) cash,

(ii) cash equivalents,

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

(iv) floating rate evidences of indebtedness not referred to in subparagraphs (ii) and (iii), if

(A) the floating interest rates of the evidences of indebtedness are reset no later than every 185 days, and

(B) the principal amounts of the obligations will continue to have a market value of approximately par at the time of each change in the rate to be paid to the holders of the evidences of indebtedness, or

(v) securities issued by one or more money market funds, if the investment is made in accordance with section 2.5,

(b) it has a portfolio of assets, excluding a security in subparagraph (a)(v), with a dollar-weighted average term to maturity not exceeding

(i) 120 days, and

(ii) 90 days when calculated on the basis that the term of a floating rate obligation is the period remaining to the date of the next rate setting,

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

(d) it has not less than

(i) 5% of its assets invested in cash or readily convertible into cash within one day, and

(ii) 15% of its assets invested in cash or readily convertible into cash within one week.

(2) A mutual fund that describes itself as a “money market fund” must not use a specified derivative or enter into a short sale transaction. ”.

**14. Subsection 3.1(1) is amended by striking out “simplified” wherever it occurs.**

**15. Section 3.2 is amended by striking out “simplified”.**

**16. Section 3.3 is amended by renumbering it as subsection 3.3(1), by striking out “simplified” wherever it occurs, and by adding the following after subsection (1):**

“ (2) Subsection (1) does not apply to an exchange-traded mutual fund unless the fund is in continuous distribution. ”.

**17. Section 4.1 is amended**

**(a) in paragraph (4)(a) by replacing “NI 81-107” with “National Instrument 81-107 – Independent Review Committee for Investment Funds”; and**

**(b) by adding the following after subsection (5):**

“(6) In paragraph (4)(b), “approved rating” has the meaning ascribed to it in National Instrument 44-101 – Short Form Prospectus Distributions.”.

18. *Subsection 4.3(2) is amended by replacing “NI 81-107” wherever it occurs with “National Instrument 81-107 – Independent Review Committee for Investment Funds”.*

19. *Section 5.3 is amended*

(a) *by replacing subsection (1) with the following:*

**“ 5.3 Circumstances in Which Approval of Securityholders Not Required – (1) Despite section 5.1, the approval of securityholders of a mutual fund is not required to be obtained for a change referred to in paragraphs 5.1(a) or 5.1(a.1) if any of the following sets of conditions are met:**

(a) the mutual fund

(i) is at arm’s length to the person or company charging the fee or expense that is to be changed or introduced,

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

(iii) sends the notice referred to in subparagraph (ii) 60 days before the effective date of the change;

(b) the mutual fund

(i) is permitted by this Instrument to be described as a “no-load” fund,

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

(iii) sends the notice referred to in subparagraph (ii) 60 days before the effective date of the change. ”;

- (b) *in paragraphs (2)(a) and (2)(b) by replacing “NI 81-107” with “National Instrument 81-107 – Independent Review Committee for Investment Funds”; and*
- (c) *in paragraph (2)(d) by striking out “simplified”.*
20. *Section 5.3.1 is amended*
- (a) *in paragraph (a) by replacing “NI 81-107” with “National Instrument 81-107 – Independent Review Committee for Investment Funds”; and*
- (b) *in paragraph (b) by striking out “simplified”.*
21. *Section 5.6 is amended by striking out “simplified” in subparagraphs (1)(a)(iv) and (1)(f)(ii).*
22. *Paragraph 5.7(1)(d) is amended by striking out “simplified”.*
23. *The following provisions are amended by replacing “sections 6.8 and 6.9” with “sections 6.8, 6.8.1 and 6.9”:*
- (a) *subsections 6.1(1) and 6.1(2);*
- (b) *subsection 6.5(1).*
24. *The following is added after section 6.8:*
- “ 6.8.1 Custodial Provisions relating to Short Sales –** (1) Except when the borrowing agent is the mutual fund’s custodian or sub-custodian, if a mutual fund deposits portfolio assets with a borrowing agent as security in connection with a short sale transaction, the amount of portfolio assets deposited with the borrowing agent must not, when aggregated with the amount of portfolio assets already held by the borrowing agent as security for outstanding short sale transactions by the mutual fund, exceed 10% of the net asset value of the mutual fund at the time of deposit.
- (2) A mutual fund may not deposit portfolio assets in connection with a short sale transaction with a dealer in Canada unless the dealer is registered in a jurisdiction of Canada and is a member of IIROC.
- (3) A mutual fund may not deposit portfolio assets in connection with a short sale transaction with a dealer outside of Canada unless that dealer
- (a) is a member of a stock exchange that requires the dealer to be subjected to a regulatory audit; and

(b) has a net worth, determined from its most recent audited financial statements that have been made public, in excess of the equivalent of \$50 million. ”.

25. *The following provisions are amended by striking out “simplified”:*

(a) *paragraph 7.1(c);*

(b) *paragraph 8.1(a);*

(c) *paragraph 9.2(c).*

26. *Section 9.4 is amended*

(a) *in subsection (1) by*

(i) *adding “or securities” after the first occurrence of “cash”, and*

(ii) *striking out “arrives” and substituting “or securities arrive”; and*

(b) *by replacing subsection (2) with the following:*

“(2) Payment of the issue price of securities of a mutual fund must be made to the mutual fund on or before the third business day after the pricing date for the securities by using any of the following methods of payment:

(a) a payment of cash in a currency in which the net asset value per security of the mutual fund is calculated;

(b) good delivery of securities if

(i) the mutual fund would at the time of payment be permitted to purchase those securities,

(ii) the securities are acceptable to the portfolio adviser of the mutual fund and consistent with the mutual fund’s investment objectives, and

(iii) the value of the securities is at least equal to the issue price of the securities of the mutual fund for which they are payment, valued as if the securities were portfolio assets of the mutual fund;

(c) a combination of the methods of payments referred to in paragraphs (a) and (b).”.

27. ***Section 10.3 is amended by renumbering it as subsection 10.3(1), by replacing “net asset value of a security” with “net asset value per security”, and by adding the following after subsection (1):***

“(2) Despite subsection (1) the redemption price of a security of an exchange-traded mutual fund that is not in continuous distribution may be a price that is less than the net asset value of the security and that is determined on a date specified in the exchange-traded mutual fund’s prospectus or annual information form.

(3) Despite subsection (1) the redemption price of a security of an exchange-traded mutual fund that is in continuous distribution may, if a securityholder redeems less than the manager-prescribed number of units, be a price that is computed by reference to the closing price of the security on the stock exchange on which the security is listed and posted for trading, next determined after the receipt by the exchange-traded mutual fund of the redemption order. ”.

28. ***Section 10.4 is amended by:***

- (a) adding the following after subsection (1):***

“(1.1) Despite subsection (1), an exchange-traded mutual fund that is not in continuous distribution may pay the redemption price for securities that are the subject of a redemption order on the redemption payment date that next follows the valuation date on which the redemption price was established. ”;

- (b) replacing subsection (3) with the following:***

“(3) A mutual fund must pay the redemption price of a security by using any of the following methods of payment:

(a) a payment of cash in the currency in which the net asset value per security of the redeemed security was calculated;

(b) with the prior written consent of the securityholder, by making good delivery to the securityholder of portfolio assets, the value of which is equal to the amount at which those portfolio assets were valued in calculating the net asset value per security used to establish the redemption price;

(c) a combination of the methods of payment referred to in paragraphs (a) and (b).”.

29. *Subsection 10.6(1) is replaced with the following:*

“ 10.6 **Suspension of Redemptions** – (1) A mutual fund may suspend the right of securityholders to request that the mutual fund redeem its securities for the whole or any part of a period during which any of the following occurs:

(a) normal trading is suspended on a stock exchange, options exchange or futures exchange within or outside Canada on which securities are listed and posted for trading, or on which specified derivatives are traded, if those securities or specified derivatives represent more than 50% by value, or underlying market exposure, of the total assets of the mutual fund without allowance for liabilities and if those securities or specified derivatives are not traded on any other exchange that represents a reasonably practical alternative for the mutual fund;

(b) in the case of a clone fund, the underlying fund to which its performance is linked has suspended redemptions. ”.

30. *Subsection 11.2(2) is amended by inserting “in” immediately after “referred to”.*

31. *Subsection 11.4(1) is replaced with the following:*

“ 11.4 **Exemption** – (1) Sections 11.1 and 11.2 do not apply to a member of IIROC, the MFDA or in Quebec, a mutual fund dealer. ”.

32. *Subsection 12.1(4) is replaced with the following:*

“ (4) Subsections (2) and (3) do not apply to a member of IIROC, the MFDA or in Quebec, a mutual fund dealer. ”.

33. *Section 14.1 is replaced with the following:*

“14.1 **Record Date** – The record date for determining the right of securityholders of a mutual fund to receive a dividend or distribution by the mutual fund must be one of the following:

(a) the day on which the net asset value per security is determined for the purpose of calculating the amount of the payment of the dividend or distribution;

(b) the last day on which the net asset value per security of the mutual fund was calculated before the day referred to in paragraph (a);



(c) if the day referred to in paragraph (b) is not a business day, the last day on which the net asset value per security of the mutual fund was calculated before the day referred to in paragraph (b);

(d) in the case of an exchange-traded mutual fund, a date determined in accordance with the rules of the exchange on which the securities of the exchange-traded mutual fund are listed and posted for trading. ”.

**34. Paragraph 15.2(1)(b) is amended by striking out “simplified” wherever it occurs.**

**35. Section 15.3 is amended by:**

**(a) replacing subsection (4) with the following:**

“ (4) A sales communication may not refer to a performance rating or ranking of a mutual fund or asset allocation service unless

(a) the rating or ranking is prepared by a mutual fund rating entity;

(b) standard performance data is provided for any mutual fund or asset allocation service for which a performance rating or ranking is given;

(c) the rating or ranking is provided for each period for which standard performance data is required to be given, except the period since the inception of the mutual fund;

(d) the rating or ranking is based on a published category of mutual funds that

(i) provides a reasonable basis for evaluating the performance of the mutual fund, and

(ii) is not established or maintained by an organization that is a member of the organization of the mutual fund;

(e) the sales communication contains the following disclosure:

(i) the name of the category within which the mutual fund is rated or ranked, including the name of the organization that maintains the category,

(ii) the number of investment funds in the applicable category for each period of standard performance data required under paragraph (c),

(iii) the name of the mutual fund rating entity that provided the rating or ranking,

(iv) the length of the period or the first day of the period on which the rating or ranking is based, and its ending date,

(v) a statement that the rating or ranking is subject to change every month,

(vi) the key elements of the methodology used by the rating entity to establish the rating or ranking, along with a reference to the mutual fund rating entity's website for greater detail on the methodology, and

(vii) the significance of the rating or ranking on the mutual fund rating entity's scale of ratings and rankings, and

(f) the rating or ranking is to the same calendar month end that is

(i) not more than 45 days before the date of the appearance or use of the advertisement in which it is included, and

(ii) not more than three months before the date of first publication of any other sales communication in which it is included. ”;

**(b) adding the following after subsection (4):**

“ (4.1) Despite paragraph (4)(c), a sales communication may refer to an overall rating or ranking of a mutual fund or asset allocation service in addition to each rating or ranking required under paragraph (4)(c) if the sales communication otherwise complies with the requirements of subsection (4). ”.

**36. The following provisions are amended by striking out “simplified” wherever it occurs:**

**(a) subsection 15.4(9);**

**(b) paragraphs 15.5(1)(b) and 15.5(1)(c);**

**(c) subparagraph 15.6(a)(i) and paragraph 15.6(d);**

*(d) paragraphs 15.8(2)(a) and 15.8(3)(a);*

*(e) section 15.12;*

*(f) subsections 19.2(2) and 19.2(3);*

*(g) paragraph 20.4(b).*

**37. This instrument comes into force on ■, 2010.**

**Proposed Amendment To  
Companion Policy 81-102CP – To National Instrument 81-102  
Mutual Funds**

1. *Companion Policy 81-102CP – To National Instrument 81-102 Mutual Funds is amended by this Instrument.*
2. *Subsection 3.4(1) is repealed.*
3. *This Instrument becomes effective on ■, 2010.*

## ANNEX B

**Proposed Amendment To  
National Instrument 81-101  
Mutual Fund Prospectus Disclosure  
And  
Form 81-101F1  
Contents of Simplified Prospectus  
And  
Form 81-101F2  
Contents of Annual Information Form**

1. *National Instrument 81-101 - Mutual Fund Prospectus Disclosure is amended by this instrument.*
2. *Form 81-101F1 - Contents of a Simplified Prospectus is amended:*
  - (a) *in Item 7 of Part B by:*
    - (i) *replacing “if the mutual fund may hold other mutual funds,” in paragraph (1)(c) with “if the mutual fund may hold securities of other mutual funds,”;*
    - (ii) *replacing subsection (4) with the following:*

“(4) State whether any, and if so what proportion, of the assets of the mutual fund may or will be invested in foreign securities.”;
    - (iii) *adding the following after subsection (9):*

“(10) If the mutual fund intends to effect short sale transactions under section 2.6.1 of National Instrument 81-102

      - (a) state that the mutual fund may effect short sale transactions; and
      - (b) briefly describe
        - (i) the short selling process, and
        - (ii) how short sale 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.”;

**(b) in Item 9 of Part B by:**

**(i) replacing subsection (6) with the following:**

“(6) If, at any time during the 12 month period immediately preceding the date of the simplified prospectus, more than 10% of the net asset value of a mutual fund was 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 asset value 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.”;

**(ii) replacing subsection (7) with the following:**

“(7) As applicable, describe the risks associated with the mutual fund entering into

(a) derivative transactions for non-hedging purposes;

(b) securities lending, repurchase or reverse repurchase transactions; and

(c) short sale transactions.”;

**(iii) replacing instruction (5) with the following:**

“(5) 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% of the net asset value 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.”; **and**

**(iv) deleting instruction (6).**

3. ***Form 81-101F2 - Contents of Annual Information Form is amended:***

***(a) in Item 7 by adding the following after subsection (2):***

“ (2.1) Describe how the net asset value of the mutual fund will be made available to the public at no cost. ”;

***(b) in Item 12 by:***

***(i) replacing subsection (2) with the following:***

“ (2) If the mutual fund intends to use derivatives or effect short sales, describe the policies and practices of the mutual fund to manage the risks associated with engaging in those types of transactions. ”;

***(ii) replacing paragraph (3)(a) with the following:***

“ (a) whether there are written policies and procedures in place that set out the objectives and goals for derivatives trading and short selling and the risk management procedures applicable to those transactions; ”; ***and***

***(iii) replacing paragraph (3)(c) with the following:***

“ (c) whether there are trading limits or other controls on derivative trading or short selling in place and who is responsible for authorizing the trading and placing limits or other controls on the trading; ”.

4. ***This instrument comes into force on ■, 2010.***

## ANNEX C

### **Proposed Amendments To National Instrument 41-101 General Prospectus Requirements And Form 41-101F2 Information Required In An Investment Fund Prospectus**

1. *National Instrument 41-101 – General Prospectus Requirements is amended by this Instrument.*
2. *The following section is added after section 14.8:*

“ 14.8.1 **Custodian provisions relating to short sales** – (1) For the purposes of subsection (2), “borrowing agent” has the same meaning as in NI 81-102 except that references in that definition to “mutual fund” must be read as references to “investment fund”.

(2) Except where the borrowing agent is the investment fund’s custodian or sub-custodian, if an investment fund deposits portfolio assets with a borrowing agent as security in connection with a short sale transaction, the amount of portfolio assets deposited with the borrowing agent must not, when aggregated with the amount of portfolio assets already held by the borrowing agent as security for outstanding short sale transactions by the investment fund, exceed 10% of the net asset value of the investment fund at the time of deposit.

(3) Every dealer that holds portfolio assets as security in connection with short sale transactions effected by an investment fund in Canada must be a registered dealer in Canada and a member of IIROC.

(4) Every dealer that holds portfolio assets as security in connection with short sale transactions effected by an investment fund outside of Canada must

(a) be a member of a stock exchange and, as a result, subject to a regulatory audit, and

(b) have a net worth, determined from its most recent audited financial statements that have been made public, in excess of the equivalent of \$50 million. ”.
3. *Form 41-101F2 - Information Required in an Investment Fund Prospectus is amended:*



**(a) in Item 6.1 by adding the following after subsection (5):**

“ (6) If the investment fund intends to effect short sale transactions

(a) state that the investment fund may effect short sale transactions;  
and

(b) briefly describe

(i) the short selling process, and

(ii) how short sale transactions are or will be entered into in conjunction with other strategies and investments of the investment fund to achieve the investment fund’s investment objectives. ”;

**(b) in Item 12.1 by replacing subsection (4) with the following:**

“ (4) As applicable, describe the risks associated with the investment fund entering into

(a) derivative transactions for non-hedging purposes,

(b) securities lending, repurchase or reverse repurchase transactions; and

(c) short sale transactions. ”.

**4. This instrument comes into force on ■, 2010.**

## ANNEX D

### Proposed Amendments To National Instrument 81-106 Investment Fund Continuous Disclosure

1. *National Instrument 81-106 - Investment Fund Continuous Disclosure is amended by this Instrument.*
2. *Section 1.1 is amended by adding the following definition, after the definition of “labour sponsored or venture capital fund”:*

“ “limited life fund” means an investment fund

(a) established to fulfill a specific short-term objective,

(b) whose securities are

(i) not redeemable by its securityholders, and

(ii) not listed and posted for trading on a stock exchange or quoted on an over-the-counter market, and

(c) whose prospectus discloses that the manager intends to cause the fund to be terminated within 24 months of its formation. ”.

3. *Subsections 3.5(4) and (5) are repealed.*
4. *Section 9.2 is replaced with the following:*

“ **9.2 Requirement to File Annual Information Form** – (1) An investment fund, other than a limited life fund, must file an annual information form if the investment fund has not obtained a receipt for a prospectus during the last 12 months preceding its financial year end.

(2) A limited life fund must file an annual information form if the limited life fund has not obtained a receipt for a prospectus during the last 24 months preceding its financial year end. ”.

5. *Section 14.2 is amended by:*

(a) *replacing subsection (3) with the following:*

“ (3) The net asset value of an investment fund must be calculated with the following frequency:

(a) if the investment fund does not use specified derivatives or sell securities short, at least once in each week;

(b) if the investment fund uses specified derivatives or sells securities short, at least once every business day. ”; **and**

**(b) adding the following after subsection (7):**

“ (8) The net asset value of an investment fund must, upon being calculated in accordance with this section, be made available to the public at no cost by the investment fund or its investment fund manager. ”.

**6. This instrument comes into force on ■, 2010.**