Appendix B

Summary of Comments and CSA Responses

Part I Background

On May 28, 2004 the CSA published for comment revised versions of the Rule and other consequential amendments. The comment period for the Rule expired on July 27, 2004, while the comment period for certain consequential amendments expired August 26, 2004. The CSA received 36 submissions from the commenters identified in Schedule 1.

The CSA have considered the comments received and thank all the commenters for providing their comments.

The section references in this summary are the same as the sections in the Rule as published on May 28, 2004. The section numbers in square parentheses are the corresponding section references in the current version of the Rule.

Part II Comments received on the Rule

Part 1 - Definitions and Applications

1.1 Definitions

One commenter suggested that the definition of "current value" is problematic for funds of funds where the underlying fund is exchange-traded given that it requires the top fund to value the underlying fund at its market price rather than its net asset value.

Response: The definition of current value has been changed to indicate that it is the value as determined in accordance with Canadian GAAP.

One commenter suggested deleting the definition of "management fees" as this is a commonly used and easily understood term. Three commenters believe the definition of "management fees" is too restrictive as the list of excluded expenses is not complete.

Response: We have defined this term in order to ensure that it is a comparable amount between funds. However, we have changed the definition as follows: "management fees" means the total fees paid or payable by an investment fund to its manager or one or more portfolio advisers or sub-advisers, including incentive fees or performance fees, but excluding operating expenses of the investment fund.

One commenter suggested deleting the definition of "manager" as this term is already defined in NI 81-102. Another commenter wondered why the definition of "manager" is slightly different than the definition in NI 81-102.

Response: We deleted the definition of "manager" as this term is defined in NI 81-102.

One commenter asked why "material change" is defined (notwithstanding the explanation provided in the CP).

Response: We consider it useful to have a definition of "material change", applicable to all investment funds, in the Rule.

Five commenters noted that the definition of "net asset value" is problematic to the extent that it requires the fair valuation of liabilities, which might conflict with Canadian GAAP in certain circumstances.

Response: We modified the definition of "current value" as indicated above so that it applies more appropriately to liabilities within the definition of "net asset value".

Four commenters pointed out the differences between the two definitions of "non-redeemable investment fund". The commenters submitted that the Ontario definition of "non-redeemable investment fund" is preferable because it excludes issuers which exercise (or seek to exercise) effective control or which become actively involved in the management of other issuers. The commenters suggested that the definition should clearly apply to investment vehicles whose intentions are passive.

Response: The Ontario version of the definition of "non-redeemable investment fund" has been adopted by all jurisdictions for the purpose of this Rule (and other related rules such as NI 51-102). The discussion in the CP about the application of the Rule has also been expanded.

One commenter suggested defining the terms "investment portfolio", "long portfolio" and "short portfolio".

Response: We are of the view that these terms will be readily understood in the context in which they are used.

1.2 Application

One commenter noted that the Rule should apply equally to certain other products (for example, pooled funds and wrap accounts) that are sold competitively to mutual funds. Another commenter encouraged the CSA to continue its efforts in the area of harmonized regulation for mutual funds and segregated funds so that mutual funds are not subject to a greater regulatory burden than segregated funds.

Response: The CSA acknowledges the comments concerning harmonized regulation for similar products, but the regulation of segregated funds is not within our jurisdiction. The goal of harmonization is being pursued in the context of other initiatives (for

example, the Joint Forum of Financial Market Regulators' initiatives to harmonize the regulation of segregated funds and mutual funds).

One commenter stated that the Rule should not have jurisdictional carve-outs for mutual funds that are non-reporting issuers as this leads to an uneven playing field. Another commenter asked the CSA to reconsider whether the Rule should apply to pooled funds, given that the requirements do not apply in all jurisdictions.

Response: The Rule generally maintains the current requirements applicable to pooled funds in each jurisdiction. In jurisdictions where pooled funds currently have filing requirements, the Rule provides an exemption from filing, subject to certain conditions, similar to exemptive relief which has already been granted in the past.

One commenter requested that limited partnerships established to provide the financing for deferred sales commissions of mutual funds be explicitly included in the Rule.

Response: Every issuer must consider whether or not they are an "investment fund" as defined in the Rule. The CP contains a detailed discussion of the application of the Rule.

Part 2 - Financial Statements

2.1 Annual Financial Statements and Auditor's Report

One commenter noted that the Rule requires a statement of changes in net assets only if a statement of cashflows is not required by GAAP. A statement of cashflows is only not required under GAAP when most of the assets are very liquid. In the commenter's opinion, for investment funds, the statement of changes in net assets is more relevant than the statement of cashflows.

Response: Every investment fund must file a statement of changes in net assets. A statement of cashflows must be filed unless an exemption exists under Canadian GAAP.

2.2 Filing Deadline for Annual Financial Statements and 2.4 Filing Deadline for Interim Financial Statements

Nine commenters are of the view that the new filing deadlines will place a significant strain on fund complexes and raise practical problems given the various stages of preparation (printing, auditing, translation, approvals) of both the financial statements and the MRFPs. These commenters are concerned about the potential increase in errors, the overall quality of the reports and the increased costs which will be passed on to securityholders.

Four commenters stated that the 45-day interim filing deadline will be difficult to meet given the additional requirements regarding the interim MRFP, auditor involvement and board approval.

Two commenters submitted that it would be appropriate for the filing deadlines for investment funds to be different than those for other reporting issuers because of the number of funds and attendant documents to be completed by fund managers. One commenter suggested that investment funds be treated like "venture issuers" under NI 51-102.

Three commenters support the move to a 90-day filing deadline for annual statements. Eight commenters recommend maintaining the 60-day interim deadline and amending the deadline to 120 days for annual filings.

Response: Given the additional requirements related to interim financial statements, we have decided to leave the interim filing deadline at 60 days. However, we continue to believe that 90 days is an appropriate annual filing deadline to ensure the timely disclosure of useful financial information.

2.3 Interim Financial Statements

One commenter asked for clarification of whether the interim financial statements must contain a full set of notes or whether the principles of paragraph 14 of Section 1751 of the CICA Handbook should be followed.

Response: We have clarified in the CP that the principles of paragraph 14 of Section 1751 of the CICA Handbook can be applied to the requirements regarding the notes to interim financial statements.

2.5 Approval of Financial Statements

One commenter noted that a fund which is organized as a trust can have its financial statements approved by the manager, but a fund that is a corporation cannot. The commenter suggested that there is no reason to make this distinction between corporate and trust funds.

Response: Corporate law requires the board of directors of a corporation to approve the financial statements. For investment funds organized as trusts, the financial statements must be approved by the trustee or another person authorized to do so by the constating documents of the trust.

2.6 Acceptable Accounting Principles

One commenter requested clarification that other than the specific additional requirements set out in the Rule, the financial statements required by the Rule are to be prepared in accordance with GAAP and application of the CICA Handbook.

Response: Section 2.6(1) [2.6] of the Rule requires the financial statements to be prepared in accordance with Canadian GAAP. We are of the view that the specific additional requirements set out in the Rule are not inconsistent with Canadian GAAP.

One commenter suggested that the requirement to prepare financial statements in accordance with the same accounting principles for all periods presented be clarified. This commenter also noted that the reference to "accounting principles" should be changed to "significant accounting policies". Another commenter suggested removing subsection 2.6(2) as GAAP provides for how to deal with changes in accounting policies.

Response: We have removed subsections 2.6(2) and (3) from the Rule as we agree that GAAP addresses these issues.

2.9 Change in Year End

One commenter suggested that the change in year end provisions should be completely contained in the Rule as the cross-reference to NI 51-102 is less user-friendly.

Response: We are of the view that referring to NI 51-102 for these requirements is appropriate, given that the requirements are substantially the same.

One commenter suggested that the change in year end requirements should not apply to investment funds that are non-reporting issuers.

Response: We have changed section 2.9 to indicate that it only applies to investment funds that are reporting issuers.

Three commenters noted that section 2.9 requires that for a transition year, the comparative periods in the financial statements be the corresponding months from the prior year, which could result in having to redo financial statements for the prior year.

Response: The requirements will not result in having to redo financial statements for the prior year. In some cases, the requirements will result in having to prepare financial statements for an interim period that were not previously prepared. Please see the discussion in the CP as well as Appendix A to the CP.

One commenter proposed separating the requirements for a comparative interim statement of net assets from those for the other financial statements in order to ensure compliance with Section 1751 of the CICA Handbook.

Response: We have made this change to subsection 2.9(3) [2.9(4)] of the Rule.

2.10 Change in Legal Structure

One commenter recommended deleting subsection 5.8(2) of NI 81-102 and adding any investment fund termination provisions to the Rule. This commenter also recommends that with respect to fund mergers, the drafting be conformed to the language used in Part 5 of NI 81-102.

Response: The Rule sets out requirements applicable to all investment funds. We have retained, in NI 81-102, the specific requirements applicable only to mutual funds.

One commenter asked for confirmation that the requirement to file a notice does not infer that regulatory approval of the change is necessary.

Response: The requirement to file a notice does not infer that regulatory approval is necessary.

One commenter asked for clarification as to when the notice required by section 2.10 would have to be filed in cases where the investment fund terminates or ceases to be a reporting issuer. This commenter also noted that the drafting should be clarified as some of the items listed in (e) to (j) might not apply in all circumstances. This commenter also requested clarification as to whether the notice must be filed on SEDAR.

Response: In cases where the investment fund terminates, the notice must be filed as soon as practicable. We confirm that the notice must be filed on SEDAR. We have added the words "if applicable" to paragraphs 2.10(i) and (j), as (e), (f) and (g) will always be applicable.

2.11 Exemption and Requirements for Mutual Funds that are Non-Reporting Issuers

Three commenters suggested that this section be clarified to indicate that pooled funds must prepare and deliver financial statements within the same annual and interim deadlines applicable to other investment funds.

Response: We have clarified this.

One commenter suggested that a pooled fund be permitted to provide a one-time notice to the regulators that it is relying on the exemption in section 2.11.

Response: We have clarified in the CP that a pooled fund may provide a one-time notice.

One commenter is concerned about the requirement for investment funds that are non-reporting issuers to deliver a statement of investment portfolio to their securityholders, as proprietary investment strategies and trading patterns will be revealed, and disclosing short positions could be particularly damaging if those short positions are still in place.

Response: The Rule only applies to mutual funds, not non-redeemable investment funds, that are non-reporting issuers. Mutual funds (regardless of whether or not they are reporting issuers) are currently required to provide this disclosure pursuant to securities legislation in some jurisdictions.

2.12 Disclosure of Auditor Review of Interim Financial Statements

One commenter is of the view that while having both the interim and annual financial statements approved is a good control measure, providing a notice that interim financial statements have not been reviewed by the auditors is redundant if the interim statements are marked as "unaudited".

Response: Interim financial statements, although not audited, could be reviewed by an auditor. The purpose of the notice is to advise that this review has not been performed.

One commenter noted that although auditor involvement in the preparation of interim financial statements is not required, the practical impact of the requirement to provide this notice will trend toward full auditor involvement in order to avoid the perception that funds that do not involve their auditors are producing "less reliable" interim financial statements. Another commenter suggested that smaller funds are less likely to have the financial resources to engage an auditor to review interim financial statements and will be put at a competitive disadvantage as unfair inferences may be drawn from the fact that the statements were not reviewed.

Response: We encourage auditor involvement in the preparation of interim financial statements and every investment fund will have to make a business decision as to the level of this involvement.

Three commenters requested clarification of the disclosure requirements if the review of the interim statements was not carried out prior to the filing of those statements, but was carried out at a different time (for example, in order to obtain a comfort letter for the purposes of filing the prospectus).

Response: The notice must be provided if the auditor review has not taken place by the time the interim financial statements are filed.

Three commenters wanted the CSA to provide the format for the notice to be included with interim financial statements that have not been reviewed.

Response: We have not provided a form of notice, but we have added guidance to the CP.

Part 3 - Financial Disclosure Requirements

3.1 Statement of Net Assets

One commenter requested guidance as to how the requirement to present the statement of net assets at current value should be applied to liabilities. Alternatively, the commenter suggested that the requirement to present current values be limited to only assets or investments.

Response: We have amended the definition of "current value" as indicated above.

Two commenters asked for confirmation that the requirement is to disclose net asset value per security, not total net assets by series/class for multiple class funds.

Response: In our view, both total net assets and net asset value per security should be shown by series/class for multiple class funds. We added specific line items to the statement of net assets to require this disclosure.

One commenter thinks that the terms "securities", "investments" and "portfolio assets" are used in confusing ways and suggested that "portfolio asset" be used when referring to the investments of the fund (consistent with NI 81-102) and "securities" be used to signify the securities issued by the fund.

Response: Generally, the term "securities" is used to refer to the securities issued by the fund and the term "portfolio asset" is used to refer to the investments of the fund. However, in some cases, the word "securities" has been retained if it is common terminology (for example, in parts of the Rule dealing with securities lending or proxy voting).

3.2 Statement of Operations

One commenter noted that the statement of operations does not contain any concept of materiality so that even trivial amounts would have to be disclosed. Another commenter noted that while specific line items should be disclosed on the statement of net assets, the disclosure requirements for the other statements are too prescriptive. Three commenters suggested that the 5% threshold currently found in securities legislation be maintained and applied to all of the separate line item disclosures.

Response: We purposely set out the minimum line items to be disclosed on each of the statements. Additional line items should be included if they are material. Please see the discussion in subsection 2.1(2) of the CP.

One commenter agrees with the requirement to include income from derivatives as one line item (instead of disclosing income per type of derivative).

Response: None required.

Two commenters recommended changing "securityholder information costs" (item 11) to "securityholder reporting costs" in order to avoid confusion with expenses for information systems or technology.

Response: We have made this change.

One commenter noted that item 12 should read "dividends *paid* on securities sold short" (not "dividends received on securities sold short").

Response: We agree, but have removed this line item. The disclosure will have to be provided by investment funds for which this item is material.

One commenter noted that the statement of operations should not require the inclusion of amounts that were waived or paid by the manager as these amounts are not part of the fund's results, and the requirement is inconsistent with the requirement to calculate both the actual MER and the MER as if the expenses had not been waived. (This commenter does not object to disclosing this information in a note.)

Response: We are of the view that the amounts waived or paid by the manager should be shown separately on the statement of operations because this reduction in expenses is at the discretion of the manager and investors should be able to see if the manager is waiving or paying these amounts.

Three commenters are of the view that filing fees paid to securities regulators should be a separate, mandated line item.

Response: Investment funds should add any other line items they believe are necessary in order to comply with GAAP.

One commenter is of the view that distribution expenses should appear as a separate line item on the statement of operations.

Response: The Rule requires a breakdown of management fees in the MRFP which should include disclosure of distribution expenses.

Two commenters suggested that the disclosure of net earnings per security should be specifically required, given that this is now required by GAAP.

Response: The line item "increase or decrease in net assets from operations per security" has been added to the statement of operations.

One commenter noted that disclosing the increase or decrease in net assets from operations per security will not agree with "increase or decrease in net assets per security by class" that is required to be reflected in the statement of operations in accordance with GAAP.

Response: For investment funds with more than one series/class of securities, the Rule requires financial statements to present any "per security" amounts as "per series/class" amounts.

One commenter asked why subsection 3.2(2) only applies to commodity pools.

Response: These requirements were adopted from section 8.3 of NI 81-104. However, we have deleted them as these items are already captured in the statement of operations.

3.3 Statement of Changes in Net Assets

Two commenters asked for clarification of whether there was any requirement to disclose proceeds from the issuance of securities of the investment fund (item 3), aggregate amounts paid on redemption of securities (item 4) and distributions (item 6) by series/class or just in total for the fund.

Response: Multi-class investment funds must present all of the items in the statement of changes in net assets on a per series/class basis.

Three commenters noted that the terms used in paragraph 6 of this section should be made consistent with the tax nature of distributions/dividends as the difference between GAAP and tax rules are such that a taxable capital gain could occur and be distributed, but no gain is realized for GAAP purposes. Two commenters suggested that the paragraph read: "distributions, showing separately the amount out of taxable income, taxable capital gains and return of capital" (instead of the current "distributions, showing separately the amount out of net investment income, out of realized gains on portfolio securities sold, and return of capital").

Response: We are of the view that the more general terms are readily understood and can be applied to both investment funds that are tax neutral and those that are not.

One commenter noted that a breakdown of distributions between net investment income, realized gains and return of capital cannot be provided on interim statements as these amounts are not finalized until the fund's tax year-end. This disclosure can only be provided in annual financial statements for a December 31 year-end.

Response: We are of the view that the allocation of distributions can be estimated at the interim period and is within the scope of Section 1508 Measurement Uncertainty of the Handbook.

3.5 Statement of Investment Portfolio

Three commenters asked if short term debt instruments are aggregated with cash as a line item on the statement of net assets, and not listed on the statement of investment portfolio, whether there is any requirement to separately report the short term debt instruments by currency. If so, the commenters suggested that the requirement should only be to distinguish between domestic or reporting currency and foreign currencies, as it would be onerous to report short term debt by each currency.

Response: We have addressed this by deleting the requirement to break down the disclosure by currency of issue and requiring separate disclosure of the aggregate short term debt instruments by currency of issue, if these exceed 5% of the total short term debt instruments.

One commenter pointed out that the terms "derivatives" (defined in securities regulation in some provinces) and "specified derivatives" (defined in NI 81-102) seem to be used interchangeably and recommended the use of the NI 81-102 term.

Response: We have used the term "derivative" throughout the Rule, except for Part 14 where the requirement to calculate net asset value more frequently is based on the use of "specified derivatives" as defined in NI 81-102.

Two commenters suggested deleting the words "per option" from the phrase "quantity of the underlying interest per option" in subsection 3.5(6) as the quantity per underlying option is not standardized.

Response: We have made this change.

One commenter agrees with the change made to not require disclosure of the credit rating of the counterparty.

Response: None required.

One commenter suggested that holdings which may represent a conflict (for example, a fund's investment in its manager's parent company) should be highlighted on the statement of investment portfolio.

Response: These conflicts are being considered in the context of proposed NI 81-107, which may result in amendments to the Rule at a later date.

3.6 Notes to Financial Statements

Two commenters suggested that labour sponsored investment funds (LSIFs) should be exempt from the requirement to provide details of portfolio transactions with related parties of the investment fund (that are venture investments) given that LSIF shareholders know that LSIFs are active investors that frequently serve on the boards of their portfolio companies. Another commenter requested confirmation that disclosure of transactions with related parties only has to be provided if the related party is acting as principal, not agent (similar to the exception in subsection 4.2(2) of NI 81-102).

Response: We have removed the requirement to provide details of related party transactions in the notes to the financial statements. Related party disclosure will have to be provided in the notes to the financial statements when required by GAAP.

The notes to the financial statements of an investment fund must contain: details of the total commission paid to dealers for portfolio transactions, including dollar amounts of commissions paid and soft dollar transactions; and the basis for calculating the management fees paid and a breakdown of the services received in consideration of the management fees. Four commenters noted that the effort required to audit these disclosures could be considerable, and if the auditor of the fund is not also the auditor of

the manager, the auditor may not have the ability to audit the information being disclosed. The commenters suggested that this disclosure be provided outside of the body of the audited financial statements.

Response: We have moved the requirement to disclose the breakdown of management fees from the notes to the financial statements to the MRFP. However, we are of the view that it is appropriate to disclose the commission paid to dealers, including soft dollar disclosure, in the notes to the financial statements.

Three commenters requested clarification of what soft dollar disclosure must be provided and note that the term "soft dollars" is not defined or explained in the CP.

Response: We have specified in the Rule that soft dollars refers to the amount other than order execution costs and must be disclosed if ascertainable. We have clarified in the CP that soft dollars include the goods and services received from either the dealer directly or a third party.

Two commenters are of the view that disclosing soft dollars in addition to total commission paid is redundant.

Response: We believe that separate disclosure of soft dollar amounts is important to investors.

Four commenters are of the view that the soft dollar disclosure will require arbitrary allocation of transactions to a specific fund. Calculating soft dollar transactions per fund by subtracting the usual market rate for commissions from the total amount paid to a broker does not contemplate any "preferential pricing" of trades based on volume that does not otherwise involve soft dollar services provided by the broker to the manager.

Response: As part of ensuring that each fund is getting best execution, we are of the view that it is the responsibility of the manager to allocate soft dollars equitably to each fund.

One commenter noted that as the OSC is presently conducting a study of soft dollar arrangements, changes to the disclosure requirements are premature until the study is completed.

Response: Some soft dollar disclosure is already required (for example, mutual funds using a simplified prospectus must disclose whether any statistical, research or other investment decision-making services were received). Given our understanding of the prevalence of soft dollar arrangements, we are of the view that this disclosure should be provided.

Three commenters asked for clarification of the purpose of the disclosure required by paragraph 5 of subsection 3.6(1) [Form 81-106F1, Part B, Item 3.3] (breakdown of management fees).

Response: The purpose of this disclosure is to inform investors of what services they receive in exchange for the management fees paid by the fund. Investors should understand what is included in the management fee and what is not.

One commenter requested clarification on whether the breakdown of the services received in consideration of the management fees must be calculated on a series by series basis or on a fund by fund basis. The commenter is concerned that absent specific guidance on how to separate and account for the various fees, investors will not have comparable information to make a comparison between funds.

Response: In order to provide meaningful disclosure, the basis for calculating the management fees and the breakdown of the services received as a percentage of management fees should be provided for each series/class, as the management fee differs for each series/class.

Two commenters asked for guidance as to how detailed the breakdown of the management fees needs to be. One commenter asked whether profit would be imbedded into each type of service provided, or whether it would be a separate component. Another commenter suggested including an example of the required disclosure in the CP.

Response: We expect the disclosure to list the major services paid for out of the management fees (for example, portfolio adviser compensation, trailer fees, sales commissions) depending on each fund's arrangement with the manager. We have added an instruction to the Form that includes these examples.

One commenter suggested that an alternative place and format for this disclosure might be more appropriate (for example, like the disclosure in the simplified prospectus of the percentage of management fees paid to dealers).

Response: We have amended the Rule to require this disclosure in the MRFP, instead of the notes to the financial statements. We are of the view that this disclosure should be provided in a document that investors can request on a regular basis.

Two commenters are of the view that the requirement to disclose amounts that would have been payable by the fund but were paid by the manager instead is too broad and request clarification of what information is to be disclosed. Two commenters are of the view that there will be significant inconsistencies among fund companies as to what is disclosed.

Response: As amounts that were waived or paid by the manager will be disclosed in the statement of operations, we have removed this requirement from the notes to the financial statements.

Two commenters requested that the requirement to disclose borrowing details in the notes and in the MRFP not apply to investment funds that already have similar disclosure elsewhere in their financial statements.

Response: We have clarified that note disclosure with respect to borrowing only has to be provided if it is not already provided elsewhere in the financial statements. We have also eliminated certain disclosure from the notes, as a full discussion of borrowing activities is required in the MRFP.

One commenter suggested that given the restriction on borrowing in NI 81-102, disclosure in the financial statements and MRFP be limited to borrowing outside of the normal course of business (as otherwise permitted by NI 81-102).

Response: The requirement may not be applicable to the majority of mutual funds as they do not engage in borrowing. However, as the Rule applies to all investment funds, the disclosure must be provided for all borrowing activity, including borrowing in the normal course of business.

One commenter requested clarification that borrowings include margin.

Response: Yes, borrowing includes margin.

One commenter is of the view that the notes to the annual financial statements should include the dollar amount and percentage of total brokerage commissions paid to related parties for the current and prior year.

Response: Details of related party transactions must be disclosed in the MRFP.

3.7 Inapplicable Line Items

Section 3.7 permits an investment fund to omit any line item for which it has nothing to disclose. One commenter suggested that omissions should be permitted if the fund has nothing *material* to disclose, while two commenters recommended a materiality threshold of 5% of total revenue or expense, as applicable.

Response: We purposely set out the minimum line items to be disclosed on each of the statements. Additional line items are to be included if they are material. Please see the discussion in subsection 2.1(2) of the CP.

3.11 Incentive Arrangements

The statement of net assets must disclose the current value of incentive arrangements. One commenter noted that GAAP requires an accrual to be made when the definition of liability is met and requests clarification as to whether the intention is to have incentive arrangements recorded on the statement of net assets regardless of whether the definition of liability is met.

Response: We have deleted section 3.11 from the Rule as sufficient guidance is provided in Canadian GAAP. We have added a line item to the statement of net assets for incentive arrangements and compensation.

Two commenters requested clarification that the requirement is to disclose the expense from incentive arrangements separately and suggested that subsection 3.11(2) read "The statement of operations of an investment fund must disclose changes in the amount referred to in subsection (1) *together with amounts paid under the incentive arrangements during the period* as a separate line item."

Response: We agree and have made a corresponding change to the line items in the statement of net assets and statement of operations.

One commenter was unclear as to why section 3.11 is necessary and suggests adding these items to the appropriate statements. This commenter also wondered whether the phrase "current value of an incentive arrangement or compensation" will be properly understood and whether it means something other than "fees that are determined by the performance of the mutual fund" as set out in NI 81-102.

Response: We deleted section 3.11.

3.12 Group Scholarship Plans [3.11]

One commenter suggested deleting the definitions of "education savings plan", "group scholarship plan" and "scholarship award" as these terms are commonly understood.

Response: These definitions have been included in order to provide consistent terminology, as the scholarship plan industry has not consistently used these terms in the past.

One commenter requested that the definition of "group scholarship plan" be modified to include the self-determined plan option.

Response: The definition of "group scholarship plan" includes individual (self-determined), family and group plans, but does not include self-directed registered education savings plans. For greater clarity, we have changed the references to "group scholarship plan" to "scholarship plan".

One commenter noted that the terms "scholarship agreements" and "scholarship plan" are used without being defined and wondered whether they mean something different than "education savings plan" and "group scholarship plan" which are defined terms.

Response: We have made these references consistent.

One commenter requested that the "net asset value per security" line item not apply to scholarship plans, as the concept that scholarship plans not be unitized has been accepted.

Response: We have included an exemption for scholarship plans from the requirement to provide net asset value per security and increase or decrease in net assets from operations per security.

One commenter asked whether the statement of scholarship awards paid to beneficiaries is a cumulative statement or a statement for the applicable year only.

Response: This statement is for the applicable year only.

One commenter suggested that the summary of scholarship agreements and units outstanding should be provided by year of *eligibility* (not year of maturity).

Response: We have made this change.

One commenter submitted that only ending units should be reported by year of eligibility. This commenter suggested the disclosure be changed to opening units, units purchased, units cancelled, units transferred to another plan administered by the same organization, units where the beneficiary has received all available scholarship awards, matured units no longer eligible for further scholarship awards, other miscellaneous activities and ending units, all based on total units for all combined years of eligibility.

Response: Each item must be disclosed by year of eligibility in order to provide investors with meaningful information, as investors will only receive benefits based on their particular year of eligibility.

One commenter asked what the purpose of subsection 3.12(b) is and what further information must be provided if the group scholarship plan must already reconcile scholarship awards paid to beneficiaries with its statement of operations.

Response: We have deleted this requirement.

Part 4 - Management Reports of Fund Performance and Form 81-106F1

4.1 Application

One commenter asked whether a mutual fund that is not a reporting issuer must file MRFPs.

Response: Section 4.1 states that Part 4 (the requirement to prepare and file a management report of fund performance) only applies to an investment fund that is a reporting issuer.

4.2 Filing of Management Reports of Fund Performance

One commenter is of the view that the MRFP is a "step in the right direction" toward disclosure directly related to a specific fund, rather than general commentary about the economy.

Response: None required.

Three commenters agree with the elimination of quarterly MRFPs, but continue to have concerns with respect to the cost and resources needed to produce semi-annual MRFPs.

Response: We are of the view that it is important for investors to have current information.

4.4 Contents of Management Reports of Fund Performance

One commenter recommended that the discussion of risks and trends be combined for more than one fund in one MRFP where this discussion pertains equally to the funds and noted that the financial highlights and performance could be provided separately in the same MRFP. Fund managers could tailor their comments with respect to specific funds within the same commentary. Permitting this flexibility would achieve the goal of facilitating comparisons between funds while reducing the associated time, cost and overall size of MRFPs.

Response: The purpose of the MRFP is to provide fund-specific information, not a general discussion of risks and trends.

Three commenters requested that the CSA consider fund of fund arrangements where a top fund has fixed allocation among a number of mutual funds. One commenter suggested that the top fund's MRFP will be identical to that of the underlying fund. Another commenter believes that this type of disclosure would not be meaningful to the investor and may defeat the actual purpose of the MRFP. The commenters seek clarification as to whether the MRFP should be prepared for top funds and/or each of the underlying funds.

Response: An MRFP must be prepared for every investment fund. The disclosure for top funds with more than one underlying fund will be specific to the top fund. Even in fund of fund arrangements with only one underlying fund, the performance of the top fund will differ from the underlying fund (because of different fees, expenses, etc.) and the management discussion should address the specific investment strategy employed by the top fund.

Form 81-106F1 – Contents of Annual and Interim Management Report of Fund Performance

Part A Instructions and Interpretation

One commenter is of the view that prescribing the contents of the MRFP may not be very useful and that the market and the manager should have the right to determine the amount and type of information to be included in the MRFP. This commenter also indicated that they already provide much of the information required by the Form.

Response: The Form identifies information which, in our view, should be provided, at a minimum, in order to give meaningful disclosure. The Form also allows managers to give additional information which reflects their investment style and ensures that they meet their responsibility of providing all material disclosure.

One commenter encouraged the CSA to more narrowly focus the disclosure requirements so that the MRFP only includes the compound performance table, performance bar chart, MER and summary of fund holdings by category, with any necessary commentary to explain these items.

Response: We are of the view that the requirements in the Form are focused on the elements necessary to provide valuable, consistent and meaningful disclosure.

Three commenters noted that the CSA expects the average annual MRFP to be four pages in length, but as the MRFP must include the financial highlights tables, a past performance bar chart, and an annual compound returns table for each series of the fund, and given that commercial printing can only be done in multiples of four pages, the average MRFP is likely to be eight pages (allowing for a reasonably sized font), which will be more expensive to produce.

Response: We acknowledge that the MRFP will be longer for funds with more than one series/class of securities.

Two commenters noted that additional information may be included in the MRFP, as long as this does not excessively lengthen the document. In the commenters' view, this is too restrictive as it may be useful to allow funds to deliver a fund's MRFP and financial statements together as a package and permit the MRFP to cross-reference certain items of disclosure in the financial statements. This could shorten the length of the MRFP.

Response: The MRFP was designed as a stand-alone document which investors can review and understand without having to receive the financial statements.

Part B Content Requirements for Annual Management Report of Fund Performance

2.1 Investment Objectives and Strategies

Four commenters noted that the Form requires the inclusion of the investment objectives and a risk profile discussion. In the commenters' view, this information is redundant to investors, as it is already outlined in the prospectus and is unlikely to change. Some of these commenters also noted that the investment objectives are not to be "copied" directly from the prospectus and are unclear as to the rationale behind this restriction

since the prospectus language has been reviewed and approved by securities regulators. The commenters are concerned that by requiring the investment objectives to be rewritten, investors could interpret the rewritten objectives differently which could result in increased liability for fund companies.

Response: The Form requires a brief summary of the fundamental investment objectives and strategies of the fund. There is no requirement to "rewrite" the investment objectives, but the entire investment objectives and strategies sections should not be copied from the prospectus. Also, the fund may have altered its investment strategy (which does not necessarily involve securityholder approval), so updated disclosure should be provided. The disclosure is included in the MRFP in order to provide context for the required management discussion.

The Form also requires a discussion of how changes to the fund have affected the overall risk associated with an investment in the fund, which will not replicate the disclosure previously provided in the prospectus.

2.2 Risk

Two commenters are of the view that in the absence of an industry convention and given no consensus as to appropriate benchmarks, it would not be meaningful (and could cause confusion) to require a discussion of risk/volatility in the MRFP. One commenter requested guidance on how to gauge changes in risk.

Response: The requirement is to discuss any changes to the risk factors or investment suitability associated with the fund (the instructions cross reference items 9 and 10 of Part B of Form 81-101F1). There is no requirement to quantify how these changes might affect the price of the fund's securities.

One commenter asked for clarification of whether any risk disclosure is necessary if the fund has not experienced a material or significant change. The commenter also asks why the term "significant change" is used as it will be deleted from NI 81-102.

Response: We have removed the reference to "material or significant" change from this disclosure requirement. As indicated in Part A of the Form, only material information needs to be disclosed.

One commenter suggested that there is a contradiction between the risk disclosure requirements in the Form and the definition of material or significant change. The commenter stated that if changes to a fund's risk are material or significant and could affect the suitability or risk tolerance stated in the prospectus, an investor should be informed of such a change when it occurs, as informing the investor through the MRFP would not be appropriate. Additionally, the commenter states that any major change in the risk of the fund is likely to have an impact on the fund's objective, which cannot be changed without investor approval.

Response: The requirement to provide certain disclosure in the MRFP does not replace a fund's obligation to report material changes at the time they occur or to seek securityholder approval if necessary in order to implement a particular change.

2.3 Results of Operations

One commenter suggested that the discussion of transactions involving related parties required by Part B, Item 2.3(f) [Part B, Item 2.5] of the Form be limited to transactions involving the portfolio assets of the fund, not ownership of fund securities by a related party. The commenter noted that the definition of "related party" in the Rule refers to section 4.2 of NI 81-102 which clearly only refers to portfolio assets of the fund.

Response: We have removed the definition of "related party" from the Rule, but have added an instruction to the Form indicating that "related party" has the meaning given to it in the Handbook and have also listed some entities that we consider to be related parties for investment funds. The Form requires disclosure of all related party transactions, including, but not limited to, portfolio transactions.

2.4 Recent Developments

One commenter noted that the Form requires a discussion of "unusual or infrequent" events or market conditions that affected performance. In the commenter's view, the discussion of unusual market conditions should be consolidated into the "results of operations" section of the MRFP, while the remaining items in Part B, Item 2.4 should be discussed separately. The commenter is also of the view that "unusual events" should only be included if they would constitute a "material change" for the fund, and it should be made clear that disclosure of these events in the MRFP is in lieu of other notice requirements (such as change of manager under section 5.8 of NI 81-102).

Response: The requirements have been rearranged to distinguish between "results of operations" and "recent developments". Disclosure in the MRFP does not replace any other obligations an investment fund may have upon the occurrence of either a material change or another specific event (for example, when notice to securityholders is expressly required by NI 81-102).

2.5 Other Information

Five commenters requested clarification as to whether forward-looking information is optional or mandatory disclosure. The instructions in the Form appear to indicate such disclosure is mandatory, but the CSA's response to comments in Appendix B to the Notice and Request for Comments indicated that the provision of forward-looking information is optional.

Response: The provision of forward-looking information is optional. The instructions in the Form have been clarified.

3.1 Financial Highlights

Two commenters noted that the split of total revenue and total expenses per unit is excessive information. In their view, total net income per unit, MER, distributions and actual returns are sufficient.

Response: We are of the view that the disclosure required in the financial highlights tables is relevant and useful to investors.

One commenter is of the view that the requirement to distinguish between realized and unrealized gains or losses from securities versus gains or losses from foreign exchange should be deleted.

Response: We have removed this requirement.

Three commenters asked the CSA to reconsider the table "The Fund's Net Asset Value per [Unit/Share]" as a reconciliation of opening to closing NAV per unit. Given the denominator being used in the calculation, this table cannot be created without a "plug" in order for the opening and closing NAV per unit/share to tie into the financial statements.

Response: This table is not intended to be a reconciliation of opening to closing NAV per security. We have added a footnote to the table explaining which figures are based on the actual number of securities outstanding and which are based on the weighted average number of securities outstanding over the financial period.

One commenter recommended that the "Fund's Net Asset Value per Unit/Share" table be amended to require 3 separate sections: (i) the opening NAV, the closing NAV (current day's closing), (ii) Net Investment Income Per Unit, Net Realized Gains or Losses per Unit and (iii) Distributions per Unit.

Response: We have added a sub-heading to the table to better distinguish the items relating to the increase/decrease from operations. We have also added a footnote explaining how the per unit/share amounts are calculated.

Three commenters questioned the value of disclosing the number of investments held in the "Ratios and Supplemental Data" table.

Response: We have replaced this requirement with the requirement to disclose the total percentage of portfolio assets represented by the top 25 holdings of the investment fund.

Two commenters suggested that passively managed fund of fund structures should be exempted from the requirement to provide a portfolio turnover rate (similar to the exemption currently given to money market funds).

Response: We are of the view that the portfolio turnover rate should be provided for top funds. This requirement currently exists in NI 81-101.

One commenter asked whether in the Ratios and Supplemental Data table, it would be more consistent with the disclosure in the financial statements to also disclose MER without waivers or absorption.

Response: We have added this item.

One commenter suggested that disclosure of brokerage commissions as a percentage of fund assets should be disclosed.

Response: We have added this item to the Ratios and Supplemental Data table as a "trading expense ratio".

3.2 Group Scholarship Plans

One commenter suggested that the financial highlights should refer to the "total number of units in plans" rather than the "total number of agreements in plans" (for group plans, not self-determined plans).

Response: The table has been modified to allow for either total number of units or total number of agreements, as applicable to the particular scholarship plan.

Item 4 Past Performance

One commenter suggested that funds should have the option of including the bar chart or compound return table, or both.

Response: We are of the view that both the bar chart and the annual compound returns table provide useful information.

One commenter noted that if exchange-traded funds do not assume that distributions are reinvested in additional securities of the fund, investors will be unable to compare the performance of an exchange-traded fund to the performance of a fund that is not exchange-traded in a meaningful way.

Response: We have removed this requirement.

4.2 Year-by-Year Returns

Five commenters have concerns with the requirement to disclose the best and worst six-month period. The commenters are of the view that this is not a meaningful statistic and unduly emphasizes short-term performance. One commenter noted that this disclosure will be problematic for new funds (one six-month period will be both the best and worst) and is of questionable relevance for funds with long track records (more than 10 years).

Response: We have removed this requirement.

4.4 Group Scholarship Plans

One commenter questioned the usefulness of having scholarship plans provide past performance, particularly the best and worst return for a six month period.

Response: We have removed the requirement to disclose the best and worst return for a six month period. Otherwise, we are of the view that it is appropriate for scholarship plans to disclose performance information, given that they are providing an investment management service.

Item 5 Summary of Investment Portfolio

Two commenters expressed concern with the requirement to disclose the top 25 long and short positions in the summary of investment portfolio because if the fund maintains a concentrated portfolio, the result is to disclose the fund's entire investment portfolio and strategy. Another commenter suggested that disclosing the top 15 positions would be more in line with the goal of presenting a summary.

Response: The investment fund's full portfolio is disclosed in the statement of investment portfolio which must be prepared and filed on a semi-annual basis. Providing a summary in the MRFP does not result in any additional disclosure, although the requirement has been modified to disclose the top 25 positions, either long or short (instead of long and short).

One commenter is of the view that the majority of securityholders would be happy to receive just the break down of their fund's portfolio by appropriate sub-group and the percentage of net assets constituted by each sub-group. This commenter is also of the view that if the top 25 is required, the securities should be listed in alphabetical order and only the total percentage of net assets represented by the top 25 should be disclosed (not the percentage of each security).

Response: In our view, the percentage of fund assets invested in each position should be provided. This disclosure is already given by mutual funds using a simplified prospectus in the top ten holdings. We have also added a requirement to disclose the total percentage represented by the top 25 (in lieu of the requirement to disclose the number of investments held).

Two commenters noted that the portfolio subgroups must be shown in a table, but can also be shown in a pie chart. The commenters are of the view that the Form should be more flexible about presentation format and suggest that just the pie chart should be acceptable.

Response: The Form has been modified to indicate that either a table or a pie chart can be provided.

The instructions indicate that if a fund holds a long position in a derivative or holds an index participation unit (IPU), the fund should consider that it holds directly the underlying interest of the derivative or its proportionate share of the securities held by the issuer of the IPU. Two commenters noted that this is consistent with subsection 2.1(3) of NI 81-102, except that NI 81-102 provides an exemption if the underlying issuer comprises less than 10% of the derivative or IPU. The commenters suggested that the same exception should apply for the purposes of disclosing the summary of investment portfolio.

Response: The exception in NI 81-102 is for the purposes of concentration restrictions. The requirement in the Form is consistent with the current disclosure required by NI 81-101.

One commenter reminded the CSA of the difficulties associated with fund of fund portfolio disclosure, as the top fund must wait for the quarterly filings of third party funds before the top fund can complete its summary of investment portfolio. The commenter asked whether the most recent underlying fund data could be used, provided there is sufficient disclosure of the period of the underlying fund's data.

Response: The instructions indicate that the top fund must list the holdings of the underlying fund as disclosed by the underlying fund as at the most recent quarter end.

Part C Content Requirements for Interim Management Report of Fund Performance

Two commenters asked for clarification that the financial highlights and past performance provided in the previous annual MRFP are to be repeated in the interim MRFP, with an additional column showing the interim results. In one commenter's view, this will be unnecessarily duplicative, while in the other commenter's view, this will be inconsistent with the interim financial statements, where the requirement is to disclose 5 years of interim comparative data.

Response: Yes, the interim MRFP will contain the previous annual data, with the additional interim results. The purpose of the interim MRFP is to update the annual disclosure, so we are of the view that it is useful to provide the previous annual results. There is no requirement to provide five years of comparative data in the interim financial statements.

One commenter noted that the financial highlights in an interim MRFP require per unit distribution information, but this information is not available until the year-end characterization of the income is determined.

Response: We have provided an exemption from disclosing distributions by type in the interim MRFP.

One commenter asked for clarification that in the interim MRFP, only a bar chart is required, not an annual compound returns table.

Response: Yes, only the bar chart must be provided in the interim MRFP.

Part 5 - Delivery of Financial Statements and Management Reports of Fund Performance

5.1 Delivery of Certain Continuous Disclosure Documents

One commenter noted that the CSA indicated that combining mailings to clients in the same residence is not permitted. The commenter suggested that the CSA permit mailings on a household basis since there is no confidential client information in the MRFP and it would reduce postage costs and the number of mailings received.

Response: One of the purposes of the Rule is to ensure that securityholders only receive the continuous disclosure documents that they have requested and that pertain to the specific investment funds held by them. If there is more than one securityholder in a particular household, there is no prohibition against placing the requested documents into one envelope, as long as this purpose is achieved.

Four commenters suggested deleting the requirement for the delivery of annual and interim financial statements and only requiring the delivery of the annual and interim MRFP on request.

Response: Investment funds are currently required to deliver annual financial statements to all of their securityholders (NI 54-102 provides an exemption from delivering interim financial statements). We believe it is inappropriate to delete this obligation altogether, and that sending the financial statements only on request strikes a fair balance between the needs of securityholders and the obligations of issuers.

One commenter agreed with the requirement to allow investors to elect to receive any or all of the financial statements and MRFPs produced by a fund.

Response: None required.

One commenter believes that users of the Rule would benefit from a clear explanation in the CP as to the rationale in establishing three different procedures under Part 5.

Response: We have expanded our discussion in the CP.

One commenter is concerned with the requirement to contact beneficial owners. The commenter noted that some funds may have only incomplete beneficial owner information, while other funds may not have any access to beneficial owner information. The commenter suggested that a method be provided for funds to obtain the required information.

Response: Continuous disclosure documents must be sent to beneficial owners using the procedures set out in National Instrument 54-101 Communication with Beneficial Owners of Securities of a Reporting Issuer (NI 54-101). However, the Rule gives an exemption from using NI 54-101 to those investment funds that do have complete beneficial owner information and are able to obtain delivery instructions from beneficial owners directly.

Two commenters suggested that the prohibition from going back to an annual solicitation after moving to a standing order is too restrictive, as a situation may arise where it is either impossible or not in the best interests of investors to continue with standing orders.

Response: The Rule recognizes that some investment funds may be using annual instructions pursuant to the requirements of exemptive relief orders and allows funds to continue with this method. However, we are of the view that it is preferable, for both investors and issuers, to obtain standing instructions. If there is a change in the operational systems employed by an investment fund, the Rule does not prohibit it from obtaining new or updated standing instructions.

Five commenters suggested that investors should elect to receive materials at the fund company level. In their experience, investors do not have different reporting needs for funds held with the same fund manager. Two commenters noted that this would also help to manage costs.

Response: We have changed the Rule to indicate that instructions can be solicited for all funds managed by the same manager.

5.2 Sending According to Standing Instructions

Ten commenters suggested that the requirement to solicit standing instructions within three months after the Rule comes into force is too prescriptive. The commenters suggested that funds have discretion to determine the timing of first solicitation of standing instructions so they can combine it with other mailings.

Response: We have removed the requirement to solicit standing instructions within three months of the Rule coming into force. Investment funds that choose to deliver the continuous disclosure documents pursuant to standing instructions can solicit those instructions at a time that is appropriate for the fund. In the meantime, these funds will either have to deliver to all investors or deliver pursuant to annual instructions.

One commenter asked how an investment fund is expected to comply with the requirement to obtain standing instructions at the time that the investment fund first accepts a purchase order from a registered holder or beneficial owner. If the dealer does not provide the investment fund with the identity of the beneficial owner, the investment fund will be unable to comply with this provision.

Response: We have modified the provisions to clarify that the procedures in NI 54-101 should be used in order to communicate with beneficial owners, but investment funds that do have beneficial owner information are given an exemption from NI 54-101 in the Rule.

Two commenters suggested that the process outlined for soliciting instructions at the time of purchase is administratively incompatible with Fundserv. One commenter suggested that the investment fund would incur significant costs if forced to solicit request information at the time a purchase order is accepted and suggested that the solicitation be done as soon as reasonably practicable after a purchase order has been accepted.

Response: We have made this change.

Five commenters asked whether instructions received from clients through annual requests under previously issued exemptive relief orders can be relied upon in the same way as instructions previously received under NI 54-101.

Response: Previous annual instructions cannot be relied upon as standing instructions as this was not explained to investors at the time they provided these instructions. In soliciting standing instructions, investment funds must clearly explain to their holders that these instructions will stand until the investor changes them.

Two commenters asked for clarification that funds can use the annual instructions in one year and subsequently move to standing instructions.

Response: Yes, investment funds can continue to use annual instructions until they move to standing instructions.

One commenter suggested that mandatory delivery of annual financial statements is a fundamental obligation of investment funds and that no response should automatically require a mailing.

Response: As financial statements are publicly available through other sources (for example, the SEDAR or fund website), investors may not wish to have a paper copy delivered to them. We think it is acceptable for investment funds to deem no response to mean the securityholder does not want to receive the documents.

One commenter suggested that a document outlining the effect of a negative response be required to set an appropriate reasonable deadline for responses.

Response: We have stated in the CP that a reasonable deadline for responses should be set.

One commenter noted that in several places the phrase “deemed to have been received” is used in the context of standing instructions. The commenter asked whether it is intended to incorporate the deemed instructions from investors when no response is received.

Response: Yes, the phrase "deemed to have been received" referred to instructions given by non-response, but we have removed this phrase from Part 5 of the Rule.

Eleven commenters submitted that the requirement to send an annual reminder if documents are sent to securityholders pursuant to standing instructions will be onerous as the reminder will have to be programmed separately for each client.

Response: We have clarified this requirement to indicate that it does not have to be client-specific, but if standing instructions are used, holders must be reminded annually of the documents they are entitled to receive and of how they can change their instructions.

One commenter stated that the requirement to remind clients each year that they can change their election is reasonable.

Response: None required.

5.3 Sending According to Annual Instructions

One commenter noted that the provisions relating to annual instructions do not specifically state that no response to the request form can be interpreted to mean that the securityholder does not wish to receive any documents, while the provisions relating to standing instructions explicitly say this.

Response: We have explained in the CP the implications of no response for investment funds using either annual or standing instructions.

Four commenters suggested that dates for sending annual request forms to investors should not be prescribed in the Rule as each investment fund should send these according to its own mailing schedule.

Response: We have removed this requirement.

Two commenters asked what should be done for investors who become clients after the annual request form is mailed, but before the financial reports are mailed. The commenters asked whether the requirements of subsection 5.2(4) [5.2(3)] would apply.

Response: Investment funds are exempt from the requirement to deliver only if they have obtained either standing or annual instructions from securityholders who were holders as of the date of the relevant financial statements and MRFPs. Subsection 5.2(4) [5.2(3)] is in the "Sending According to Standing Instructions" section of the Rule, which only applies to investment funds using standing instructions, not annual instructions.

5.4 General

One commenter believes that delivery by no later than the filing deadline plus 10 days is reasonable.

Response: We have removed the additional ten days for mailing given that the interim filing deadline has been maintained at 60 days. The requirement to mail by the filing deadline is also consistent with NI 51-102 which is applicable to all reporting issuers other than investment funds.

Part 6 - Quarterly Portfolio Disclosure

One commenter supports the quarterly disclosure of portfolio holdings and believes that it is important to investors.

Response: None required.

One commenter urged the CSA to maintain the requirement to make available on request, and without charge, a summary of portfolio transactions.

Response: We are of the view that this statement did not provide useful information for most investors so that the cost of producing it outweighed its benefits. The information this statement did provide can be obtained through other sources.

Three commenters asked why there was a requirement to provide quarterly portfolio disclosure. One commenter believes that the quarterly portfolio disclosure is not useful given that: (i) it does not form part of the fund's disclosure record, it is not incorporated by reference into the prospectus, and it is not filed on SEDAR; (ii) a complete statement of investment portfolio must be provided in the financial statements; (iii) a risk exists that sophisticated investors will use more frequent summaries of investment portfolio to "shadow" the actions of a portfolio manager; and (iv) it is not clear whether investors will know that this disclosure exists.

Response: In the first publication of the Rule, quarterly reporting was proposed, but after consideration of the comments received, the requirement to provide a quarterly MRFP was removed. However, limited quarterly disclosure has been added to balance the obligations of investment funds with the requests of investors to receive more frequent information. The MRFP must state on its front cover that this disclosure is available. We are of the view that the requirement to post this on the fund's website is an appropriate way to provide both actual and prospective investors with access to this information.

We also note that exchange-traded investment funds are currently required to do quarterly reporting, and that mutual funds using a simplified prospectus indicate that investors can receive an updated portfolio summary upon request.

One commenter asked why investment funds are required to determine their net asset value at the end of the applicable quarter given that there is no disclosure requirement provided for in the Rule.

Response: We have clarified that the total net asset value is to be disclosed as part of the quarterly portfolio disclosure.

Two commenters reiterated the industry's concerns over predatory trading and suggested that the 60 day timeline for disclosure of portfolio holdings should be maintained.

Response: We have changed the deadline to 60 days to be consistent with the interim filing deadline.

Four commenters suggested that for some investment funds with concentrated portfolios disclosing the top 25 long positions and top 25 short positions held would lead to disclosing the fund's entire investment portfolio and strategy.

Response: The investment fund's full portfolio is already disclosed on a semi-annual basis. The requirement has been modified to disclose the top 25 positions, either long or short (instead of long and short).

Five commenters recommended that investment funds have the ability to remove references to securities where the fund is in the midst of or about to begin a buying or selling program in order to avoid front running.

Response: We believe this concern is significantly reduced by extending the deadline for the provision of this disclosure to 60 days.

Two commenters noted that Part 5 does not extend to quarterly portfolio disclosure but that the disclosure is mentioned in paragraph 7.2(1)(d). The commenters asked whether the standing/annual instructions requirements apply to quarterly portfolio disclosure or whether clients have to specifically request the information. The commenters also asked why the CSA considers it necessary to include quarterly portfolio disclosure in the MRFP.

Response: The delivery instructions provided by securityholders do not apply to the quarterly portfolio disclosure. The front page of the MRFP indicates that this disclosure is available. Securityholders will be able to access the quarterly portfolio disclosure on the fund's website, but may also request a copy be sent to them. We have deleted section 7.2 of the Rule.

Part 7 - Financial Disclosure – General

7.2 Documents Available on Request

Two commenters pointed out that subsection 7.2(2) and subsection 5.4(1) appear to have different deadlines for the delivery of documents to investors.

Response: We have deleted section 7.2.

7.3 Toll-Free Telephone Number or Collect Telephone Calls

One commenter suggested a fund manager be permitted to comply with the intent of this section by disclosing an e-mail address where investors can send requests for additional information.

Response: We have deleted section 7.3. This requirement is already contained in NI 81-101 for mutual funds.

7.4 Binding of Financial Statements and Management Reports of Fund Performance

Two commenters requested that if the CSA wishes the industry to move to securityholder-specific mailings of only the funds that the securityholder holds at the period end, this should be explicitly stated.

Response: We have not specifically prohibited the mailing of financial statements or MRFPs to people who are not securityholders of the fund because, in certain circumstances, this mailing may be appropriate (for example, if a prospective purchaser requests information about the fund). However, the Rule has been designed so that securityholders only receive the continuous disclosure documents that they have requested and that relate to the particular funds that they actually own.

Seven commenters disagree with the CSA's position that presenting information in parallel columns makes it hard to extract useful information from the financial statements and suggest that funds continue to prepare financial statements in columnar fashion.

Response: We continue to be of the view that investors can better understand the disclosure for their particular fund if the financial statements present all of the information for that fund together. We note that several investment funds already use this format.

Fifteen commenters said that they do not agree with the prohibition against binding one MRFP with another investment fund's MRFP. Some commenters suggested that this will increase costs and that investors will be unable to make comparisons within and between fund families. Some commenters suggested that the binding restrictions do not provide any benefits to investors and that fund managers should have the flexibility to determine what documents are bound together.

Response: The purpose of the MRFP is to inform investors of the activities of the investment funds that they own. The focus is on the actual operation and performance of the investment fund, not the fund family as a whole. We are of the view that the MRFPs will be more "user friendly" if they are relevant to a securityholder's actual investment, and that inundating investors with information about funds which they do not own will not further this goal. We also note that fund managers may send marketing materials as appropriate to securityholders.

Five commenters suggested that disclosure materials relating to a specific fund category (eg. money market funds, balanced funds, income funds, RSP clone funds) should be bound together. One commenter suggested that binding be limited to 10 funds in order to avoid large documents.

Response: We are of the view that is preferable to present the disclosure for each investment fund separately.

One commenter suggested that the proposed format for binding is not practical for funds sold as part of a mutual fund wrap or sold on a discretionary basis as part of a client's overall investment portfolio.

Response: When a securityholder holds more than one fund, we have amended the Rule to allow the MRFPs relating to the funds held by the securityholder to be bound together for the purposes of delivery of the MRFPs to the securityholder.

One commenter suggested that an approach similar to public company disclosure be adopted where public companies currently attach the information presented in the MD&A with the financial statements so that the MD&A is read in conjunction with the financial statements.

Response: We have clarified in the CP that the MRFP for an investment fund may be attached to the financial statements for that investment fund.

Four commenters suggested that binding of MRFPs is useful for distributors who wish to see multiple funds in one comprehensive document (rather than trying to go through numerous pages of unbound documents).

Response: The Rule only deals with binding for the purposes of delivery to securityholders.

One commenter suggested that the inability to bind the MRFPs together will result in significant difficulties when these documents are filed on SEDAR. The commenter suggested that it is very difficult to keep track of each fund's individual MRFP and also file it on SEDAR for each fund individually.

Response: We encourage the filing of only the relevant MRFP under the fund's list of documents on SEDAR.

7.5 Multiple Class Investment Funds

Two commenters suggested that it is inappropriate to separate the financial statements for each series of the same fund. Since many funds contain multiple series of securities which invest in the same portfolio, the commenters questioned why this would be allowed since a shortfall in one series may have to be assumed by the other. The

commenters suggested that allowing the preparation of separate financial statements per series may be misleading and lacks authoritative accounting support.

Response: We agree that if a fund has more than one series of securities referable to the same portfolio of assets, the financial statements should be prepared for the fund as a whole. We have amended the Rule accordingly.

Two commenters suggested that funds should be permitted to present information for some or all classes of the fund in one MRFP. The commenters note that the same fund may be sold through different distribution channels, and that some classes may be common to one channel where it makes sense to consolidate classes, but other classes of the same fund may be restricted to other channels.

Response: The MRFP must be prepared for the fund as a whole, and include all series or classes of the fund. We have amended the Rule accordingly.

One commenter indicated that from a programming standpoint it will likely be difficult to segregate different classes into separate MRFPs for each client.

Response: MRFPs cannot be segregated by class.

Two commenters suggested that if the CSA wishes to require the provision of information on the varying results by class, the commenter submits that this is already achieved by the requirement to disclose in the notes the material differences between classes, to calculate separate MERs and through the discussion of performance by class and financial highlights by class in the management report.

Response: Given that there is already a requirement to distinguish differences between classes, we have amended the Rule to indicate that both the financial statements and the MRFP must be prepared for the fund as a whole.

Part 8 – Independent Valuations for Labour Sponsored or Venture Capital Funds

8.2 Exemption from Requirement to Disclose Individual Current Values for certain Portfolio Assets

Two commenters are of the view that the apparent choice under Part 8 is not a choice in reality as it places LSIFs in a conflict. LSIFs must choose between obtaining more costly valuation reports or disclosing confidential information about the carrying values of individual investee companies.

Response: The choice represents an alternative given to the LSIF industry to provide accurate and useful information for retail investors regarding an LSIF's investment holdings. If LSIFs cannot provide current value for individual holdings, then independent valuation is a reasonable alternative to ensure that the aggregate portfolio is valued accurately.

Two commenters are concerned that mandating segmented disclosure by stage and industry class may not be suitable for all LSIFs since some focus mainly on one industry class while others focus mainly on companies at one particular stage. These commenters point out that if a fund has only one investment in a company in one particular stage and industry class, then the investment's carrying value is effectively disclosed.

Response: Section 8.2 provides an exemption from disclosing the individual value of each venture investment. Therefore, there is no requirement to reveal individual values in the table required by subsection 8.2(b). By requiring venture investments to be shown by stage of development and industry classification, we are of the view that there is sufficient flexibility so as to avoid the disclosure of the value of one investment.

Two commenters suggested that sector-specific LSIFs should only be required to provide segmented disclosure by stage. Requiring such funds to split their portfolios into sub-sectors will probably not be useful to investors or comparable as between LSIFs.

Response: The requirement is to organize the portfolio by industry classification. There is no requirement to further divide the portfolio into sub-sectors.

Two commenters suggested that the reference in subsection 8.2(b) to "a table" be changed to "two tables", one of which would show segmentation by sector and one of which would show segmentation by stage.

Response: We have made this change.

Two commenters are of the view that the valuation report requirement should be deferred as there will likely be significant developments in measuring fair value under GAAP in the near future. These commenters stated that deferring this requirement would be consistent with the CSA's indication that the study of investment valuation is the second phase of this policy initiative and propose that the CSA work with the industry, valuation professionals, and the government to define a standardized valuation framework for LSIFs. One commenter suggested that the current standard for "fair value" will not produce a relatively narrow range of results when applied to the same set of facts for development stage and private companies.

Response: We note that a valuation report is already required by Ontario LSIF legislation and understand that it is industry practice in most other jurisdictions. We are of the view that independent valuation is necessary to ensure that LSIFs are valued accurately for retail investors.

One commenter pointed out that LSIFs are currently required under LSIF legislation in Ontario to have the value of the fund's shares determined on an annual basis by means of a "valuation" carried out by an independent qualified person. The commenter submits that the current annual reviews conducted pursuant to LSIF legislation should be accepted in satisfaction of the valuation requirement under the Rule. If the CSA does not accept

these annual reviews, then the Rule will be imposing a higher standard which conflicts with the premise on which Regulation 240 under the *Securities Act* (Ontario) is based, and will also increase operating costs of the funds.

Response: We are of the view that the valuation required by the Rule is consistent with the Ontario legislative requirement.

Two commenters suggested that the costs of the new requirement for annual independent valuations will be significant for LSIFs.

Response: We have provided guidance on the scope of the independent valuation and are of the view that the costs will be justified in order to provide assurance that the valuation is accurate.

One commenter suggested that the requirement for LSIFs to provide independent valuations of the investment portfolio as a whole is inconsistent with the practices of the private equity investment industry and would mean that the expenses applicable to investments in LSIFs will be unnecessarily higher.

Response: The practices of the private equity investment industry have been designed for "accredited investors". LSIFs are sold to retail investors and provincial legislation already requires an annual valuation.

One commenter suggested that some audit firms may be unable or unwilling to act as independent valuators due to issues of independence and liability. Private companies which LSIFs invest in may be detrimentally affected by the time and effort required to assist with the valuations.

Response: We have provided guidance on the scope of the independent valuation in order to address some of these concerns.

8.3 Disclosure Concerning Valuator

One commenter suggested that the requirement to include the compensation paid to the valuator in the financial statements is not meaningful.

Response: We have removed this requirement.

8.4 Subject Matter of Independent Valuation

One commenter pointed out that the Rule does not contain any guidelines as to the scope of the valuator's work or as to the wording of the report to be provided by the valuator.

Response: We have indicated in the CP that the independent valuator should look to the Canadian Institute of Chartered Business Valuators for guidance on reporting standards.

8.5 Filing of Valuation Report

One commenter stated that it is not clear whether there will be a requirement to obtain independent valuations annually or periodically or whether this part only deals with those circumstances where a valuation is obtained voluntarily by an LSIF.

Response: An annual independent valuation is required when an LSIF does not wish to disclose the current value for individual venture investments in the financial statements.

Other LSIF Specific Comments

One commenter is of the view that where a series of securities shares a large, common venture portfolio and core investment mandate with other series of securities and the only difference among the series is in the much smaller non-venture investment portfolio, treating each series as a separate fund is not appropriate.

Response: Generally, a fund is defined by the portfolio of assets to which the fund's securities are referable. We recognize that in some cases, it may be necessary for certain investment funds to seek clarification or exemptive relief if this general assumption does not accurately describe their structure.

One commenter stated that the requirement for funds to establish proxy voting policies and procedures should not apply to LSIFs, as an LSIF's private investments are governed by shareholder agreements that refer to shareholders many decisions of a type that a public company would take at the board level. Given the extensive nature of these items, any stated policies would have to be general in nature thereby providing limited value to LSIF investors.

Response: We are of the view that LSIFs should establish proxy voting policies and procedures so that investors can understand how certain decisions are made.

One commenter requested that the Rule acknowledge that pricing NAV (which includes the unamortized balance of sales commissions) is used by many LSIFs and that the Form expressly provide for the use of "Pricing NAV per Shares" in applicable jurisdictions.

Response: We have made this change. The Form requires disclosure of both the pricing NAV and the NAV for accounting purposes.

One commenter suggested that the Rule and Form should contain an express provision permitting LSIFs to continue providing segmented disclosure of certain MER components, particularly changes to incentive fee accruals.

Response: The Rule does not prohibit disclosure of additional cost information.

One commenter said that section 240 of the Regulation to the *Securities Act* (Ontario) should not be changed without the similar extensive debate, consultation and discussions

that were carried out in the early 1990's to form the basis of section 240 of the Regulation. The commenter does not believe that the OSC should seek to broaden its mandate for regulating LSIFs unless it also wishes to assume from the Finance Ministry the obligation to assess the public policy ramifications of its decisions in these new areas. Another commenter is not clear on the authority of the OSC to revoke paragraph 240(2)(9) and amend paragraph 240(2)(8) of the Regulation.

Response: The Securities Act (Ontario) gives the Commission the authority to make rules regulating LSIFs, including rules prescribing disclosure requirements, and to revoke or amend any provision of a regulation if necessary to effectively implement a rule. As the Rule requires investment funds to comply with Canadian GAAP, the Regulation has been modified in order to implement this requirement. We are not of the view that the Commission has broadened its existing mandate concerning the regulation of LSIFs.

Part 9 - Annual Information Form (AIF)

One commenter asked for clarification as to why investment funds that are required by corporate law to hold annual meetings are exempt from the requirement to file an AIF under the Rule.

Response: Upon further review, we concluded that the information circular prepared for an annual general meeting does not contain information that is similar to the AIF. Accordingly, we have removed this exemption. All investment funds must prepare and file an AIF if they do not have a current prospectus.

One commenter noted that the AIF requires information that goes beyond the nature and extent of information that would be meaningful for scholarship plans. This commenter also noted that an AIF is typically prepared for investment funds sold under a simplified prospectus and that scholarship plans use a long form prospectus.

Response: Investment funds that have a current prospectus are not required to prepare and file an AIF in accordance with the Rule. Accordingly, investment funds that use either a simplified prospectus (which includes an AIF prepared in accordance with NI 81-101) or a long form prospectus, and renew their prospectus annually, are not required to prepare an AIF in accordance with the Rule. If an investment fund ceases to have a current prospectus (because it has completed its offering of securities pursuant to that prospectus or it allows its prospectus to lapse), then the investment fund must prepare and file an AIF in accordance with the Rule for as long as the investment fund remains a reporting issuer.

One commenter noted that the filing deadline for an AIF is the same as for annual financial statements which could be problematic if the AIF requires information which is derived from the financial statements.

Response: The AIF filing deadline in the Rule is consistent with the AIF filing deadline for reporting issuers that are not investment funds. The AIF does not contain financial information that is derived from the financial statements.

One commenter submitted that the deadline for filing an AIF should be after a reasonable period of time following the expiry of an investment fund's current prospectus. (For example, if the prospectus expires April 30/04 and the fund has a December 31 financial year end, the current drafting requires the AIF to be filed by March 31/04, which is not realistic.)

Response: The provision has been modified to require an AIF if the investment fund does not have a current prospectus as at its financial year end.

One commenter noted that the Rule does not appear to allow an AIF that pertains to more than one investment fund, even though the CSA's response to an earlier comment was that this restriction had been removed.

Response: The previous version of the Rule contained an express prohibition against combining the AIF for one investment fund with the AIF for another investment fund which has been removed. We have revised the references to Form 81-101F2 to clarify that multiple AIFs are permitted, if a multiple prospectus was also used.

One commenter is of the view that the requirement to prepare an AIF only using portions of Form 81-101F2 will result in an uninformative document. This commenter suggested that the AIF will be more meaningful if it also includes some of the disclosure required by Form 81-101F1.

Response: Certain of the information currently required by Form 81-101F1 will be updated more frequently in the MRFP prepared in accordance with Form 81-106F1. We are of the view that the AIF required by the Rule will update appropriate material information on an annual basis.

Part 10 – Proxy Voting Disclosure For Securities Held

Four commenters commended the CSA on the requirements for mandatory disclosure of proxy voting policies and records, and congratulated the CSA for promoting transparency in proxy voting by Canadian investment funds. Two commenters are of the view that compiling and providing a proxy voting record to investors is necessary and part of a fund manager's fiduciary duty. Two other commenters have already adopted a proxy voting policy and do not object to providing interested securityholders with a copy of the policy and procedures or the actual proxy voting record upon request.

Response: None required.

One commenter believes that funds and their advisers take the responsibility to vote proxies very seriously and that it is universally recognized that advisers, as part of their

fiduciary responsibilities, must exercise proxy voting solely in the best interests of the funds and their securityholders. Another commenter agrees with the AIMR assertion (in its *Standards of Practice Handbook*) that not exercising proxy voting rights "ignores a valuable ownership right that could be managed for the benefit of the portfolio and, in certain accounts, may constitute a dereliction of legal and fiduciary responsibilities to clients."

Response: None required.

Two commenters believe that the investing public lacks a general awareness and understanding as to the fact that proxy voting occurs, its significance and that the results of proxy voting could be made available to them. The commenters are of the view that investors need to be better educated about the fact that exercising proxies is one of the responsibilities delegated to fund managers and about the types of decisions that are covered by proxy votes. Another commenter stated that investors are becoming more aware that their proxy votes can have a major impact on the long-term performance of companies.

Response: None required.

Three commenters believe that the cost and effort required to compile the proxy voting record in order to make it available to a small minority of interested investors is not justified. However, another commenter stated that cost is not a barrier to proxy voting disclosure, as some of the funds that already provide this disclosure have less than average MERs.

Response: We note that we received several comments from investor advocates in favour of the proposals requiring proxy voting disclosure. We are also of the view that the cost of this disclosure is reasonable.

Four commenters are of the view that people invest in funds in order to delegate the complex process of investment management (proxy voting is a subset of that process). Two of these commenters question why detailed disclosure is required about decisions made by portfolio managers on this one aspect of investment management, but not on other important aspects such as valuation, liquidity and strength of management.

Response: The delegation of decision-making to an investment manager does not preclude the manager from providing disclosure of its activities to investors.

One commenter is of the view that requiring disclosure of proxy votes could put a manager in an awkward situation if the manager votes against a management proposal it believes is not in the best interests of fund investors, but continues to need the cooperation of management of the corporation in order to carry out its due diligence on the corporation as part of its portfolio management function.

Response: In many cases, the issuer will know how its shareholders voted at the time of the meeting. We also note that the proxy voting record must only be disclosed once per year, which will be many months after the actual vote took place.

10.2 Requirement to Establish Policies and Procedures

Five commenters support the requirement of written policies and procedures designed to ensure that proxies are voted in the best interests of fund securityholders and support the disclosure of these policies.

Response: None required.

Four commenters asked that the CSA clarify (perhaps in the CP) that section 10.2 permits policies to be established by the manager for funds it manages, and not separate policies for each fund. One commenter requested confirmation that it is unnecessary for securityholders to approve the policy applicable to their fund.

Response: Each investment fund is required to have proxy voting policies and procedures, but we acknowledge that these may be the same for a group of funds under common management (and, for example, to the extent that mutual funds use a common AIF, the summary disclosure may be provided for the fund family). We confirm that it is unnecessary for securityholders to approve the policy applicable to their fund.

One commenter noted that paragraph 10.2(2)(d) reads: *"the establishment of procedures to ensure that securities held by the investment fund are voted in accordance with the instructions of the investment fund"* [emphasis added] and suggested that it should read "proxies" held by the fund instead of "securities".

Response: We have not made this change as we are of the view that the wording is correct.

Four commenters asked the CSA to clarify the requirement of paragraph 10.2(2)(e) to establish procedures to advise clients of any changes to the policies and procedures. One commenter asked whether a fund must send a notice to all securityholders whenever it makes a material change to its proxy voting policy.

Response: We have deleted this requirement. Changes to these policies should be dealt with in the same way as changes to any other policies of the fund.

One commenter suggested that regulators maintain the right to disapprove proxy voting policies.

Response: The Rule sets out what the policy must contain at a minimum, but does not dictate best practice standards. As regulators, we may review the disclosure of these policies and procedures to ensure that the disclosure is complete and in compliance with the requirements.

10.3 Proxy Voting Record

One commenter suggested that the requirement to make proxy voting records available to securityholders should not apply to private company investments.

Response: We have amended the Rule to require that the proxy voting record be maintained with respect to meetings of reporting issuers only.

Three commenters urged the CSA not to make the compiling of a proxy voting record (and the provision of this record to securityholders upon request) mandatory, so as to acknowledge that in the experience of many fund managers, investors are not demanding this type of information. This approach would also allow fund managers who currently provide proxy voting information to continue to do so, in the manner that they have determined to be the most efficient.

Response: We are of the view that this disclosure should be available to every securityholder.

One commenter supports the requirement to maintain some form of proxy voting record, but takes issue with the requirement to disclose each and every proxy vote cast, given the extensive administration involved, the cost of which will be substantial and ultimately borne by securityholders. Another commenter would prefer to deal with individual requests for proxy voting information rather than producing an unwieldy record that investors may ultimately not want access to.

Response: The Rule ensures that a certain minimum amount of information is available to securityholders who request it.

Five commenters are strongly opposed to the requirement to compile, maintain and deliver a proxy voting record, and suggest that at the very least, the requirement should be narrowed to votes where the fund opposed management's recommendations or deviated from its voting policy.

Response: We are of the view that full disclosure of the proxy voting record is appropriate.

One commenter suggested that if the CSA maintains this requirement in order to promote accountability, funds should only be required to disclose the record to the CSA.

Response: The purpose of the requirement is to provide securityholders, not regulators, with disclosure of how their fund voted.

One commenter is concerned with the requirement to prepare the proxy voting record on a fund-by-fund basis as this will be expensive to produce. The commenter currently maintains its proxy voting records on an issuer-by-issuer basis because it generally

exercises all of its funds' proxies for one issuer in the same manner. The commenter supports separate disclosure on a fund-by-fund basis in the rare circumstances when the best interests of one fund's securityholders would require an advisor to vote the fund's proxies differently.

Response: In order for securityholders to determine how their fund voted, we are of the view that proxy voting records should be prepared on a per fund basis. However, we recognize that in some cases an alternative method of presenting this disclosure may be suitable (for example, because of the way proxy voting decisions are made within a fund family) to meet the goal of providing securityholders with information that is relevant to them. We will consider these alternatives on a case by case basis.

Two commenters note that compiling this information into a consolidated record could be difficult where there are external portfolio managers who vote independently of the manager (especially on routine matters when they follow the fund's proxy voting policy). This task will be more daunting where a fund employs a "multi-manager" approach pursuant to which each portfolio manager is responsible for a different segment of the fund's portfolio.

Response: The proxy voting record must be prepared on a per fund basis, but there is no prohibition against distinguishing between different portfolio managers within the record.

One commenter supports the CSA's recognition that filtering proxy information between routine and non-routine matters is not necessarily beneficial due to the time and cost involved in setting up this type of system (which would have to be a manual system because proxy voting services do not have this type of filter). However, two commenters suggested that if a proxy voting record is required, it should be limited to votes involving "non-routine" matters, or only to special meetings.

Response: We agree with the first commenter. When originally proposed, the Rule required disclosure of only "non-routine" matters, but this was changed to disclosure of all votes because of the difficulties in separating "routine" from "non-routine" matters.

One commenter disagrees with the requirement to file the proxy voting record.

Response: There is no requirement to file the proxy voting record.

One commenter noted that proxy voting can be complicated and onerous in other countries and recommends that the CSA provide a "safe harbour" due diligence defense for the voting of proxies in countries where barriers exist.

Response: An investment fund's proxy voting policies should establish appropriate procedures to address these concerns. The Rule does not obligate an investment fund to vote in every instance.

10.4 Preparation and Availability of Proxy Voting Record

One commenter suggested that the timing of the proposed disclosure coincides with the interim reporting period for funds with a calendar year end which is an additional burden for funds that are already working under an extremely tight timeline to produce other documents during the same time period. The commenter suggests that this timing be either flexible or sometime within the fund's third quarter.

Response: Because the majority of shareholder meetings are held between April and June, June 30 was chosen as the date at which the proxy voting record must be prepared. Given that the information should be compiled during the course of the year, and that investment funds are given 60 days to provide this disclosure, we are of the view that the timing is appropriate.

One commenter submitted that the proxy voting disclosure should be provided on the fund's website no more than 30 days after the vote.

Response: We are of the view that annual disclosure of the proxy voting record appropriately balances the rights of securityholders to access this information with the concerns that the disclosure will be difficult and costly to produce.

One commenter noted that an investment fund must promptly send a copy of its proxy voting policies and procedures and proxy voting record to an investor upon a request made more than 60 days after the end of the period to which the proxy voting record pertains [emphasis added]. The commenter asked for clarification that if an investor makes a request more than 60 days after the end of the period to which the proxy voting record pertains, the fund must deliver the current year's proxy voting record, but if the investor makes a request less than 60 days after the end of the period to which the proxy voting record pertains, the fund would deliver the previous year's proxy voting record.

Response: We have amended the Rule to clarify this point.

Four commenters suggested that the proxy voting record should be posted on the fund's website. One commenter discloses their actual proxy voting activity on their website and encouraged the CSA to adopt this method of disclosure as, in their experience, it satisfies securityholders' needs in a cost effective manner.

Response: We have amended the Rule to require the proxy voting record to be posted on an investment fund's website.

One commenter recommended that investment fund managers disclose how they intend to vote in advance of the actual vote taking place.

Response: Investment funds are free to disclose how they intend to vote in advance of a meeting, but we are not of the view that it would be appropriate to require this in every case.

Part 11 – Material Change Reports

Two commenters noted that in the case where a material change report is filed on a confidential basis, section 7.1 [7.2] of the CP provides that the fund must notify all insiders of the prohibition against trading until the material change report is made public. The commenters question whether this is appropriate for funds other than exchange-traded funds, given that the NAV per unit is based on the market value of fund holdings.

Response: Securities legislation prohibits trading by an insider of a reporting issuer with knowledge of a material change that has not been generally disclosed. This section of the CP reminds investment funds that if they file a confidential material change report, they should ensure that no inappropriate trading in the securities of the investment fund is taking place. The terms "insider" and "insider of a mutual fund" are defined in securities legislation.

One commenter suggested that material change reports should be filed within 5 days rather than 10 days.

Response: The requirement is consistent with that for reporting issuers other than investment funds.

One commenter is of the view that the Rule should state the requirements applicable to investment funds, rather than refer readers to another national instrument.

Response: We are of the view that referring to NI 51-102 for these requirements is appropriate, given that the requirements are substantially the same.

Part 12 - Proxy Solicitation and Information Circulars

Two commenters noted that "securityholder" is used in this part of the Rule and suggested that this term should mean the securityholder registered as a holder of securities on the records of the fund.

Response: We have changed the references to "securityholder" to "registered holder".

One commenter stated that the Rule requires investment funds to send proxy-related materials to "securityholders" entitled to notice of the meeting, which includes both registered and beneficial owners. The commenter noted that section 8.1 of the CP indicates that NI 54-101 should be used to send proxy-related materials to securityholders, but NI 54-101 only applies to sending these materials to beneficial owners.

Response: We have clarified this in the CP.

Two commenters noted that Part 12 contemplates that investment funds can use NI 54-101 to contact their beneficial owners in sending meeting materials, and asks how this relates to the delivery of financial statements and MRFPs.

Response: Part 12 of the Rule only relates to the delivery of proxy-related materials. The provisions in Part 5 of the Rule with respect to the delivery of financial statements and MRFPs to securityholders are intended to exempt investment funds from the procedures in NI 54-101 if they are otherwise able to obtain delivery instructions from beneficial owners of their securities with respect to these documents.

One commenter noted that Item 6.5 of Form 51-102F5 should not apply to a multi-class fund if votes are tabulated at the fund level, not the class level.

Response: We are not of the view that this disclosure should be provided differently for investment funds than is required for other reporting issuers. We also note that this requirement is consistent with the disclosure already required in the AIF of mutual funds (Form 81-101F2, Item 11).

Part 13 - Change in Auditor Disclosure

Three commenters suggested that the CSA is now proposing to apply the requirements of section 4.11 of NI 51-102 to investment funds without removing the requirement for investor approval for a change in auditor in subsection 5.1(d) of NI 81-102. The commenters disagree with the CSA position that the investor approval issue is outside the scope of the Rule and note that the CSA has made conforming changes to NI 81-102 and NI 81-101 to accommodate the Rule.

Response: The requirements in the Rule with respect to change in auditor disclosure already exist in National Policy Statement 31 Change of Auditor of a Reporting Issuer, which will be rescinded when the Rule comes into force. These disclosure requirements are different and independent of the approval right given to securityholders in NI 81-102.

One commenter suggested that the Rule should be a complete rule-book for all continuous disclosure obligations and that it should restate the requirements for change in auditor rather than refer to NI 51-102.

Response: Staff is of the view that referring to NI 51-102 for these requirements is appropriate, given that the requirements are the same for all reporting issuers.

Part 14 – Calculation of Net Asset Value

Three commenters noted that the net asset value per unit ("NAVPU") must be calculated in U.S. or Canadian dollars or both and are concerned that this restriction would prevent the launch of a fund whose NAVPU is calculated in another currency.

Response: This requirement currently exists in Part 13 of NI 81-102 which the CSA is not proposing to change at this time.

One commenter questioned why the CSA has moved from "specified derivatives" to all derivatives in requiring daily net asset value calculations and suggested that the Rule be amended to follow the current requirements of NI 81-102.

Response: We have made this change.

Part 15 - Calculation of Management Expense Ratio

One commenter asked for confirmation that MER will only be presented in the MRFP and not in the financial statements.

Response: Part 17 of NI 81-102 (which required disclosure of the MER in the financial statements) will be repealed when the Rule comes into force. The Rule only requires disclosure of the MER in the MRFP.

15.1 Calculation of Management Expense Ratio

One commenter suggested that closed-end funds have prescribed rules under OSC Policy 5.4 for determining fees charged that are calculated based on average total assets that are valued at the lower of cost or market. The commenter suggested that section 15.1 does not consider this as it requires that MER be calculated based on market value. This will lead to substantial year to year changes to MER given that MER and maximum fund expenses will be calculated differently.

Response: We are of the view that there is no inconsistency between OSC Policy 5.4 and the MER calculation in the Rule as the Policy addresses maximum fees, while the Rule deals with disclosure of those fees.

One commenter suggested that the inclusion in paragraph 15.1(1)(a)(i)(B) of *"any other fee, charge or expense of the investment fund that has the effect of reducing the investment fund's net asset value"* indicates that fees that would be included in calculating the return of the fund (i.e., fees for forward contracts used by RSP clone funds) should be included in the calculation of MER.

Response: If these fees are not otherwise included in the total expenses of the fund, and they have the effect of reducing net asset value, we are of the view that they should be added for the purposes of the MER calculation. We are of the view that this requirement will not capture portfolio transaction costs included in the trading expense ratio (disclosed in the MRFP).

One commenter suggested that if the MER includes performance fees, it will shed an unnecessarily negative light on strong, performing funds and believes that investors may be misled into thinking that a high MER will apply in a year in which the fund loses

money. The commenter questioned whether investors reviewing the listing of MERs in a newspaper would understand the distinction.

Response: The purpose of the MER is to capture all of the actual expenses incurred by the fund during the period for which the MER is calculated. Investment funds may provide additional disclosure regarding the components of MER.

Two commenters disagree with the semi-annual calculation of MER because it may require the manager to commit to waivers or accept relatively higher MERs based only on information available at the interim date.

Response: Both interim and annual MER are based on actual expenses incurred by the investment fund as set out in the financial statements. Therefore, it is our view that disclosure of MER at the interim date is useful and not misleading.

Two commenters agree with the exclusion of non-optional fees from the calculation of MER, but questioned the value of providing separate disclosure of these fees.

Response: We have removed this requirement.

Two commenters noted that the MER must be "grossed up" for fees paid by unitholders outside of the fund and suggested that the allocation of fees would be arbitrary as they are paid at the account level for the entire investment portfolio.

Response: There is no requirement to "gross up" MER for fees paid outside of the fund.

One commenter noted that service providers must be able to accept from fund companies some indication that management fees have been waived or paid directly by investors and suggested that this section incorporate expenses absorbed, and not just management fees waived, as both expenses and management fees make up the MER.

Response: We have made this change.

One commenter stated that Part 15 imposes a new method of MER calculation for pooled funds that is inconsistent with industry practice and suggested that pooled funds be exempt from providing MER.

Response: Pooled funds are not required to disclose MER as they are exempted from preparing MRFPs.

<u>15.2 Fund of Funds Calculation</u>

One commenter is of the view that the MER should be calculated using the expenses of the top fund only, as the expenses of the underlying fund are already reflected in that fund's performance and, ultimately, in the top fund's performance. The commenter

suggested that the top fund has no decision-making power over the expenses incurred by the bottom fund(s).

Response: In our view, the MER of the top fund should reflect the top fund's proportionate share of the expenses of the bottom fund. This MER calculation was recently reviewed in the context of the "fund of fund" amendments made to NI 81-102 by the CSA. We do not propose to change these requirements in the Rule.

Part 16 - Additional Filing Requirements

Three commenters noted an inconsistency between subsection 16.2(2) which states that a fund must file any document required by the Rule on the same date as or as soon as practicable after the date the fund sends the documents to security holders and section 5.4 which states that a fund must send documents to security holders within 10 days of filing.

Response: We have modified this provision to clarify that it pertains to disclosure documents, other than those required under the Rule, which investment funds may send to their securityholders.

One commenter asked whether they would be required to file solicitation of instructions, annual reminders and request forms sent under Part 5 in order to comply with the requirement to file any document sent to security holders.

Response: As indicated above, the requirement has been modified to apply only to disclosure documents not required by the Rule.

One commenter asked whether the voting results report must be sent to securityholders and whether there is an obligation to send a notice to securityholders of the outcome of the meeting.

Response: There is no requirement to deliver the voting results report to securityholders. If the matter voted upon materially affects the investment fund, it will have to be discussed in the MRFP.

Part 18 – Effective Date and Transitional

Twelve commenters indicated that implementing the Rule will involve significant operational changes, time and resources, so that the application of the Rule to financial years ending on or after December 31, 2004 is tight and will cause considerable hardship for the industry. The commenters suggested effective dates ranging from financial years ending after December 31, 2004 to financial years beginning October 1, 2005.

Response: The Rule will apply to financial periods ending on or after June 30, 2005.

One commenter asked for clarification of when certain other requirements take effect.

Response: Section 18.2 has been amended to set out certain additional transition provisions.

One commenter suggested that a second transitional year be added since the volume of work required and deadlines proposed by the Rule will require investment funds, and suppliers of services to investment funds, to potentially re-engineer their processes to meet all the reporting requirements.

Response: The CSA initially published its proposal to introduce MRFPs for investment funds, and to shorten filing deadlines for financial statements, in September 2002. We are of the view that a one year transition period for annual filings is appropriate, given that the interim filing deadline will not change from the current deadline of 60 days.

18.5 Initial Delivery of Annual Management Report of Fund Performance

Two commenters suggested that the requirement to deliver to all investors the first annual MRFP is an expensive way to educate investors on the new report that is available to them. As an alternative, the commenters recommended that the industry prepare a series of mock-ups which could be used in the first standing order/annual instruction solicitation. The example format could be highlighted with educational descriptions and explanations to help the investors understand the meaning of the report.

Response: We are of the view that sending the first MRFP to all investors is an appropriate compromise given that any future delivery (of either MRFPs or financial statements) will only be required upon securityholder request. Investors should base their decision on whether to continue receiving MRFPs after reviewing the content and format of the actual disclosure, instead of an "example" with "educational descriptions" that does not provide information directly related to the performance and activity of the fund.

One commenter asked when the first MRFP should be sent.

Response: We have clarified that the first MRFP must be sent no later than the filing deadline for the transition year (120 days after the fund's financial year end).

One commenter questioned the authority to revoke individual orders exempting the recipient of that order from provisions in securities regulation. The commenter also questioned the purpose of section 18.6 as the Rule imposes new rules that must be complied with regardless of any previously granted exemption.

Response: We have changed this section so that it allows reliance on previously granted exemptions from provisions that are substantially similar to provisions in the Rule.

Companion Policy

Part 2 – Financial Statements

Two commenters noted that the CP states that if an investment fund sends documents to its securityholders pursuant to standing instructions, it cannot later switch to annual instructions. The commenters do not see anything in the Rule concerning this prohibition.

Response: We have added this prohibition to the Rule.

Part 4 – Other Provisions

One commenter believes that the CSA views expressed in section 4.3 of the CP contravene the "spirit and the letter" of the Handbook, including Section 1100. Another commenter pointed out that the Emerging Issues Committee of the CICA is studying this topic and is expected to issue a pronouncement.

Response: We removed section 4.3 of the CP, and added a requirement in the Rule to disclose the costs of distribution of the investment fund's securities in the notes to the financial statements.

Part 6 – Proxy Voting Disclosure for Securities Held

One commenter noted that earning revenue from securities lending may outweigh the exercise of voting rights in some cases. In securities lending, the proxy voting right accrues to the borrower. The commenter suggested that it may be appropriate to recognize securities lending in the CP and to distinguish between securities held by the fund and securities for which proxies are received. Another commenter suggested that the Rule should ensure that investment funds engaging in securities lending retain the right to vote proxies.

Response: This issue was previously considered by the CSA with respect to mutual funds in the context of the securities lending amendments made to National Instrument 81-102. We have revised the CP to include the view expressed in subsection 3.7(15) of NI 81-102CP. An investment fund's proxy voting policies and procedures should deal with securities lending as appropriate.

Part 10 – Calculation of Management Expense Ratio

One commenter asked for clarification of the types of charges that are contemplated in subsection 10.1(3) of the CP and asked whether a load charged to a top fund's investment in a mutual fund would be included.

Response: We are of the view that amounts charged to retained earnings should be reflected in the MER. The example in the CP has been clarified to mean sales commissions paid by the fund in connection with the sale of the fund's securities. Expenses incurred by an investment fund to acquire portfolio securities are part of the cost of purchasing those securities and will be included in the trading expense ratio.

Three commenters suggested that subsection 10.1(4) of the CP should refer to brokerage *and other portfolio transaction* charges.

Response: We have made this change.

Consequential Amendments

One commenter recommended that the CSA revoke or rescind remaining regulation of investment funds, at least to the extent that this regulation concerns continuous disclosure matters. The commenter recommended that National Policy Statement No. 29 (Mortgage Mutual Funds), National Policy 15 (Scholarship Plans) and OSC Policy Statements 5.3 (Real Estate Funds) and 5.4 (Closed-end funds) be revoked when NI 81-106 comes into force.

Response: We are not making these changes at this time. We will consider these comments in the context of the completion of our reformulation initiative.

Amendments to National Instrument 81-101 Mutual Fund Prospectus Disclosure

One commenter noted that the proposed amendments to Form 81-101F1 do not require mutual funds to state that quarterly portfolio disclosure will be available.

Response: Form 81-101F1 has been amended to indicate that the MRFPs are incorporated by reference into the simplified prospectus. The availability of quarterly portfolio and proxy voting disclosure will be disclosed on the front cover of the MRFP.

One commenter disagrees with the removal of top ten holdings, past performance and financial highlights from the simplified prospectus. In the commenter's view, the simplified prospectus plays a different role for mutual fund investors than does the continuous disclosure regime and the proposed changes will result in investors making investment decisions based on less information.

Response: The amendments to Form 81-101F1 were proposed in the first publication of the Rule (September 2002) and several commenters expressed their agreement with these amendments. The amendments to Form 81-101F1 recognize that mutual funds will now have the obligation to report their primary holdings, past performance and financial highlights in the MRFP, which must be updated on a semi-annual basis, and which is incorporated by reference into the simplified prospectus. We are of the view that the more current information in the MRFP will be more useful to prospective investors than the staler information that is currently in the simplified prospectus.

Amendments to National Instrument 81-102 Mutual Funds

One commenter suggested that the definition of "management expense ratio" be deleted from NI 81-102 as this term will no longer be used in that Instrument.

Response: The term is still used in NI 81-102 (for example, in section 5.4).

One commenter asked why subsection 10.1(4) of NI 81-102 is being deleted and asks whether the CSA intends for all mutual funds to send the notice required by subsection 10.1(3) as a separate annual notice.

Response: Rather than repeal subsection 10.1(4) of NI 81-102, we will amend it to state that the annual notice required by 10.1(3) does not have to be separately provided if it is contained in a document which is sent to all securityholders.

One commenter noted that the CSA proposes to delete the valuation rules provided in section 13.5 Valuation of Specified Derivatives of NI 81-102 without replacing them at this time. The commenter suggested keeping section 13.5 in force until the CSA completes the work on valuation it has indicated it is going to do.

Response: We are of the view that section 13.5 does not provide any additional guidance beyond established industry practice as supported by Canadian GAAP.

One commenter suggested that as the Rule will contain all the substantive regulation with respect to material changes, section 7.4 of 81-102CP should be moved to the CP for proposed NI 81-106.

Response: We have moved the discussion from section 7.4 of 81-102CP into 81-106CP, with appropriate modifications.

Amendments to National Instrument 81-104 Commodity Pools

One commenter recommended that the CSA explain in the CP that commodity pools do not have to prepare quarterly financial statements as they are being treated like other investment funds.

Response: We think that it is clear that for some types of investment funds, the Rule replaces the obligation to file quarterly statements with the obligation to file semi-annual statements.

Schedule 1

List of Commenters

ADP Investor Communications
Sue Britton

AGF Management Limited
Judy G. Goldring

AIC Group of Funds
Jennifer I. McDougall

AIMA Canada
David Jarvis

The Association of Canadian Pension Management
Michael Beswick

Association of Labour Sponsored Investment Funds
Dale Patterson

BMO Harris Investment Management Inc.
R. Ian Niven

BMO Mutual Funds
Edgar Legzdins

BMO Nesbitt Burns Inc.
Connie Stefankiewicz

Barclays Global Investors Canada Limited
Gerry Rocchi

Borden Ladner Gervais
Investment Management Practice Group

Desjardins Trust
Louis Chartrain

Ernst and Young LLP
Ross Pearman

The Ethical Funds Company
Robert Walker

Fasken Martineau
Garth J. Foster

Fidelity Investments Canada Limited
Peter S. Bowen

Gowlings
Paul A. Dempsey

Guardian Group of Funds
Steven P. Rostowsky

The Investment Funds Institute of Canada
John W. Murray, Anne Ramsay, Aamir Mirza

Investors Group Inc.
W. Terrence Wright

Irwin, White & Jennings
Jill W. McFarlane

KAIROS – Canadian Ecumenical Justice Initiatives
Rory O'Brien

KPMG LLP
Alan G. Van Weelden

Leith Wheeler Investment Counsel Ltd.
Cecilia Wong

Mackenzie Financial Corporation
W. Sian B. Brown, Ann Savege, Venkat Kannan

PFSL Investments Canada Ltd.
Joe Yassi

Phillips, Hager & North Investment Management Ltd.
Don S. Panchuk

RBC Financial Group
Reena S. Lalji, Frank Lippa

RESP Dealers Association of Canada
Ray Riley

Simon Romano

Shareholder Association for Research and Education
Gil Yaron

Small Investor Protection Association
Ken Kivenko, Stan I. Buell

Social Investment Organization
Eugene Ellmen

TD Asset Management Inc.
Steve Geist

Tradex Management Inc.
Robert C. White

Westcap Mgt. Ltd.
Trevor S. Giles