Annex D-3

Proposed Changes to
Companion Policy 81-102CP to
National Instrument 81-102 *Investment Funds*

1. ***Companion Policy 81-102CP to National Instrument 81-102 Investment Funds is amended by this Document.***

2. ***Part 2 is changed by adding the following sections:***

2.01 "alternative funds" – The Instrument defines the term "alternative fund" as a mutual fund that has adopted fundamental investment objectives that permit it to invest in asset classes or adopt investment strategies that are otherwise prohibited but for prescribed exemptions from Part 2 of this Instrument. This generally refers to the ability to adopt higher concentration limits, invest in commodities, as well as employ leverage, through borrowing cash, selling securities short or by invest in specified derivatives. This term replaced the term "commodity pool" that was defined under the former National Instrument 81-104 *Commodity Pool* (NI 81-104), which has been repealed. The Canadian securities regulatory authorities will generally deem a mutual fund that was a commodity pool under NI 81-104 to be an alternative fund under this Instrument and will therefore be subject to the provisions in this Instrument applicable to alternative funds. This definition contemplates that the alternative fund's fundamental investment objectives will reflect those fundamental features that distinguish an alternative fund from other types of mutual funds. We would therefore expect that a "conventional" mutual fund that intends to become an alternative fund would need to amend its investment objectives to do so, which would require securityholder approval under Part 5 of the Instrument.

2.3.1 "cleared specified derivative" – the definition of "cleared specified derivative" is intended to apply to derivatives transactions that take place through the facilities of a clearing corporation, where that clearing corporation has been registered or authorized by one of the US Securities and Exchange Commission, the US Commodity Futures Trading Commission or the European Securities and Markets Authority, or is generally recognized as a clearing agency in Canada. This term is part of the codification of certain exemptive relief granted in connection with the adoption of the *Dodd-Frank Wall Street Reform and Consumer Protect Act* in the US and similar legislation in Europe (Dodd-Frank), which mandated that certain types of derivatives transactions be cleared through a clearing corporation registered or authorized by the applicable regulatory agency in the US or Europe. In practice, our expectation is that, given the global efforts to coordinate the clearing mandates of the Dodd-Frank legislation most clearing corporations in operation will be approved by more than one, if not each of the agencies referenced in that definition. The definition of cleared specified derivative in the Instrument does not refer only to those derivatives required to be cleared; it includes derivatives that are voluntarily cleared under the same infrastructure as those subject to mandatory clearing obligation. The Instrument provides exceptions from certain of the restrictions on specified derivatives transactions in section 2.7 for cleared specified derivatives transactions, in recognition of the mandates of the Dodd-Frank legislation,

including the protections and safeguards built into that clearing corporation infrastructure, consistent with the exemptive relief orders. **.**

3. Part 3 is changed by adding the following sections:

3.6.1 Cash Borrowing, Short Selling – (1) subsection 2.6(2), provides an exemption from the general prohibition on cash borrowing by investment funds, to allow alternative funds and non-redeemable investment funds to borrow up to 50% of their net asset value. This is to help facilitate the use of certain alternative strategies that require may require a fund to borrow cash. Borrowing under this provision will be subject to certain restrictions, including restrictions on persons or companies that may act as lenders. Specifically, a fund may only borrow cash from a lender that meets the criteria to qualify as a custodian or sub-custodian under section 6.2 of this Instrument, which is restricted to entities incorporated or registered in Canada. This may include a fund's own custodian or sub-custodian. However, if the proposed lender is an affiliate of the funds' investment fund manager, approval of the fund's independent review committee will be required as this will be viewed as a conflict of interest. Despite this, the Canadian securities regulatory authorities will generally expect that a fund will only seek to borrow from a lender that is an affiliate of the investment fund manager where it is clear that such as arrangement is in the investment fund's best interest, relative to the alternatives.

(2) For short-selling, section 2.6.1 permits alternative funds to exceed the limits on short-selling applicable to mutual funds generally and also exempts alternative funds from the restrictions on cash cover and using the proceeds from short sales to purchase long positions in a security. This is intended to facilitate the use of "long/short" strategies, which is a common strategy in the alternative fund space.

(3) Section 2.6.2 limits the use of these special exemptions for cash borrowing and short-selling by alternative funds, by imposing an overall combined cap on the use of these strategies to 50% of an alternative fund's net asset value. This reflects the view of the Canadian securities regulators that the special exemptions on the short-selling restrictions for alternative funds under section 2.6.1 are another means of facilitating borrowing by the fund. The intent is to limit overall borrowing by an alternative fund to 50% of NAV, whether it is through direct cash borrowing, short selling or a combination of both.

3.6.2 Total Leverage – Section 2.9.1 limits a fund's total exposure through borrowing, short selling or the use of specified derivatives to no more than 3 times the fund's net asset value. This overall limit is in addition to any specific limits applicable to borrowing, short-selling or specified derivatives transactions. For the purposes of the overall leverage limit, the fund's total exposure is to be calculated as the sum of the total amount of cash borrowed by the fund, the market value of all securities sold short, and the gross notional amount of its specified derivatives positions, in the latter case. The calculation of the specified derivatives positions does not allow for any offsetting of hedging transactions. It is intended to reflect a fund's total exposure to transactions that may create leverage, and is not necessarily intended as a measure of the fund's risk exposure. However, we do expect that the prospectus or other

disclosure documents of any investment fund that uses leverage will include specific disclosure concerning the risks associated with these strategies."

3.6.3 Notional Amount – Section 2.9.1 requires an investment fund to determine the notional amount of all of the fund's specified derivatives positions. The Canadian securities regulators are not mandating any specific method to calculate the notion amount of a specified derivative. However, we expect the investment fund to use generally recognized standards to determine the notional amount of a specified derivative and to apply the same methodology consistently when calculating its aggregate gross exposure or its net asset value**..**

4. This document become effective on •.