CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

Notice of
Proposed Amendments to

National Instrument 81-102
Mutual Funds

and to

National Instrument 81-106
Investment Fund Continuous Disclosure

and Related Consequential Amendments

Introduction

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

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

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

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

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

Background

The CSA is currently reviewing the product regulation of conventional mutual funds and other investment funds with a view to modernizing it. The following types of prospectus qualified investment funds are within the scope of this project: (i) conventional mutual funds, (ii) exchange-traded mutual funds and (iii) non-redeemable investment funds.

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

Phase 1

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

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

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

Phase 2

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

(i) no changes to current investment fund product regulation,
(ii) new base level product regulation for all investment funds, or
(iii) less prescriptive product regulation for conventional mutual funds and exchange-traded mutual funds.

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

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

(i) Exchange-Traded Mutual Funds

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

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

Amendments Relating to all Exchange-Traded Mutual Funds

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

Amendments Relating to Exchange-Traded Mutual Funds in Continuous Distribution

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

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

Determination of Redemption Price
Retail investors seeking to dispose of securities of exchange-traded mutual funds in continuous distribution do not normally redeem their holdings as they would with a

conventional mutual fund. Retail investors are more likely to sell their securities in the secondary market through the exchange. Redemptions of exchange-traded mutual funds in continuous distribution are typically only made by designated brokers. A designated broker will typically purchase fund securities in the secondary market and redeem these securities in large quantities set by the manager of the mutual fund known as a manager-prescribed number of units.

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

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

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

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

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

Organizational Costs
We propose to amend section 3.3 to create an exemption for exchange-traded mutual funds not in continuous distribution from the prohibition of the reimbursement of organizational costs. Conventional mutual funds are prohibited from reimbursing their manager or promoters for or funding their organizational costs on the basis that these costs would be prejudicial to the initial investors in the mutual fund. This is not the case in a one time offering where all the securities of the mutual fund are sold to investors on the closing of the offering and not through continuous distribution.

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

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

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

Amendments Relating to Fixed Portfolio Exchange-Traded Mutual Funds

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

Concentration Restriction
We propose to amend section 2.1 to create an exemption from the concentration restriction for purchases of equity securities by a fixed portfolio exchange-traded mutual fund in accordance with its investment objectives. We have added this exemption in recognition of the fact that these funds typically make concentrated investments. The issuers in which a fixed portfolio exchange-traded mutual fund invests would be disclosed in the fund's prospectus along with disclosure in the prospectus or annual information form about concentration risk.

(ii) Investments in Other Mutual Funds

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

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

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

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

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

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

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

(iii) Short Selling

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

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

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

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

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

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

(iv) Derivatives

Cash Cover
We propose amending the definition of "cash cover" in the Instrument to include:

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

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

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

(v) Money Market Funds

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

(i) whether a specific concentration restriction for money market funds would be appropriate;
(ii) whether to further restrict the types of investments a money market fund can make;
(iii) whether assets such as asset-backed short-term debt are appropriate as eligible assets in the definition of "cash cover" and "qualified security";
(iv) whether short-term debt instruments, including asset-backed commercial paper with a specified credit rating, should be permitted to be aggregated in a statement of investment portfolio.

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

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

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

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

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

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

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

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

We seek feedback on whether you agree or disagree with the 90 and 120-day dollar-weighted average term to maturity limits and whether there should be any limit on the exposure of a money market fund to floating rate notes. We also seek feedback on whether the 90-day limit should be reduced to a shorter time frame as is the case in the money market funds rules approved by the United States Securities and Exchange Commission on January 27, 2010, which specify a 60-day limit.

(vi) Mutual Fund Dealers

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

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

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

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

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

We understand that because the cash sits in the trust account for a very brief period of time before being disbursed, the amount of interest earned on the trust account and remitted by a dealer is most often nominal. We further understand that costs to implement the internal controls and procedures necessary to comply with the interest determination, allocation and distribution requirements are significant relative to the amount of interest paid out.

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

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

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

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

(vii) Mutual Fund Ratings

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

Use of Mutual Fund Ratings in Sales Communications
We propose to amend section 15.3 to clarify how mutual funds may use performance ratings or rankings in sales communications. Mutual funds that wish to utilize ratings or rankings in sales communications would still be required to present the rating or ranking for each period in which standard performance data is required to be given except for the period since the mutual fund's inception. It is not possible to accurately compare the performance of one mutual fund to another on a since inception basis because each fund may have a different inception date. The amendments would also permit mutual funds to

provide an overall rating or ranking in addition to the ratings or rankings based on standard periods of performance.

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

(viii) Drafting Changes

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

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

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

Summary and Purpose of the Amendments to National Instrument 81-106

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

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

Limited Life Funds
The CSA has frequently granted relief from certain continuous disclosure requirements to investment funds that we consider to be limited life funds such as flow-through limited partnerships. As part of these amendments, we propose to add a definition of "limited life fund" to NI 81-106. A limited life fund would be defined as an investment fund

established to fulfil a specific short-term objective, whose securities are not redeemable and not listed on an exchange or quoted on an over-the-counter market. The limited life fund's prospectus must also disclose that the manager intends to cause the fund to be terminated within 24 months of its formation.

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

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

Related Consequential Amendments

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

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

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

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

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

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

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

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

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

Alternatives Considered

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

Anticipated Costs and Benefits

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

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

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

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

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

Local Rule Amendments

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

Materials Published

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

Annex A – proposed amendments to NI 81-102 and to 81-102CP
Annex B – proposed amendments to NI 81-101, Form 81-101F1 and Form 81-101F2
Annex C – proposed amendments to NI 41-101 and Form 41-101F2
Annex D – proposed amendments to NI 81-106
Annex E – local amendments or local information

Unpublished Materials

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

Request for Comments

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

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

Thank you in advance for your comments.

Deadline for Comments

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

Please send your comments electronically in Word, Windows format.

Where to Send Your Comments

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

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

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

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, ON M5H 3S8
Fax: 416-593-2318
E-mail: jstevenson@osc.gov.on.ca

M^e^ Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Fax : 514-864-6381
E-mail: consultation-en-cours@lautorite.qc.ca

Questions

Please refer your questions to any of,

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