

ANNEX A

Proposed Amendment to National Instrument 81-102 *Mutual Funds*

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

““borrowing agent” means any of the following:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

“ “mutual fund rating entity” means an entity

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

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

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

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

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

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

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

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

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

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

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

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

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

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

5. ***Section 2.1 is amended by:***

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

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

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

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

6. ***Section 2.2 is amended by:***

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

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

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

7. ***Section 2.5 is amended by:***

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

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

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

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

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

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

8. *Section 2.6 is amended by:*

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

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

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

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

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

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

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

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

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

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

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

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

(ii) an illiquid asset;

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

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

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

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

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

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

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

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

“ **2.7 Transactions in Specified Derivatives for Hedging and Non-hedging Purposes** – (1) A mutual fund may not purchase an option that is not a clearing corporation option or a debt-like security or enter into a swap or a forward contract unless at the time of the transaction, the option, debt-like security, swap or contract, or equivalent debt of the counterparty, or of a person or company that has fully and unconditionally guaranteed the obligations of the counterparty in respect of the option, debt-like security, swap or contract, has an approved credit rating. ”.

11. Section 2.11 is replaced with the following:

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

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

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

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

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

13. The following section is added after section 2.17:

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

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

(i) cash,

(ii) cash equivalents,

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

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

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

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

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

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

(i) 120 days, and

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

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

(d) it has not less than

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

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

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

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

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

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

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

17. Section 4.1 is amended

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

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

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

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

19. *Section 5.3 is amended*

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

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

(a) the mutual fund

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

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

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

(b) the mutual fund

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

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

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

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

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

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

(a) *paragraph 7.1(c);*

(b) *paragraph 8.1(a);*

(c) *paragraph 9.2(c).*

26. *Section 9.4 is amended*

(a) *in subsection (1) by*

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

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

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

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

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

(b) good delivery of securities if

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

33. Section 14.1 is replaced with the following:

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

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

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

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

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

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

35. Section 15.3 is amended by:

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

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

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

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

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

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

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

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

(e) the sales communication contains the following disclosure:

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

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

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

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

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

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

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

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

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

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

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

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

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

(a) subsection 15.4(9);

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

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

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

(e) section 15.12;

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

(g) paragraph 20.4(b).

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

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

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