

**AMENDMENT TO
NATIONAL INSTRUMENT 81-102
MUTUAL FUNDS**

PART 1 AMENDMENTS

1.1 Amendments

(1) Section 1.1 of National Instrument 81-102 Mutual Funds is amended by

(a) the addition of the following as paragraphs 5 and 6 of the definition of "cash cover":

"5. Securities purchased by the mutual fund in a reverse repurchase transaction under section 2.14, to the extent of the cash paid for those securities by the mutual fund.

6. Commercial paper that has a term to maturity of 365 days or less and an approved credit rating and that was issued by a person or company other than a government or permitted supranational agency.";

(b) the deletion of the definition of "index mutual fund" and the substitution of the following:

““index mutual fund” means a mutual fund that has adopted fundamental investment objectives that require the mutual fund to

(a) hold the securities that are included in a permitted index or permitted indices of the mutual fund in substantially the same proportion as those securities are reflected in that permitted index or those permitted indices, or

(b) invest in a manner that causes the mutual fund to replicate the performance of that permitted index or those permitted indices;”;

(c) the addition of the following definition:

““permitted index” means, in relation to a mutual fund, a market index that is

(a) both

- (i) administered by an organization that is not affiliated with any of the mutual fund, its manager, its portfolio adviser or its principal distributor, and
 - (ii) available to persons or companies other than the mutual fund, or
- (b) widely recognized and used;"
- (d) the addition of the following definition:

““qualified security” means
 - (a) an evidence of indebtedness that is issued, or fully and unconditionally guaranteed as to principal and interest, by
 - (i) the government of Canada or the government of a jurisdiction,
 - (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, or
 - (iii) a Canadian financial institution or a financial institution that is not incorporated or organized under the laws of Canada or of a jurisdiction if, in either case, evidences of indebtedness of that issuer or guarantor that are rated as short term debt by an approved credit rating organization have an approved credit rating, or
 - (b) commercial paper that has a term to maturity of 365 days or less and an approved credit rating and that was issued by a person or company other than a government or permitted supranational agency;" and
- (e) the deletion of item 1 of paragraph (b) of the definition of "sales communication", and the renumbering of existing items 2 through 6 of that paragraph as items 1 through 5.

(2) National Instrument 81-102 is amended by the renumbering of section 1.3 as subsection 1.3(1), and by the addition of the following as subsections 1.3(2) and (3):

"(2) A mutual fund that renews or extends a securities lending, repurchase or reverse repurchase transaction is entering into a securities lending, repurchase or reverse repurchase agreement for the purposes of section 2.12, 2.13 or 2.14.

(3) In this Instrument, a reference to a "simplified prospectus" includes a prospectus, a reference to a "preliminary simplified prospectus" includes a preliminary prospectus and a reference to a "*pro forma* simplified prospectus" includes a *pro forma* prospectus."

(3) National Instrument 81-102 is amended by

(a) the deletion of the words "prospectus or" in each of paragraph 1.2(a), paragraph 8.1(a), paragraph 17.3(2)(a) and paragraph 20.4(b);

(b) the addition of the word "simplified" immediately before the word "prospectus" in paragraph 1.2(b); and

(c) the deletion of the words "preliminary prospectus or" and "prospectus or" in subsection 15.4(9).

(4) Section 2.1 of National Instrument 81-102 Mutual Funds is amended by the addition of the following as subsections 2.1(5), (6) and (7):

"(5) Despite subsection (1), an index mutual fund, the name of which includes the word "index", may purchase a security, enter into a specified derivatives transaction or purchase index participation units if required to allow the index mutual fund to satisfy its fundamental investment objectives.

(6) An index mutual fund shall not rely on the relief provided by subsection (5) unless

(a) its simplified prospectus contains the disclosure referred to in subsection (5) of Item 6 and subsection (5) of Item 9 of Part B of Form 81-101F1 Contents of Simplified Prospectus; and

- (b) the index mutual fund has provided to its securityholders written notice given not less than 60 days before it first relies on the relief provided by subsection (5), that discloses that it may, from time to time, rely on that relief and that contains the disclosure referred to in paragraph (a).
- (7) Paragraph (6)(b) does not apply if each simplified prospectus of the index mutual fund since its inception contains the disclosure referred to in paragraph (6)(a).”
- (5) National Instrument 81-102 is amended by the deletion of subsections 2.7(1) and (2) and the substitution of the following:
 - "(1) A mutual fund shall 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
 - (a) in the case of an option, swap or forward contract, the option, swap or contract has a remaining term to maturity of
 - (i) three years or less, or
 - (ii) between three and five years if, at the time of the transaction, the option, swap or contract provides the mutual fund with a right, at its election, to eliminate its exposure under the option, swap or contract no later than three years after the mutual fund has purchased the option or entered into the swap or contract; and
 - (b) 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.
 - (2) If the credit rating of an option that is not a clearing corporation option, the credit rating of a debt-like security, swap or forward contract, or the credit rating of the equivalent debt of the writer or guarantor of the option, debt-like security, swap or contract, falls

below the level of approved credit rating while the option, debt-like security, swap or contract is held by a mutual fund, the mutual fund shall take the steps that are reasonably required to close out its position in the option, debt-like security, swap or contract in an orderly and timely fashion."

- (6) National Instrument 81-102 is amended by the addition of the following as section 2.12:

"2.12 Securities Loans

- (1) Despite any other provision of this Instrument, a mutual fund may enter into a securities lending transaction as lender if the following conditions are satisfied for the transaction:
1. The transaction is administered and supervised in the manner required by sections 2.15 and 2.16.
 2. The transaction is made under a written agreement that implements the requirements of this section.
 3. Securities are loaned by the mutual fund in exchange for collateral.
 4. The securities transferred, either by the mutual fund or to the mutual fund as collateral, as part of the transaction are immediately available for good delivery under applicable legislation.
 5. The collateral to be delivered to the mutual fund at the beginning of the transaction
 - (a) is received by the mutual fund either before or at the same time as it delivers the loaned securities; and
 - (b) has a market value equal to at least 102 percent of the market value of the loaned securities.
 6. The collateral to be delivered to the mutual fund is one or more of
 - (a) cash;

- (b) qualified securities;
 - (c) securities that are immediately convertible into, or exchangeable for, securities of the same issuer, class or type, and the same term, if applicable, as the securities that are being loaned by the mutual fund, and in at least the same number as those loaned by the mutual fund; or
 - (d) irrevocable letters of credit issued by a Canadian financial institution that is not the counterparty, or an affiliate of the counterparty, of the mutual fund in the transaction, if evidences of indebtedness of the Canadian financial institution that are rated as short term debt by an approved credit rating organization have an approved credit rating.
7. The collateral and loaned securities are marked to market on each business day, and the amount of collateral in the possession of the mutual fund is adjusted on each business day to ensure that the market value of collateral maintained by the mutual fund in connection with the transaction is at least 102 percent of the market value of the loaned securities.
 8. If an event of default by a borrower occurs, the mutual fund, in addition to any other remedy available under the agreement or applicable law, has the right under the agreement to retain and dispose of the collateral to the extent necessary to satisfy its claims under the agreement.
 9. The borrower is required to pay promptly to the mutual fund amounts equal to and as compensation for all dividends and interest paid, and all distributions made, on the loaned securities during the term of the transaction.
 10. The transaction is a "securities lending arrangement" under section 260 of the ITA.
 11. The mutual fund is entitled to terminate the transaction at any time and recall the loaned securities within the normal and customary settlement period for securities lending transactions in the market in which the securities are lent.

12. Immediately after the mutual fund enters into the transaction, the aggregate market value of all securities loaned by the mutual fund in securities lending transactions and not yet returned to it or sold by the mutual fund in repurchase transactions under section 2.13 and not yet repurchased does not exceed 50 percent of the total assets of the mutual fund, and for such purposes collateral held by the mutual fund for the loaned securities and cash held by the mutual fund for the sold securities shall not be included in total assets.
- (2) A mutual fund may hold all cash delivered to it as the collateral in a securities lending transaction or may use the cash to purchase
 - (a) qualified securities having a remaining term to maturity no longer than 90 days;
 - (b) securities under a reverse repurchase agreement permitted by section 2.14; or
 - (c) a combination of the securities referred to in paragraphs (a) and (b).
 - (3) A mutual fund, during the term of a securities lending transaction, shall hold all, and shall not invest or dispose of any, non-cash collateral delivered to it as collateral in the transaction."
- (7) National Instrument 81-102 is amended by the addition of the following as section 2.13:

"2.13 Repurchase Transactions

- (1) Despite any other provision of this Instrument, a mutual fund may enter into a repurchase transaction if the following conditions are satisfied for the transaction:
 1. The transaction is administered and supervised in the manner required by sections 2.15 and 2.16.
 2. The transaction is made under a written agreement that implements the requirements of this section.

3. Securities are sold for cash by the mutual fund, with the mutual fund assuming an obligation to repurchase the securities for cash.
4. The securities transferred by the mutual fund as part of the transaction are immediately available for good delivery under applicable legislation.
5. The cash to be delivered to the mutual fund at the beginning of the transaction
 - (a) is received by the mutual fund either before or at the same time as it delivers the sold securities; and
 - (b) is in an amount equal to at least 102 percent of the market value of the sold securities.
6. The sold securities are marked to market on each business day, and the amount of sale proceeds in the possession of the mutual fund is adjusted on each business day to ensure that the amount of cash maintained by the mutual fund in connection with the transaction is at least 102 percent of the market value of the sold securities.
7. If an event of default by a purchaser occurs, the mutual fund, in addition to any other remedy available under the agreement or applicable law, has the right under the agreement to retain or dispose of the sale proceeds delivered to it by the purchaser to the extent necessary to satisfy its claims under the agreement.
8. The purchaser of the securities is required to pay promptly to the mutual fund amounts equal to and as compensation for all dividends and interest paid, and all distributions made, on the sold securities during the term of the transaction.
9. The transaction is a "securities lending arrangement" under section 260 of the ITA.

10. The term of the repurchase agreement, before any extension or renewal that requires the consent of both the mutual fund and the purchaser, is not more than 30 days.
 11. Immediately after the mutual fund enters into the transaction, the aggregate market value of all securities loaned by the mutual fund in securities lending transactions under section 2.12 and not yet returned to it or sold by the mutual fund in repurchase transactions and not yet repurchased does not exceed 50 percent of the total assets of the mutual fund, and for such purposes collateral held by the mutual fund for the loaned securities and the cash held by the mutual fund for the sold securities shall not be included in total assets.
- (2) A mutual fund may hold cash delivered to it as consideration for sold securities in a repurchase transaction or may use the cash to purchase
- (a) qualified securities having a remaining term to maturity no longer than 30 days;
 - (b) securities under a reverse repurchase agreement permitted by section 2.14; or
 - (c) a combination of the securities referred to in paragraphs (a) and (b)."
- (8) National Instrument 81-102 is amended by the addition of the following as section 2.14:

"2.14 Reverse Repurchase Transactions

- (1) Despite any other provision of this Instrument, a mutual fund may enter into a reverse repurchase transaction if the following conditions are satisfied for the transaction:
 1. The transaction is administered and supervised in the manner required by sections 2.15 and 2.16.
 2. The transaction is made under a written agreement that implements the requirements of this section.

3. Qualified securities are purchased for cash by the mutual fund, with the mutual fund assuming the obligation to resell them for cash.
4. The securities transferred as part of the transaction are immediately available for good delivery under applicable legislation.
5. The securities to be delivered to the mutual fund at the beginning of the transaction
 - (a) are received by the mutual fund either before or at the same time as it delivers the cash used by it to purchase those securities; and
 - (b) have a market value equal to at least 102 percent of the cash paid for the securities by the mutual fund.
6. The purchased securities are marked to market on each business day, and either the amount of cash paid for the purchased securities or the amount of purchased securities in the possession of the seller or the mutual fund is adjusted on each business day to ensure that the market value of purchased securities held by the mutual fund in connection with the transaction is not less than 102 percent of the cash paid by the mutual fund.
7. If an event of default by a seller occurs, the mutual fund, in addition to any other remedy available in the agreement or applicable law, has the right under the agreement to retain or dispose of the purchased securities delivered to it by the seller to the extent necessary to satisfy its claims under the agreement.
8. The transaction is a "securities lending arrangement" under section 260 of the ITA.
9. The term of the reverse repurchase agreement, before any extension or renewal that requires the consent of both the seller and the mutual fund, is not more than 30 days.”.

- (9) National Instrument 81-102 is amended by the addition of the following as section 2.15:

"2.15 Agent for Securities Lending, Repurchase and Reverse Repurchase Transactions

- (1) The manager of a mutual fund shall appoint an agent or agents to act on behalf of the mutual fund in administering the securities lending and repurchase transactions entered into by the mutual fund.
- (2) The manager of a mutual fund may appoint an agent or agents to act on behalf of the mutual fund to administer the reverse repurchase transactions entered into by the mutual fund.
- (3) The custodian or a sub-custodian of the mutual fund shall be the agent appointed under subsection (1) or (2).
- (4) The manager of a mutual fund shall not authorize an agent to enter into a securities lending, repurchase or, if applicable, reverse repurchase transactions on behalf of the mutual fund until the agent enters into a written agreement with the manager and the mutual fund in which
 - (a) the mutual fund and the manager provide instructions to the agent on the parameters to be followed in entering into the type of transactions to which the agreement pertains;
 - (b) the agent agrees to comply with this Instrument, accepts the standard of care referred to in subsection (5) and agrees to ensure that all transactions entered into by it on behalf of the mutual fund will comply with this Instrument; and
 - (c) the agent agrees to provide to the mutual fund and the manager regular, comprehensive and timely reports summarizing the mutual fund's securities lending, repurchase and reverse repurchase transactions, as applicable.

- (5) An agent appointed under this section, in administering the securities lending, repurchase and, if applicable, reverse repurchase transactions of the mutual fund shall exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances."
- (10) National Instrument 81-102 is amended by the addition of the following as section 2.16:

"2.16 Controls and Records

- (1) A mutual fund shall not enter into transactions under sections 2.12, 2.13 or 2.14 unless,
 - (a) for transactions to be entered into through an agent appointed under section 2.15, the manager has reasonable grounds to believe that the agent has established and maintains appropriate internal controls and procedures and records; and
 - (b) for reverse repurchase transactions directly entered into by the mutual fund without an agent, the manager has established and maintains appropriate internal controls, procedures and records.
- (2) The internal controls, procedures and records referred to in subsection (1) shall include
 - (a) a list of approved borrowers, purchasers and sellers based on generally accepted creditworthiness standards;
 - (b) as applicable, transaction and credit limits for each counterparty; and
 - (c) collateral diversification standards.
- (3) The manager of a mutual fund shall, on a periodic basis not less frequently than annually,
 - (a) review the agreements with any agent appointed under section 2.15 to determine if the agreements are in compliance with this Instrument;

- (b) review the internal controls described in subsection (2) to ensure their continued adequacy and appropriateness;
- (c) make reasonable enquiries as to whether the agent is administering the securities lending, repurchase or reverse repurchase transactions of the mutual fund in a competent and responsible manner, in conformity with the requirements of this Instrument and in conformity with the agreement between the agent, the manager and the mutual fund entered into under subsection 2.15(4);
- (d) review the terms of any agreement between the mutual fund and an agent entered into under subsection 2.15(4) in order to determine if the instructions provided to the agent in connection with the securities lending, repurchase or reverse repurchase transactions of the mutual fund continue to be appropriate; and
- (e) make or cause to be made any changes that may be necessary to ensure that
 - (i) the agreements with agents are in compliance with this Instrument,
 - (ii) the internal controls described in subsection (2) are adequate and appropriate,
 - (iii) the securities lending, repurchase or reverse repurchase transactions of the mutual fund are administered in the manner described in paragraph (c), and
 - (iv) the terms of each agreement between the mutual fund and an agent entered into under subsection 2.15(4) are appropriate."

(11) National Instrument 81-102 is amended by the addition of the following as section 2.17:

"2.17 Commencement of Securities Lending, Repurchase and Reverse Repurchase Transactions by a Mutual Fund

- (1) A mutual fund shall not enter into securities lending, repurchase or reverse repurchase transactions unless
 - (a) its simplified prospectus contains the disclosure required for mutual funds entering into those types of transactions; and
 - (b) the mutual fund has provided to its securityholders, not less than 60 days before it begins entering into those types of transactions, written notice that discloses its intent to begin entering into those types of transactions and the disclosure required for mutual funds entering into those types of transactions.
 - (2) Paragraph (1)(b) does not apply to a mutual fund that has entered into reverse repurchase agreements as permitted by a decision of the securities regulatory authority or regulator.”.
- (12) National Instrument 81-102 is amended by the deletion of section 4.2 and the substitution of the following:

"4.2 Self-Dealing

- (1) A mutual fund shall not purchase a security from, sell a security to, or enter into a securities lending, repurchase or reverse repurchase transaction under section 2.12, 2.13 or 2.14 with, any of the following persons or companies:
 1. The manager, portfolio adviser or trustee of the mutual fund.
 2. A partner, director or officer of the mutual fund or of the manager, portfolio adviser or trustee of the mutual fund.
 3. An associate or affiliate of a person or company referred to in paragraph 1 or 2.
 4. A person or company, having fewer than 100 securityholders of record, of which a partner,

director or officer of the mutual fund or a partner, director or officer of the manager or portfolio adviser of the mutual fund is a partner, director, officer or securityholder.

- (2) Subsection (1) applies in the case of a sale of a security to, or a purchase of a security from, a mutual fund only if the person or company that would be selling to, or purchasing from, the mutual fund would be doing so as principal."
- (13) National Instrument 81-102 is amended by the deletion of subsection 4.4(5), the substitution of subsection (5) below as the new subsection (5) and the addition of subsection (6) below as subsection (6):
- "(5) This section does not apply to any losses to a mutual fund or securityholder arising out of an action or inaction by
- (a) a director of the mutual fund; or
 - (b) a custodian or sub-custodian of the mutual fund, except as set out in subsection (6).
- (6) This section applies to any losses to a mutual fund or securityholder arising out of an action or inaction by a custodian or sub-custodian acting as agent of the mutual fund in administering the securities lending, repurchase or reverse repurchase transactions of the mutual fund."
- (14) National Instrument 81-102 is amended by
- (a) the addition of the words "or regulator" immediately after the words "securities regulatory authority" in subsections 5.5(1), 5.5(2) and 5.6(1) and section 5.9; and
 - (b) the addition of the following as subsection 5.5(3):
- "(3) Despite subsection (1), in Ontario only the regulator may grant an approval referred to in subsection (1)."
- (15) Paragraph 6.3(3)(b) of National Instrument 81-102 is amended by striking out "subsidiary" and substituting "affiliate".

- (16) National Instrument 81-102 is amended by
- (a) changing the title of section 6.8 to "Custodial Provisions relating to Derivatives and Securities Lending, Repurchase and Reverse Repurchase Agreements";
 - (b) the deletion of subsection 6.8(4) and the substitution of the following:
 - "(4) The agreement by which portfolio assets of a mutual fund are deposited in accordance with subsection (1), (2) or (3) shall require the person or company holding portfolio assets of the mutual fund so deposited to ensure that its records show that that mutual fund is the beneficial owner of the portfolio assets."; and
 - (c) by the addition of the following as subsection 6.8(5):
 - "(5) A mutual fund may deliver portfolio assets to a person or company in satisfaction of its obligations under a securities lending, repurchase or reverse purchase agreement that complies with this Instrument if the collateral, cash proceeds or purchased securities that are delivered to the mutual fund in connection with the transaction are held under the custodianship of the custodian or a sub-custodian of the mutual fund in compliance with this Part."
- (17) National Instrument 81-102 is amended by the deletion of the words "immediately before the close of business" in paragraph 9.4(4)(a).
- (18) National Instrument 81-102 is amended by the deletion of subsection 11.4(1) and the substitution of the following:
- "(1) Sections 11.1 and 11.2 do not apply to members of The Investment Dealers Association of Canada, The Montreal Exchange, The Toronto Stock Exchange or the Canadian Venture Exchange Inc."
- (19) National Instrument 81-102 is amended by the deletion of subsection 12.1(4) and the substitution of the following:

- "(4) Subsection (3) does not apply to members of The Investment Dealers Association of Canada, The Montreal Exchange, The Toronto Stock Exchange or the Canadian Venture Exchange Inc."
- (20) National Instrument 81-102 is amended by the deletion of subsection 15.4(12).
- (21) National Instrument 81-102 is amended by the deletion of subparagraph 15.6(a)(i) and the substitution of the following:
- "(i) the mutual fund has distributed securities under a simplified prospectus in a jurisdiction for 12 consecutive months, or the asset allocation service has been operated for at least 12 consecutive months and has invested only in participating funds each of which has distributed securities under a simplified prospectus in a jurisdiction for at least 12 consecutive months, or"
- (22) National Instrument 81-102 is amended by the addition of the following as section 15.14:

"Sales Communication - Multi-Class Mutual Funds - A sales communication for a mutual fund that distributes different classes or series of securities that are referable to the same portfolio shall not contain performance data unless the sales communication complies with the following requirements:

1. The sales communication clearly specifies the class or series of security to which any performance data contained in the sales communication relates.
2. If the sales communication refers to more than one class or series of security and provides performance data for any one class or series, the sales communication shall provide performance data for each class or series of security referred to in the sales communication and shall clearly explain the reasons for different performance data among the classes or series.
3. A sales communication for a new class or series of security and an existing class or series of security shall not contain performance data for the existing class or series

unless the sales communication clearly explains any differences between the new class or series and the existing class or series that could affect performance."

- (23) Section 16.1 of National Instrument 81-102 is amended by the deletion of subparagraph (1)(a)(i) and the substitution of the following:

"(i) the total expenses of the mutual fund, before income taxes, for the financial year, as shown on its income statement,".

- (24) National Instrument 81-102 is amended by the addition of the following as subsection 16.1(4):

"(4) The requirements to provide note disclosure contained in subsections (2) and (3) do not apply if a mutual fund provides its management expense ratio to a service provider that will arrange for public dissemination of the management expense ratio, if the mutual fund indicates, as applicable, that management fees have been waived or that management fees were paid directly by investors during the period for which the management expense ratio was calculated."

- (25) National Instrument 81-102 is amended by the renumbering of existing subsections 16.1(4), (5), (6), (7) and (8) as subsections 16.1(5), (6), (7), (8) and (9), respectively.

- (26) National Instrument 81-102 is amended by the deletion of section 16.2 and the substitution of the following:

"16.2 Fund of Funds Calculation

- (1) For the purposes of subparagraph 16.1(1)(a)(i), the total expenses of a mutual fund that invests in securities of one or more other mutual funds is equal to the sum of:

(a) the total expenses incurred by the mutual fund that are for the period that the calculation of management expense ratio is made and that are attributable to its investment in each underlying mutual fund, as calculated by

- (i) multiplying the total expenses of each underlying mutual fund, before income taxes, for the period, by
 - (ii) the average proportion of securities of the underlying mutual fund held by the mutual fund during the period, calculated by
 - (A) adding together the proportion of securities of the underlying mutual fund held by the mutual fund on each day in the period, and
 - (B) dividing the amount obtained under clause (A) by the number of days in the period; and
 - (b) the total expenses of the mutual fund, before income taxes, for the period.
- (2) A mutual fund that has exposure to one or more other mutual funds through the use of specified derivatives in a financial year shall calculate its management expense ratio for the financial year in the manner described in subsection (1), treating each mutual fund to which it has exposure as an "underlying mutual fund" under subsection (1).
- (3) Subsection (2) does not apply if the specified derivatives do not expose the mutual fund to expenses that would be incurred by a direct investment in the relevant mutual funds.
- (4) Despite subsection 16.1(5), management fees rebated by an underlying fund to a mutual fund that invests in the underlying fund shall be deducted from total expenses of the underlying fund if the rebate is made for the purpose of avoiding duplication of fees between the two mutual funds.”
- (27) National Instrument 81-102 is amended by the addition of the following as section 16.3:

"16.3 Application of Section 16.1 - Section 16.1 does not apply to a mutual fund in respect of a financial year that ended before February 1, 2000 if the management expense ratio for that

financial year is disclosed and calculated in accordance with securities legislation applicable to mutual funds on January 31, 2000."

- (28) National Instrument 81-102 is amended by the deletion of section 20.3 and the substitution of the following:

"20.3 Reports to Securityholders - This Instrument does not apply to reports to securityholders

- (a) printed before February 1, 2000; or
- (b) that include only financial statements that relate to financial periods that ended before February 1, 2000."

PART 2 EFFECTIVE DATE

2.1 Effective Date - This Amendment comes into force on May 2, 2001.

**AMENDMENT TO
COMPANION POLICY 81-102CP
MUTUAL FUNDS**

PART 1 AMENDMENTS

1.1 Amendments

(1) Companion Policy 81-102CP is amended by the addition of the following as paragraph 5 of subsection 2.13(2):

"5. (a) The mutual fund has become legally entitled to dispose of the collateral held by it under a securities loan or repurchase agreement and to apply proceeds of realization to satisfy the obligations of the counterparty of the mutual fund under the transaction, and

(b) sufficient time has passed after the event described in paragraph (a) to enable the mutual fund to sell the collateral in a manner that maintains an orderly market and that permits the preservation of the best value for the mutual fund."

(2) Companion Policy 81-102CP is amended by the deletion of subsection 2.16(2), the substitution of subsection (2) below as the new subsection 2.16(2) and the addition of subsection (3) below as subsection 2.16(3):

“(2) Because of the broad ambit of the lead-in language to the definition, it is impossible to list every instrument, agreement or security that might be caught by that lead-in language but that is not considered to be a derivative in any normal commercial sense of that term. The Canadian securities regulatory authorities consider conventional floating rate debt instruments, securities of a mutual fund or commodity pool, non-redeemable securities of an investment fund, American depositary receipts and instalment receipts generally to be within this category, and generally will not treat those instruments as specified derivatives in administering the Instrument.

(3) However, the Canadian securities regulatory authorities note that these general exclusions may not be applicable in cases in which a mutual fund invests in one of the vehicles described in subsection

(2) with the result that the mutual fund obtains or increases exposure to a particular underlying interest in excess of the limit set out in section 2.1 of the Instrument. In such circumstances, the Canadian securities regulatory authorities are likely to consider that instrument a specified derivative under the Instrument.”

- (3) Companion Policy 81-102CP is amended by the addition of the following as section 3.2, and the consequent renumbering of existing sections 3.2, 3.3, 3.4 and 3.5 as sections 3.3, 3.4, 3.5 and 3.6, respectively:

"3.2 Index Mutual Funds

- (1) An "index mutual fund" is defined in section 1.1 of the Instrument as a mutual fund that has adopted fundamental investment objectives that require it to
- (a) hold the securities that are included in a permitted index or permitted indices of the mutual fund in substantially the same proportion as those securities are reflected in that permitted index or permitted indices; or
 - (b) invest in a manner that causes the mutual fund to replicate the performance of that permitted index or those permitted indices.
- (2) This definition includes only mutual funds whose entire portfolio is invested in accordance with one or more permitted indices. The CSA recognizes that there may be mutual funds that invest part of their portfolio in accordance with a permitted index or indices, with a remaining part of the portfolio being actively managed. Those mutual funds cannot avail themselves of the relief provided by subsection 2.1(5) of the Instrument, which provides relief from the "10 percent rule" contained in subsection 2.1(1) of the Instrument, because they are not "index mutual funds". The CSA acknowledge that there may be circumstances in which the principles behind the relief contained in subsection 2.1(5) of the Instrument is also applicable to "partially-indexed" mutual funds. Therefore, the CSA will consider applications from those types of mutual funds for relief analogous to that provided by subsection 2.1(5) of the Instrument.
- (3) It is noted that the manager of an index mutual fund may make a decision to base all or some of the investments of the mutual fund

on a different permitted index than a permitted index previously used. This decision might be made for investment reasons or because that index no longer satisfies the definition of "permitted index" in the Instrument. It is noted that this decision by the manager will be considered by the Canadian securities regulatory authorities generally to constitute a change of fundamental investment objectives, thereby requiring securityholder approval under paragraph 5.1(c) of the Instrument. In addition, this decision would also constitute a significant change for the mutual fund, thereby requiring an amendment to the simplified prospectus of the mutual fund and the issuing of a press release under section 5.10 of the Instrument."

- (4) Companion Policy 81-102CP is amended by the addition of the following as section 3.7:

"3.7 Securities Lending, Repurchase and Reverse Repurchase Transactions

- (1) Section 2.12, 2.13 and 2.14 of the Instrument each contains a number of conditions that must be satisfied in order that a mutual fund may enter into a securities lending, repurchase or reverse repurchase transaction in compliance with the Instrument. It is expected that, in addition to satisfying these conditions, the manager on behalf of the mutual fund, in co-ordination with an agent, will ensure that the documentation evidencing these types of transactions contains customary provisions to protect the mutual fund and to document the transaction properly. Among other things, these provisions would normally include
- (a) a definition of an "event of default" under the agreement, which would include failure to deliver cash or securities, or to promptly pay to the mutual fund amounts equal to dividends and interest paid, and distributions made, on loaned or sold securities, as required by the agreement;
 - (b) provisions giving non-defaulting parties rights of termination, rights to sell the collateral, rights to purchase identical securities to replace the loaned securities and legal rights of set-off in connection with their obligations if an event of default occurs; and

- (c) provisions that deal with, if an event of default occurs, how the value of collateral or securities held by the non-defaulting party that is in excess of the amount owed by the defaulting party will be treated.
- (2) Section 2.12, 2.13 and 2.14 of the Instrument each imposes a requirement that a mutual fund that has entered into a securities lending, repurchase or reverse repurchase transaction hold cash or securities of at least 102 percent of the market value of the securities or cash held by the mutual fund's counterparty under the transaction. It is noted that the 102 percent requirement is a minimum requirement, and that it may be appropriate for the manager of a mutual fund, or the agent acting on behalf of the mutual fund, to negotiate the holding of a greater amount of cash or securities if necessary to protect the interests of the mutual fund in a particular transaction, having regard to the level of risk for the mutual fund in the transaction. In addition, if the recognized best practices for a particular type of transaction in a particular market calls for a higher level of collateralization than 102 percent, it is expected that, absent special circumstances, the manager or the agent would ensure that its arrangements reflect the relevant best practices for that transaction.
- (3) Paragraph 3 of subsection 2.12(1) of the Instrument refers to securities lending transactions in terms of securities that are "loaned" by a mutual fund in exchange for collateral. Some securities lending transactions are documented so that title to the "loaned" securities is transferred from the "lender" to the "borrower". The Canadian securities regulatory authorities do not consider this fact as sufficient to disqualify those transactions as securities loan transactions within the meaning of the Instrument, so long as the transaction is in fact substantively a loan. References throughout the Instrument to "loaned" securities, and similar references, should be read to include securities "transferred" under a securities lending transaction.

- (4) Paragraph 6 of subsection 2.12(1) permits the use of irrevocable letters of credit as collateral in securities lending transactions. The Canadian securities regulatory authorities believe that, at a minimum, the prudent use of letters of credit will involve the following arrangements:
- (a) the mutual fund should be allowed to draw down any amount of the letter of credit at any time by presenting its sight draft and certifying that the borrower is in default of its obligations under the securities lending agreement, and the amount capable of being drawn down would represent the current market value of the outstanding loaned securities or the amount required to cure any other borrower default; and
 - (b) the letter of credit should be structured so that the lender may draw down, on the date immediately preceding its expiration date, an amount equal to the current market value of all outstanding loaned securities on that date.
- (5) Paragraph 9 of subsection 2.12(1) and paragraph 8 of subsection 2.13(1) of the Instrument each provides that the agreement under which a mutual fund enters into a securities lending or repurchase transaction include a provision requiring the mutual fund's counterparty to promptly pay to the mutual fund, among other things, distributions made on the securities loaned or sold in the transaction. In this context, the term "distributions" should be read broadly to include all payments or distributions of any type made on the underlying securities, including, without limitation, distributions of property, stock dividends, securities received as the result of splits, all rights to purchase additional securities and full or partial redemption proceeds. This extended meaning conforms to the meaning given the term "distributions" in several standard forms of securities loan agreements widely used in the securities lending and repurchase markets.
- (6) Section 2.12, 2.13 and 2.14 of the Instrument make reference to the "delivery" and "holding" of securities or collateral by the mutual fund. The Canadian securities

regulatory authorities note that these terms will include the delivery or holding by an agent for a mutual fund. In addition, the Canadian securities regulatory authorities recognize that under ordinary market practice, agents pool collateral for securities lending/repurchase clients; this pooling of itself is not considered a violation of the Instrument.

- (7) Section 2.12, 2.13 and 2.14 of the Instrument require that the securities involved in a securities lending, repurchase or reverse repurchase transaction be marked to market daily and adjusted as required daily. It is recognized that market practice often involves an agent marking to market a portfolio at the end of a business day, and effecting the necessary adjustments to a portfolio on the next business day. So long as each action occurs on each business day, as required by the Instrument, this market practice is not a breach of the Instrument.
- (8) As noted in subsection (7), the Instrument requires the daily marking to market of the securities involved in a securities lending, repurchase or reverse repurchase transaction. The valuation principles used in this marking to market may be those generally used by the agent acting for the mutual fund, even if those principles deviate from the principles that are used by the mutual fund in valuing its portfolio assets for the purposes of calculating net asset value.
- (9) Paragraph 6 of subsection 2.13(1) of the Instrument imposes a requirement concerning the delivery of sales proceeds to the mutual fund equal to 102 per cent of the market value of the securities sold in the transaction. It is noted that accrued interest on the sold securities should be included in the calculation of the market value of those securities.
- (10) Section 2.15 of the Instrument imposes the obligation on a manager of a mutual fund to appoint an agent or agents to administer its securities lending and repurchase transactions, and makes optional the ability of a manager to appoint an agent or agents to administer its reverse repurchase transactions. A manager that appoints more

than one agent to carry out these functions may allocate responsibility as it considers best. For instance, it may be appropriate that one agent be responsible for domestic transactions, with one or more agents responsible for off-shore transactions. Managers should ensure that the various requirements of sections 2.15 and 2.16 of the Instrument are satisfied for all agents.

- (11) It is noted that the responsibilities of an agent appointed under section 2.15 of the Instrument include all aspects of acting on behalf of a mutual fund in connection with securities lending, repurchase or reverse repurchase agreements. This includes acting in connection with the reinvestment of collateral or securities held during the life of a transaction.
- (12) Subsection 2.15(3) of the Instrument requires that an agent appointed by a mutual fund to administer its securities lending, repurchase or reverse repurchase transactions shall be a custodian or sub-custodian of the mutual fund. It is noted that the provisions of Part 6 of the Instrument generally apply to the agent in connection with its activities relating to securities lending, repurchase or reverse repurchase transactions. The agent must have been appointed as custodian or sub-custodian in accordance with section 6.1, and must satisfy the other requirements of Part 6 in carrying out its responsibilities.
- (13) Subsection 2.15(5) of the Instrument provides that the manager of a mutual fund shall not authorize an agent to enter into securities lending, repurchase or, if applicable, reverse repurchase transactions on behalf of the mutual fund unless there is a written agreement between the agent, the manager and the mutual fund that deals with certain prescribed matters. Subsection (5) requires that the manager and the mutual fund, in the agreement, provide instructions to the agent on the parameters to be followed in entering into the type of transaction to which the agreement pertains. The parameters would normally include
 - (a) details on the types of transactions that may be entered into by the mutual fund;

- (b) types of portfolio assets of the mutual fund to be used in the transaction;
 - (c) specification of maximum transaction size, or aggregate amount of assets that may be committed to transactions at any one time;
 - (d) specification of permitted counterparties;
 - (e) any specific requirements regarding collateralization, including minimum requirements as to amount and diversification of collateralization, and details on the nature of the collateral that may be accepted by the mutual fund;
 - (f) directions and an outline of responsibilities for the reinvestment of cash collateral received by the mutual fund under the program to ensure that proper levels of liquidity are maintained at all times; and
 - (g) duties and obligations on the agent to take action to obtain payment by a borrower of any amounts owed by the borrower.
- (14) The definition of "cash cover" contained in section 1.1 of the Instrument requires that the portfolio assets used for cash cover not be "allocated for specific purposes". Securities loaned by a mutual fund in a securities lending transaction have been allocated for specific purposes and therefore cannot be used as cash cover by the mutual fund for its specified derivatives obligations.
- (15) A mutual fund sometimes needs to vote securities held by it in order to protect its interests in connection with corporate transactions or developments relating to the issuers of the securities. The manager and the portfolio adviser of a mutual fund, or the agent of the mutual fund administering a securities lending program on behalf of the mutual fund, should monitor corporate developments relating to securities that are loaned by the mutual fund in securities lending transactions, and take all necessary

steps to ensure that the mutual fund can exercise a right to vote the securities when necessary. This may be done by way of a termination of a securities lending transaction and recall of loaned securities, as described in paragraph 11 of subsection 2.12(1) of the Instrument.

- (16) As part of the prudent management of a securities lending, repurchase or reverse repurchase program, managers of mutual funds, together with their agents, should ensure that transfers of securities in connection with those programs are effected in a secure manner over an organized market or settlement system. For foreign securities, this may entail ensuring that securities are cleared through central depositories. Mutual funds and their agents should pay close attention to settlement arrangements when entering into securities lending, repurchase and reverse repurchase transactions."
- (5) Companion Policy 81-102CP is amended by the addition of the following as section 5.2:

"Securities Lending, Repurchase and Reverse Repurchase Transactions

- (1) As described in section 5.1, section 4.4 of the Instrument is designed to ensure that the manager of a mutual fund is responsible for any loss that arises out of the failure of it, and of any person or company retained by it or the mutual fund to discharge any of the manager's responsibilities to the mutual fund, to satisfy the standard of care referred to in that section.
- (2) The retention by a manager of an agent under section 2.15 of the Instrument to administer the mutual fund's securities lending, repurchase or reverse repurchase transactions does not relieve the manager from ultimate responsibility for the administration of those transactions in accordance with the Instrument and in conformity with the standard of care imposed on the manager by statute and required to be imposed on the agent in the relevant agreement by subsection 2.15(6) of the Instrument.
- (3) Because the agent is required to be a custodian or sub-custodian of the mutual fund, its activities, as custodian or sub-custodian, are not within the responsibility of the manager of the mutual fund, as

provided for in subsection 4.4(5) of the Instrument. However, the activities of the agent, in its role as administering the mutual funds' securities lending, repurchase or reverse repurchase transactions, are within the ultimate responsibility of the manager, as provided for in subsection 4.4(6) of the Instrument."

(6) Companion Policy 81-102CP is amended by the addition of the following as subsections 13.2(5),(6), (7) and (8):

"(5) Subsections 15.8(2) and (3) of the Instrument require disclosure of standard performance data of a mutual fund, in some circumstances, from "the inception of the mutual fund". It is noted that paragraph 15.6(d) generally prohibits disclosure of performance data for a period that is before the time when the mutual fund offered its securities under a simplified prospectus or before an asset allocation service commenced operation. Also, Instruction (1) to Item 5 of Part B of Form 81-101F1 Contents of Simplified Prospectus requires disclosure of the date on which a mutual fund's securities first became available to the public as the date on which the mutual fund "started". Therefore, consistent with these provisions, the words "inception of the mutual fund" in subsections 15.8(2) and (3) should be read as referring to the beginning of the distribution of the securities of the mutual fund under a simplified prospectus of the mutual fund, and not from any previous time in which the mutual fund may have existed but did not offer its securities under a simplified prospectus.

(6) Paragraph 15.6(a) of the Instrument contains a prohibition against the inclusion of performance data for a mutual fund that has been distributing securities for less than 12 consecutive months. The creation of a new class or series of security of an existing mutual fund does not constitute the creation of a new mutual fund and therefore does not subject the mutual fund to the restrictions of paragraph 15.6(a) unless the new class or series is referable to a new portfolio of assets.

(7) Section 15.14 of the Instrument contains the rules relating to sales communications for multi-class mutual funds. Those rules are applicable to a mutual fund that has more

than one class of securities that are referable to the same portfolio of assets. Section 15.14 does not deal directly with asset allocation services. It is possible that asset allocation services could offer multiple "classes"; the Canadian securities regulatory authorities recommend that any sales communications for those services generally respect the principles of section 15.14 in order to ensure that those sales communications not be misleading.

- (8) The Canadian securities regulatory authorities believe that the use of hypothetical or *pro forma* performance data for new classes of securities of a multi-class mutual fund would generally be misleading."
- (7) Companion Policy 81-102CP is amended by the deletion of section 14.1 and the substitution of the following:

"14.1 Calculation of Management Expense Ratio

- (1) Part 16 of the Instrument sets out the method to be used by a mutual fund in calculating its management expense ratio. The requirements contained in Part 16 are applicable in all circumstances in which a mutual fund calculates and discloses a management expense ratio.
- (2) Subsection 16.1(1) requires a mutual fund to use its "total expenses" before income taxes for the relevant period as the basis for the calculation of management expense ratio. Total expenses before income taxes will include interest charges and taxes of virtually all types, including sales taxes, GST and capital taxes, payable by the mutual fund. Income taxes, of course, would not be included in a calculation of total expenses before income taxes. In addition, Canadian GAAP would permit a mutual fund to deduct withholding taxes from the income to which they apply; therefore, withholding taxes would not be included as part of "total expenses".
- (3) Brokerage charges are not considered to be part of total expenses as they are included in the cost of purchasing, or netted out of the proceeds from selling, portfolio assets.
- (4) Subsection 16.1(4) of the Instrument makes reference to a mutual fund indicating, when providing management expense ratio

information to a service provider that will arrange for public dissemination of the management expense ratio, whether management fees were waived or paid directly by investors during the relevant period. It is expected that the service providers will include this information in any disclosure of management expense ratio to the public in a manner that is clear and easily understandable by investors. Service providers may use symbols to inform the public of the different elements of a management expense ratio. If symbols are used, they should be accompanied by an explanatory legend.

- (5) Mutual funds are reminded to ensure that any management expense ratio provided to a service provider for public dissemination should be only the management expense ratio calculated as required by the Instrument."
- (8) Part 14 of Companion Policy 82-102CP is amended by
 - (a) the change of the title of the part to "Financial Disclosure Matters";
 - (b) the addition of the following as section 14.2:

"14.2 Financial Statement Requirements in Securities Lending, Repurchase and Reverse Repurchase Transactions - Mutual funds are required to follow Canadian GAAP in preparing financial statements, as supplemented as applicable by the requirements of other applicable securities legislation. The Canadian securities regulatory authorities wish to provide their views on the appropriate application of Canadian GAAP in circumstances where mutual funds enter into securities lending, repurchase and reverse repurchase transactions. Sections 14.3, 14.4 and 14.5 reflect the views of the Canadian securities regulatory authorities as to the steps those mutual funds should take in order to ensure that their financial statements comply with Canadian GAAP.";

(c) the addition of the following as section 14.3:

"14.3 Financial Statement Requirements Concerning Securities Lending Transactions

- (1) A mutual fund, in the statement of investment portfolio included in the annual and interim financial statements of the mutual fund, or in the notes to that statement, should
 - (a) disclose the aggregate dollar value of securities that were lent in the securities lending transactions of the mutual fund that remain outstanding as at the date of the statement; and
 - (b) disclose the type and aggregate amount of collateral received by the mutual fund under securities lending transactions of the mutual fund that remain outstanding as at the date of the statement.
- (2) A balance sheet of a mutual fund that has received cash collateral in a securities lending transaction that remains outstanding as of the date of the balance sheet should fairly present
 - (a) the cash collateral received by it as an asset; and
 - (b) the obligation to repay the cash collateral as a liability.
- (3) The asset and liability referred to in subsection (2) should be shown as separate line items in the balance sheet.
- (4) An income statement of a mutual fund should fairly present income from securities lending transactions as revenue and not as deductions from expenses.";

(d) the addition of the following as section 14.4:

"14.4 Financial Statement Requirements Concerning Repurchase Transactions

- (1) A mutual fund, in the statement of investment portfolio included in the annual and interim financial statements of the mutual fund, or in the notes to that statement, should, for each repurchase transaction of the mutual fund that remains outstanding as at the date of the statement, disclose the date of the transaction, the expiration date of the transaction, the name of the counterparty of the mutual fund, the nature and market value of the securities sold by the mutual fund, the amount of cash received, the repurchase price to be paid by the mutual fund and the market value of the sold securities as at the date of the statement.
- (2) A balance sheet of a mutual fund that has entered into a repurchase transaction that remains outstanding as of the date of the balance sheet should fairly present the obligation of the mutual fund to repay the collateral as a liability.
- (3) The liability referred to in subsection (2) should be shown as a separate line item in the balance sheet.
- (4) An income statement of a mutual fund should fairly present income from the use of the cash received on repurchase transactions as revenue and not to offset expenses incurred in connection with the repurchase transaction."; and

(e) the addition of the following as section 14.5:

"14.5 Financial Statement Requirements Concerning Reverse Repurchase Transactions

- (1) A mutual fund, in the statement of investment portfolio included in the annual and interim financial statements of the mutual fund, or in the notes to that statement, should for each reverse

repurchase transaction of the mutual fund that remains outstanding as at the date of the statement, disclose the date of the transaction, the expiration date of the transaction, the name of the counterparty of the mutual fund, the total dollar amount paid by the mutual fund, the nature and value or principal amount of the securities received by the mutual fund and the market value of the purchased securities as at the date of the statement.

- (2) A balance sheet of a mutual fund that has entered into a reverse repurchase transaction that remains outstanding as of the date of the balance sheet should fairly present the reverse repurchase agreement relating to the transaction as an asset at market value.
- (3) The asset referred to in subsection (2) should be shown as a separate line item in the balance sheet.
- (4) An income statement of a mutual fund should fairly present income from reverse repurchase transactions as revenue and not as deductions from expenses."

PART 2 EFFECTIVE DATE

2.1 Effective Date - This Amendment comes into force on May 2, 2001.