NOTICE AND REQUEST FOR COMMENT

CHANGES TO PROPOSED NATIONAL INSTRUMENT 81-107 *INDEPENDENT REVIEW COMMITTEE FOR INVESTMENT FUNDS* AND COMMENTARY (SECOND PUBLICATION) AND RELATED AMENDMENTS

Prepared by the Canadian Securities Administrators

Introduction

We, the members of the Canadian Securities Administrators (the CSA), are publishing for second comment a revised version of proposed National Instrument 81-107 (the Proposed Rule or the Rule), renamed *Independent Review Committee for Investment Funds*. This new name reflects the CSA's proposal to expand the applicability of the Proposed Rule from conventional mutual funds only to all publicly offered investment funds. We are also publishing a revised version of the companion policy to the Proposed Rule, which we call Commentary. We refer to the Proposed Rule and Commentary, together, as the Instrument.

We are also publishing for first comment:

- proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*, Form 81-101F1 *Contents of Simplified Prospectus,* and Form 81-101F2 *Contents of Annual Information Form*;

- proposed amendments to National Instrument 81-102 *Mutual Funds* (NI 81-102) and Companion Policy 81-102CP *Mutual Funds*;

- proposed amendments to National Instrument 81-106 *Investment Fund Continuous Disclosure* and Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance*;

- proposed amendments to National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)*;

- proposed amendments to National Instrument 44-101 *Short Form Prospectus Distributions* and Form 44-101F3 *Short Form Prospectus*;

- proposed amendments to National Instrument 81-104 *Commodity Pools*; and

- in some jurisdictions, certain local amendments.

Although the British Columbia Securities Commission (BCSC) supports some of the objectives of the Instrument, because of feedback the BCSC has received from industry, the BCSC is still considering whether adoption of the Instrument is appropriate and whether there are alternatives that might sufficiently address the proposed objectives in a more cost effective manner. The

BCSC has additional questions they would like to ask about this issue. These questions are in the local cover notice published in British Columbia.

We expect the Proposed Rule to be adopted as a rule in each of Alberta, Manitoba, Newfoundland and Labrador, Nova Scotia, Ontario and New Brunswick, as a commission regulation in Saskatchewan, as a regulation in Québec, and as a policy in the remaining jurisdictions represented by the CSA. If British Columbia adopts it, the Proposed Rule would be adopted as a rule. The Commentary contained in the Proposed Rule will be adopted as a policy in each of the jurisdictions represented by the CSA.

Background

On March 1, 2002, the CSA released Concept Proposal 81-402 *Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers* (the Concept Proposal) that set out our vision for mutual fund regulation in Canada. It detailed our proposals to improve mutual fund governance and introduce a registration requirement for mutual fund managers.

On January 9, 2004, we published for comment the first version of the Proposed Rule and Commentary (the 2004 Proposal). The 2004 Proposal included the requirement for every publicly offered mutual fund to have a fully independent advisory body, called the Independent Review Committee (the IRC). The IRC would review all matters involving a conflict of interest or a perceived conflict of interest between the mutual fund manager's own interests and its duty to manage its mutual funds in the best interests of those funds. The objective of the 2004 Proposal was to ensure that every mutual fund had a minimum level of independent oversight in place.

Under the 2004 Proposal, the IRC was to bring its independent perspective to the decisions of the mutual fund manager that involved an actual or perceived conflict of interest for the fund manager. The IRC was to make a recommendation to the manager on the manager's proposed course of action. Its role was to provide 'sober second thought'.

The focus on conflicts of interest was deliberate. This was an area where, in our view, independent review mattered most, and would not place an undue burden on mutual fund managers who have no experience working with an independent advisory body. We also indicated our intention to eliminate the existing conflict of interest and self-dealing prohibitions in securities legislation once the Proposed Rule became effective.

For additional background information on the Concept Proposal and the 2004 Proposal, please refer to the notices published with those documents on the websites of members of the CSA.

Summary and Purpose

Purpose of the Proposed Rule

The Proposed Rule contemplates imposing a minimum, consistent standard of governance for publicly offered investment funds. Currently, there is no requirement that an investment fund have a governance body. Under the Proposed Rule, every investment fund that is a reporting issuer must have an IRC to oversee all conflict of interest matters – not just those subject to

prohibitions or restrictions in securities legislation - faced by the fund manager in the operation of the investment fund.

We expect the Proposed Rule to enhance investor protection, by ensuring that the interests of the investment fund (and ultimately, investors) are at the forefront when a fund manager is faced with a conflict of interest, and by improving a fund manager's decision-making process in such situations through an upfront check on how the conflict of interest is resolved.

The Proposed Rule is also expected to contribute to more efficient Canadian capital markets, by permitting fund managers to engage in certain types of conflict of interest transactions without prior regulatory approval, provided the IRC approves. This will give fund managers greater flexibility to make timely investment decisions to take advantage of perceived market opportunities that they believe are in the best interests of the investment fund. The Proposed Rule addresses two types of conflicts of interest.

1. 'Business' or 'operational' conflicts faced by fund managers. These are conflicts of interest relating to the operation by the manager of its funds that are not specifically regulated under securities legislation, except through the general duties of loyalty and care imposed on the fund manager. These conflicts may include: the fund manager's decision to charge operational or incentive fees to the investment fund or to use affiliates in the operation of the investment fund, and the allocation of securities among funds in an investment fund complex.

2. 'Structural' conflicts faced by fund managers. These are conflicts of interest that result from proposed transactions by the manager with related entities of the manager, fund or portfolio manager currently prohibited or restricted by the conflict of interest and self-dealing provisions in securities legislation. Such conflicts may include: a fund manager's decision to purchase securities of an issuer related to it, or to trade securities amongst funds in an investment fund complex (inter-fund trade).

Summary of the Proposed Rule

The Proposed Rule applies to publicly offered investment funds. This includes mutual funds, commodity pools, scholarship plans, labour-sponsored or venture capital funds, and closed-end funds and mutual funds that are listed and posted for trading on a stock exchange or quoted on an over-the-counter market.

For any decision by the fund manager that involves, or that a reasonable person would consider involves, a conflict of interest for the fund manager, the fund manager must establish written policies and procedures that it must follow and refer the matter to the IRC for its review.

In the 2004 Proposal, all conflict of interest matters were referred to the IRC for a recommendation. The Proposed Rule now contemplates a two-pronged approach to IRC review.

A decision by the fund manager to engage in certain specified transactions currently prohibited or restricted by securities legislation - inter-fund trading, transactions in securities of related issuers and purchases of securities underwritten by related underwriters - must receive the prior approval of the IRC to proceed. For any other proposed course of action by the fund manager that involves, or that a reasonable person would consider involves, a conflict of interest for the

fund manager, the IRC must provide the fund manager with a recommendation, which the fund manager must consider before proceeding.

IRC approval is also required for certain changes to a mutual fund. In the consequential amendments to NI 81-102 which accompany the Proposed Rule, we specify that the IRC must approve two changes: a change in the auditor of the mutual fund, and a reorganization or transfer of assets of the mutual fund to a mutual fund managed by the same fund manager or an affiliate. We propose to eliminate the requirement for securityholder approval in these instances but continue to require a securityholder vote in other circumstances.

The Proposed Rule sets out the structure and functions of the IRC, as well as the obligations of the fund manager when faced with a conflict of interest. Prospectus disclosure and certain reporting obligations relating to the IRC are set out in the Proposed Rule and in the consequential amendments that accompany the Proposed Rule.

Contrary to the 2004 Proposal, we no longer propose to eliminate the existing conflict of interest and self-dealing prohibitions and restrictions in securities legislation. For inter-fund trading, transactions in securities of related issuers and purchases of securities underwritten by related underwriters, the Proposed Rule and the accompanying consequential amendments to NI 81-102 provide an exemption from obtaining regulatory exemptive relief, provided the IRC has given its approval to the fund manager to proceed.

We believe the Proposed Rule strikes the proper balance between management and oversight. The Proposed Rule still ensures that ultimate responsibility and accountability for the investment fund remains with the fund manager.

Form

The Proposed Rule is written in plain language. Commentary relevant to each section of the Proposed Rule appears immediately following that section for ease of reference. The purpose of the Commentary is to assist users in understanding and applying the Proposed Rule and to explain how we interpret a section of the Proposed Rule or expect the Proposed Rule to operate.

Summary of Feedback Received on the 2004 Proposal

We received 42 comment letters on the 2004 Proposal. Copies of the comment letters have been posted on the Ontario Securities Commission website at www.osc.gov.on.ca. Copies are also available from any CSA member. The names of the commenters can be found in Appendix A to this Notice.

As with the Concept Proposal, the 2004 Proposal elicited comments from a broad cross-section of the Canadian mutual fund industry and investors. We heard divergent views on almost every provision in the 2004 Proposal. We have considered all comments received and wish to thank all those who took the time to comment.

A summary of the comments we received on the 2004 Proposal, together with our responses, is also in Appendix A to this Notice.

Overarching themes

Several overarching themes emerged from the comments. The comments expressed on these themes resonated with us. As a result of the comments, we made a number of changes to the 2004 Proposal and raise the following new questions in this Notice. A summary of these themes is set out below.

The scope of the 2004 Proposal

Many mutual fund industry commenters urged us to expand the scope of the 2004 Proposal to all publicly offered investment funds. They said that fund managers of all types of investment funds face conflicts of interest, and that excluding certain funds will result in an uneven playing field between competing products vying for the same investor.

We also heard from some small mutual fund managers who expressed concern that the 2004 Proposal was not necessary for smaller mutual funds, particularly those that outsource many of the custody, processing, valuation and portfolio management functions, or have no structural conflicts of interest.

Our proposal to remove certain prohibitions in securities legislation

There was mutual fund industry support for the introduction of independent oversight by the IRC to be coupled with a relaxation of certain legislative restrictions to meet legitimate business needs. However, investors and investor advocates unanimously urged us not to replace existing conflict of interest and self-dealing prohibitions in securities legislation with an IRC whose recommendations are non-binding. They told us that the IRC's lack of "teeth" would render it ineffective in being a check and balance on a fund manager's conflicts of interest.

The need for more robust investor protection and effective monitoring of the fund manager

Investors and investor advocates unanimously told us that the requirement in the 2004 Proposal to disclose instances where the fund manager decides to proceed with an action without the positive recommendation of the IRC is not, on its own, an effective remedy, nor sufficient for robust investor protection. They said that the disclosure will probably come too late and may not be specific enough.

We also heard from industry, investors and investor advocates that the 2004 Proposal failed to provide a monitoring process or penalty for instances where the manager failed to refer conflict of interest matters to the IRC. These commenters also told us there was no guidance on what the IRC should or could do, if the fund manager refers very little to it for its review.

Our principles-based approach

Many industry commenters commended us for our commitment to principles-based regulation, and for the 2004 Proposal's user-friendly format. Yet, some commenters also asked us to provide greater specificity in the rule on certain matters. This was echoed by investors and investor advocates who expressed concern about an approach that they said relied too much on solely principles. They suggested a combination of specific rules and principles would be more effective.

The uncertainty of the liability of IRC members

The majority of industry commenters expressed concern about the uncertainty of the liability of IRC members. They told us unlimited liability would affect the availability and cost of insurance for members, and would be a strong deterrent to potential members of an IRC. We were urged to somehow limit liability.

Our proposal to remove certain securityholder votes

Industry commenters supported the 2004 Proposal's removal of the requirement for the fund manager to obtain securityholder approval for certain changes to a mutual fund under Part 5 of NI 81-102, telling us securityholder approval of ongoing administrative matters is costly and not in investors' interests. However, investors and investor advocates unanimously urged us not to eliminate what they perceived as one of few investor rights.

Summary of Changes to the 2004 Proposal and Specific Requests for Comment

The Proposed Rule and Commentary differs from the 2004 Proposal in a number of significant ways. This section of the Notice describes the key changes. We have also raised specific issues for you to comment on in the shadowboxes below.

1. The Instrument now applies to publicly offered investment funds

An expanded scope

Under the 2004 Proposal, the Instrument would have applied only to conventional mutual funds and commodity pools.

We are now proposing that the Instrument apply to all publicly offered investment funds. This includes conventional mutual funds, commodity pools, scholarship plans, labour-sponsored or venture capital funds, and closed-end funds and mutual funds (including index-based funds) that are listed and posted for trading on a stock exchange or quoted on an over-the-counter market.

In our view, some (if not all) of the conflicts of interest inherent in the management of a conventional mutual fund may exist in the management of all of these types of investment funds. Examples are: the fund manager's decision to charge operational and incentive fees to the investment fund, to use affiliates in the operation of the investment fund, and the allocation of securities among funds in an investment fund complex. Additionally, not all investment funds are currently prohibited in every jurisdiction from engaging in related-party and self-dealing transactions. For many of us, the perception of a governance 'gap' between the regulation of these products and the regulation of mutual funds and corporate issuers is difficult to reconcile.

We request comment on the expanded scope of the Proposed Rule and particularly seek feedback from those industry participants not included in the 2004 Proposal – scholarship plans, labour-sponsored or venture capital funds, and closed-end funds and mutual funds that are listed and posted for trading on a stock exchange or quoted on an over-the-counter market.

Specifically, we would like to understand what conflicts of interest could exist in the management of these investment funds, the anticipated costs the Instrument could have on these funds, whether there are additional practical considerations for each of these investment fund structures that we should address, and what other mechanisms or approaches the fund managers of these investment funds use today or could use to address any conflicts of interest.

Smaller investment funds

The proposed Instrument continues to apply to smaller investment funds. We continue to believe that there are inherent conflicts of interest in the management of smaller investment funds that could benefit from the independent perspective brought to bear on such matters. We are, however, sensitive to concerns about the cost of an IRC for smaller funds.

In our view, IRC oversight for most smaller investment funds (where there are no structural conflicts of interest and where there may be fewer business conflicts, especially if many functions have been outsourced) would be much less burdensome than for larger investment funds, and therefore, less costly. However, we are also interested in considering other ways of managing conflicts of interest for smaller funds.

We request additional comment on the impact of including smaller investment funds in the Instrument.

Specifically, we would like feedback on our view that, with fewer conflicts of interest to address, an IRC will be less costly for smaller funds. We also seek specific data on the anticipated costs of complying with the Instrument for smaller investment funds, relative to the other costs of the investment fund.

We would also like to understand what commenters consider 'smaller' – is it a test based on the size of the investment fund? or the fund manager? or the number of investors in the investment fund?

The BC Securities Commission has additional questions they would like to ask on this subject. These questions are in the local cover notice published in British Columbia.

2. The Instrument will keep existing conflict of interest and self-dealing prohibitions in securities legislation, and exempt specified transactions with IRC approval

Keeping existing rules

When we published the 2004 Proposal, we stated our intention to replace the existing conflict of interest and self-dealing prohibitions and restrictions in securities legislation with the introduction of IRC review.

In response to the comments, we now propose to retain the existing conflict of interest and self-dealing prohibitions and restrictions in securities legislation and provide exemptions in the Proposed Rule and NI 81-102 from the provisions that preclude certain specified transactions, provided that the fund manager has received the approval of the IRC to proceed. These

transactions include: inter-fund trading, transactions in securities of related issuers, and purchases of securities underwritten by related underwriters.

We believe it is important to give fund managers some flexibility to engage in these types of transactions, which can be innocuous and beneficial to investors, without the expense and delay involved in seeking regulatory approval (which ultimately imposes costs on the investment fund and its securityholders). It is our view that oversight and approval of these transactions by an independent body that is familiar with the investment fund's operations, will ensure that any actual or perceived conflicts of interest are appropriately addressed. To date, members of the CSA have granted a number of exemptions from the prohibitions in securities legislation that restrict these transactions. Based on our own experiences, we are comfortable that IRC oversight and approval can be effective in addressing the conflicts of interest in these types of transactions. Over time, as the IRC members' familiarity with the operations of the investment fund and the fund manager grows, we expect that they will be well positioned to consider and understand all of the appropriate factors in deciding whether to approve such transactions.

The Proposed Rule specifies that existing conflict of interest waivers and exemptions that deal with matters regulated by this Instrument may not, after a specified date following the coming into force of the Instrument and implementation of the IRC, be relied on.

Other types of prohibited conflict of interest transactions with which we have less familiarity will continue to be prohibited under securities legislation and require regulatory exemptive relief to proceed.

We request comment on this approach and the exemptive provisions in the Proposed Rule and consequential amendments to NI 81-102.

Specifically, we would like feedback on whether the drafting of these provisions effectively captures the conflict of interest exemptions the CSA has granted to date, and whether the conditions accompanying the exemptions in the Proposed Rule and NI 81-102 are appropriate.

The BC Securities Commission has additional questions they would like to ask on this subject. These questions are in the local cover notice published in British Columbia.

IRC approval

As outlined above, the proposed Instrument would require a fund manager to receive the prior approval of the IRC to proceed with inter-fund trading, transactions in securities of related issuers, and purchases of securities underwritten by related underwriters.

For any other proposed course of action by the fund manager that involves or may be perceived to involve a conflict of interest for the fund manager, the IRC will continue (as in the 2004 Proposal) to provide to the fund manager a positive or negative recommendation as to whether the action achieves a fair and reasonable result for the investment fund. The fund manager must consider that recommendation before proceeding.

A fund manager must also receive IRC approval under Part 5 of NI 81-102 to proceed with certain changes to a mutual fund: a change of auditor of the mutual fund, and a reorganization or

transfer of assets of the mutual fund to a mutual fund managed by the same fund manager or an affiliate.

A decision tree for different types of conflict of interest matters is included in Appendix B to this Notice.

We request comment on this approach.

3. The Instrument now provides the IRC with effective methods to oversee and report on manager conflicts of interest

As noted above, when we published the 2004 Proposal, we indicated our intention to replace the existing conflict of interest and self-dealing prohibitions and restrictions in securities legislation and instead require IRC oversight and an IRC recommendation to the fund manager as to whether the proposed transaction achieves a fair and reasonable result for the fund.

In response to the comments, we no longer propose to eliminate the existing conflict of interest and self-dealing prohibitions and restrictions in securities legislation. Instead, we intend under the Proposed Rule and NI 81-102 to exempt from the prohibitions and restrictions in securities legislation inter-fund trading, transactions in securities of related issuers, and purchases of securities underwritten by related underwriters, provided the fund manager has received the approval of the IRC to proceed, and to give the IRC the authority to stop the transaction.

For any other proposed course of action by the fund manager that involves, or that a reasonable person would consider involves, a conflict of interest for the fund manager, the IRC will give the fund manager its recommendation. In instances where the fund manager decides to proceed without the positive recommendation of the IRC, the Proposed Rule now gives the IRC the authority to require the fund manager to notify securityholders of the fund manager's decision at least 30 days before the effective date of the action.

In response to comments, we now also propose to require the IRC to prepare a report directed to securityholders at least annually, which describes what has transpired in the relevant time period. Among the matters the report must disclose is any instance where the fund manager proceeded to act without the positive recommendation of the IRC, or proceeded to act on a positive recommendation or approval but did not follow a condition imposed by the IRC in the recommendation or approval.

The Proposed Rule also requires that the IRC monitor and assess, at least annually, the adequacy and effectiveness of the fund manager's written policies and procedures related to conflict of interest matters, and the fund manager's compliance with the IRC's instructions on these matters.

Additionally, the Proposed Rule now explicitly gives the IRC the authority to communicate directly with the securities regulatory authorities. This is intended to encourage members of the IRC to inform the regulator of any concerns – including concerns about a fund manager not referring conflict of interest matters to the IRC – not otherwise required by securities legislation to be reported. The Proposed Rule further requires the IRC, in instances where the fund manager has proceeded with inter-fund trading, transactions in securities of related issuers, and purchases of securities underwritten by related underwriters, to report a breach of a specified condition imposed by securities legislation or by the IRC in its approval.

We request comment on this approach.

4. The Instrument now specifies the key governance practices we expect of the IRC and the manager

In response to the commenters who asked us to provide greater specificity in the 2004 Proposal on certain matters, we are now proposing that the Proposed Rule specify the minimum governance practices we expect of the IRC and the fund manager. Among these practices are: the appointment of a chair among the IRC members to act as the leader of the IRC and be the primary liaison between the IRC and the fund manager; the establishment of nominating criteria in the appointment of IRC members; the orientation and continuing education of IRC members; regular self assessments; and reporting obligations.

We believe this approach will create consistent minimum standards and practices among IRCs and fund managers, and will allow for a meaningful comparison by investors of investment funds.

We request comment on this approach. Specifically, we would like feedback on whether these provisions are best suited for the Proposed Rule or should be moved into the Commentary.

5. The Instrument addresses the liability of IRC members

The ultimate responsibility for the decisions made on behalf of the investment fund appropriately rests with the fund manager.

However, in response to the concerns raised about the potential unlimited liability of IRC members, we retained Carol Hansell of Davies Ward Phillips & Vineberg to provide us with advice on this issue. Based on this advice, the Instrument has been revised to emphasize the limited scope of the IRC's mandate, which in turn should limit the IRC's corresponding fiduciary duty and duty of care.

We were advised that by clarifying in the Instrument the very specific functions, duties and obligations of the IRC, we will have clarified that the IRC has a very limited role, particularly as compared to the role of corporate directors. We were also advised that the inclusion of a fiduciary duty and duty of care as well as language that mirrors certain defence provisions in corporate law statutes should serve to provide guidance to insurers and to the courts as to how we view the IRC's role.

A summary of Carol Hansell's analysis is available on the website of the Ontario Securities Commission at www.osc.gov.on.ca. and the website of the Autorité des marchés financiers at www.lautorite.qc.ca.

We request feedback on this approach.

6. The Instrument preserves investor votes for changes to the 'commercial bargain'

In the 2004 Proposal, we proposed to remove the requirement for securityholder approval for all of the changes contemplated under section 5.1 of NI 81-102, except for a change in the mutual fund's investment objectives and increases in the charges to the mutual fund or its securityholders.

With the benefit of the comments we received, we no longer propose to eliminate most of the securityholder approvals outlined in the 2004 Proposal. We believe that a securityholder vote should be required for proposed changes to a mutual fund that affect the 'commercial bargain' between the fund manager and investors.

We continue to propose, however, that a change in the auditor of a mutual fund and a reorganization or transfer of assets between affiliated mutual funds be permitted to proceed without securityholder approval, provided that the fund manager has received IRC approval. In our view, replacing securityholder approvals in these instances with approval by an independent body familiar with the investment fund's operations will serve to adequately protect investors' interests, while at the same time give the fund manager some relief from the expense and delay involved in holding securityholder meetings (which ultimately impacts the investment fund and its securityholders).

We request comment on this approach. Specifically, we would like feedback on the drafting of the proposed amendments to Part 5 of NI 81-102.

Anticipated Costs and Benefits

We believe that the cost savings estimates to fund managers from relaxing the restrictions on conflict of interest and self-dealing transactions published with the 2004 Proposal on the websites of the Ontario Securities Commission and Autorité des marchés financiers are still valid[1].

Upon review of the operational cost estimates of an IRC published with the 2004 Proposal, the Office of the Chief Economist at the Ontario Securities Commission (the Office of the Chief Economist) has concluded the cost estimates remain valid.

In the notice to the 2004 Proposal, the Office of the Chief Economist at the Ontario Securities Commission proposed to estimate some additional benefits and some of the cost savings associated with the Instrument.

Consistent with the methodology found in other studies on the subject, the Office of the Chief Economist has concluded, through the construction of a model of the most critical factors in determining fund performance, that the number of meetings of the IRC each year will not have a significant impact on an investment fund's performance. As a result, the Proposed Rule specifies only that the IRC meet at least annually. Of course, the IRC has the discretion to meet as frequently as it determines necessary.

The Office of the Chief Economist also proposed in the 2004 Proposal to estimate the benefits to a mutual fund of needing to take fewer matters to a vote of its securityholders. Through

[1] See: Mutual Fund Governance Cost Benefit Analysis Final Report, prepared for the OSC by Keith A. Martin, July 2003.

surveying the mutual fund industry, among the costs found to be associated with the voting procedure was the preparation and delivery of voting materials. The Office of the Chief Economist has determined the low end cost estimate per securityholder per meeting to be $5 per securityholder. The high end cost estimate per securityholder per meeting to be $20 per securityholder. We found the high end cost estimate is more representative of the typical costs that a mutual fund company would experience. However, to be conservative, the lowest cost estimate was used as a basis for calculating a mutual fund's cost savings per securityholder per meeting of not having to take a matter to a vote.

The Office of the Chief Economist estimates the benefit of removing a single meeting for the mutual fund industry to be $254.35 million, based on 50.87 million securityholders in conventional mutual funds as of December 31, 2004. We are proposing that a change in the auditor of a mutual fund and a reorganization or transfer of assets between affiliated mutual funds be permitted to proceed without a securityholder vote, provided that the fund manager has received the approval of the IRC to proceed.

Smaller investment funds

We continue to believe that there are inherent conflicts of interest in the management of smaller investment funds that could benefit from the independent perspective brought to bear on such matters by an IRC. We remain, however, sensitive to the cost concerns surrounding an IRC for smaller investment funds.

In our view, the scope of IRC review for most smaller investment funds (where there are no structural conflicts of interest and where there may be fewer business conflicts, especially if many functions have been outsourced) would be much less burdensome than for larger investment funds, and therefore, less costly. In other words, we perceive the cost burden will be proportionate to the benefit of an independent perspective on conflict of interest matters.

The Office of the Chief Economist, based on a review of mutual funds with existing IRCs as a condition of exemptive relief, has found the range of operational costs of an IRC to be $50,000 to $250,000 per year. Given the limited scope of responsibility of these IRCs, we anticipate the costs of an IRC for a small investment fund will be similar.

Please see the questions we asked earlier under the sub-heading 'smaller investment funds'. Specifically, we would like feedback on whether commenters agree or disagree with our perspective on the cost burden of an IRC on smaller investment funds, and seek specific data on the anticipated costs of the Instrument for such funds.

Exchange-traded funds

In our view, some (if not all) of the conflicts of interest (business and structural) inherent in the management of a mutual fund exist in the management of closed-end funds and mutual funds that are listed and posted for trading on a stock exchange or quoted on an over-the-counter market.

For those exchange-traded funds that are "mutual funds" under NI 81-102, the restrictions in securities legislation on structural conflicts of interest apply - for example, restrictions on the purchases of securities of a related issuer, or inter-fund trading. For both NI 81-102 and non-NI

81-102 exchange-traded funds, business conflicts of interest exist- for example, a decision by the fund manager to use an affiliate in the operation of the fund, or the fund manager's/affiliate's direct ownership of units in the fund.

The Office of the Chief Economist, upon review of the operational cost estimates of an IRC published in the 2004 Proposal, has concluded that the cost estimates similarly apply to exchange-traded funds.

We note that many exchange-traded investment funds today have established advisory boards to provide an independent perspective on management decisions and advice to the fund manager.

Related Amendments

National Amendments

Proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (NI 81-101), Form 81-101F1 *Contents of Simplified Prospectus,* and Form 81-101F2 *Contents of Annual Information Form* are set out in Appendix C;

Proposed amendments to National Instrument 81-102 *Mutual Funds* (NI 81-102) and Companion Policy 81-102CP *Mutual Funds* are set out in Appendix D;

Proposed amendments to National Instrument 81-106 *Investment Fund Continuous Disclosure* (NI 81-106) and Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance* are set out in Appendix E;

Proposed amendments to National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)* (NI 13-101) are set out in Appendix F;

Proposed amendments to National Instrument 44-101 *Short Form Prospectus Distributions* (NI 44-101) and Form 44-101F3 *Short Form Prospectus* is set out in Appendix G; and

Proposed amendments to Multilateral Instrument 81-104 *Commodity Pools* (NI 81-104) is set out in Appendix H.

Local Amendments

We propose to amend elements of local securities legislation, in conjunction with the implementation of the Instrument. The provincial and territorial securities regulatory authorities may publish these proposed local changes separately in their jurisdictions.

Proposed consequential amendments to rules or regulations in a particular jurisdiction are in Appendix I to this Notice published in that particular jurisdiction.

Some jurisdictions will need to implement the Instrument using a local implementing rule. Jurisdictions that must do so will separately publish the implementing rule.

Unpublished Materials

In proposing the revised version of the Instrument, we have not relied on any significant unpublished study, report or other written materials.

We did, however, retain independent legal advice to help us resolve the concerns raised by commenters on the 2004 Proposal as to the liability of IRC members. A summary of the analysis provided to us is available on the website of the Ontario Securities Commission at www.osc.gov.on.ca and the website of the Autorité des marchés financiers atwww.lautorite.qc.ca.

Authority for Proposed Rule

Clause 154(1)(oo) of *The Securities Act, 1988* (Saskatchewan) authorizes the Saskatchewan Financial Services Commission ("the Commission") to make regulations exempting any person, company, trade or security from all or any provision of the Act or the regulations, including prescribing any terms or limiations on an exemption and requiring compliance with those terms or limiations.

Clause 154(1)(h) of the Act authorizes the Commission to make regulations prescribing requirements in respect of the books, that market participants shall keep, including the form in which and the period for which the books, records and other documents shall be kept.

Clause 154(1)(r) of the Act authorizes the Commission to make regulations prescribing requirements in respect of the preparation and dissemination and other use, by reporting issuers, of documents providing for continuous disclosure that are in addition to the requirements under this Act, including requirements in respect of, i. an annual report, ii. an annual information form, and iii. supplemental analysis of financial statements.

Clause 154(1)(u.3) of the Act authorizes the Commission to make regulations prescribing the period within which insider reports must be filed for the purpose of section 116 of the Act.

Clause 154(1)(v) of the Act authorizes the Commission to make regulations "regulating mutual funds or non-redeemable investment funds and the distribution and trading of the securities of the funds.

Request for Comments

We welcome your comments on the Proposed Rule, the Commentary and related amendments, including the changes made since the 2004 Proposal.

We have raised specific issues for you to comment on in the shadowboxes of this Notice. We also welcome your comments on other aspects of the Instrument, including our general approach and anything that might be missing from it. We remind you that the BCSC has included additional questions are in the local cover Notice that they published in British Columbia. You can find those questions on the BCSC's website at www.bcsc.bc.ca in the Securities Law and Policy section.

We request your participation and input and thank you in advance for your comments.

Due Date

Your comments must be submitted in writing and are due by August 25, 2005. If you are not sending your comments by email, a diskette containing the submissions (in Windows format, Microsoft Word), should also be sent.

Where to Send Your Comments

Please address your comments to all of the CSA member commissions, 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
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

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

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All Comments are Public

Please note that 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 also be posted to the OSC website at www.osc.gov.on.ca to improve the transparency of the policy-making process.

Questions

Please refer your questions to any of the following CSA members:

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The text of the Proposed Rule, Commentary, and Related Amendments follows or can be found elsewhere on a CSA member website.