

**CSA STAFF NOTICE 81-310
FREQUENTLY ASKED QUESTIONS
FUND OF FUND AMENDMENTS**

On December 31, 2003, the Fund of Fund Amendments (the "Amendments") to National Instrument 81-102 Mutual Funds ("NI 81-102") and National Instrument 81-101 Mutual Fund Prospectus Disclosure ("NI 81-101") came into force in every jurisdiction except Québec. The Amendments came into force in Québec on March 3, 2004.

Over the last several months, staff of the Canadian Securities Administrators (referred to as "we" below) has been responding to a number of questions surrounding the transition to the new fund of fund regime. Accordingly, we are publishing this notice in order to address your frequently asked questions.

Disclosure Issues

Q1. NI 81-101 now imposes several disclosure requirements for funds of funds which were not previously imposed by way of exemptive relief orders. Consequently, does a fund of funds which decides to continue to invest in other mutual funds in accordance with its prior exemptive relief order (until the revocation of that order on December 31, 2004) have to amend its prospectus immediately upon the coming into force of the Amendments in order to include the new required disclosure?

A1. We would not expect a fund of funds that intends to continue to invest in other mutual funds on a passive basis in accordance with its exemptive relief order to have to immediately file an amendment to comply with the additional disclosure requirements for funds of funds. Staff would consider it appropriate for that fund to incorporate the required disclosure in its renewal prospectus in the year that follows the coming into force of the Amendments.

Q2. NI 81-101 now requires that all mutual funds (and not just underlying funds) include an additional risk factor in their simplified prospectus about the risks associated with a possible redemption by any security holder that holds more than 10 percent of the securities of the mutual fund as of the date of the prospectus. Will a mutual fund that has more than 10 percent of its securities owned by one security holder as of December 31, 2003, be required to immediately amend its simplified prospectus to include the new risk disclosure?

A2. We would not expect that a mutual fund would file an amendment solely to comply with the new risk disclosure requirement. We would consider it appropriate to comply with the new risk disclosure requirement (if applicable) upon the filing of the fund's renewal prospectus in the year that follows the coming into force of the Amendments.

Transition Issues

Q3 Can an existing fund of funds who wishes to take advantage of the flexibility of the new rules do so without being constrained by the conditions in their previously granted exemptive relief order?

A3. An existing fund of funds may immediately take advantage of the new rules provided it gives its existing security holders 60 days' notice of its intended transition to active management. Although NI 81-102 does not prescribe the 60 day notice requirement, we are of the view that the fund manager is required to give such a notice if it previously disclosed in the fund of funds' prospectus that it would do so in respect of any change to the underlying funds or the percentage invested in underlying funds. The fund manager will have to act consistently with what has been disclosed in the prospectus even though the 60 day notice requirement, which is a condition of previously granted exemptive relief, may no longer apply by operation of the revocation provision in s.19.3 of NI 81-102.

In addition, for those funds of funds that specified their passive investments in their fundamental investment objective, a security holder vote will have to be held in accordance with the requirements of paragraph 5.1(c) of NI 81-102 in order to make the change to active management of mutual fund securities.

As well, in almost all cases, an amendment to the fund of funds' prospectus will have to be filed to reflect the transition to active management under the new rules. This amendment will need to comply with each of the new disclosure requirements for funds of funds in NI 81-101.

It is clear that an amendment will have to be filed where there will have been a change in the investment objective. However, for those funds of funds whose passive investments were specified only in the fund's investment strategies, the requirement to file an amendment to their prospectus will depend on whether the change from a passive to an active investment strategy will constitute a "significant change" as defined in NI 81-102. The occurrence of a significant change will trigger the requirement in section 5.10 of NI 81-102 to file an amendment to reflect that change.

In the most common types of funds of funds, where substantially all the fund's assets are invested in other mutual funds, we would suggest that the change from a passive to an active investment strategy would almost always be a significant change, since the core prospectus disclosure naming the underlying funds and target percentages is no longer true. However, there may be other cases where, for example, only a portion of the assets is invested in other mutual funds, with the rest of the fund being actively managed. In such cases, the manager would have to consider carefully whether or not this constitutes a significant change.

Q4. Prior exemptive relief orders and decision documents for funds of funds often incorporated other exemptive relief that did not specifically relate to the purchase of mutual fund securities. This additional relief does not appear to have been codified in the Amendments. What will happen to this additional relief upon the

revocation of the prior exemptions (by operation of s. 19.3 of NI 81-102) on December 31, 2004?

A4. In many cases, exemptive relief orders and decision documents for funds of funds did indeed incorporate relief that did not specifically relate to a mutual fund investing in other mutual funds. Examples of this additional relief are as follows:

- relief from paragraph 2.8(1)(d) of NI 81-102 so as to allow a RSP Clone Fund to have a shortfall in its cash cover position for a period of no more than one business day in respect of its exposure under a forward contract;
- relief from section 4.2 of NI 81-102 and from related “self-dealing” provisions in the legislation of the jurisdictions to allow RSP Clone Funds to enter into forward contracts with related counterparties;
- approvals under paragraph 5.5(1)(d) of NI 81-102 to allow certain funds of funds to suspend the right of security holders to redeem their securities when the right to redeem securities of the underlying fund is suspended.

We are of the view that, where “future-oriented” relief was granted from these additional provisions prior to the coming into force of the Amendments, funds of funds may continue to rely on such relief after December 31, 2004, despite the application of the revocation provision in section 19.3 of NI 81-102. However, all filers should review their existing fund of fund exemptive relief decisions to determine where the sunset provision occurs. Unless the sunset provision clearly applies to the additional relief mentioned above, the additional relief will not expire.

We however stress that in order to be able to continue to rely on this additional relief on a going forward basis, the fund in question, whether existing or new, should be operated in a manner that is consistent with the representations made in the exemptive relief order and/or decision document. If the current facts differ from those presented in the original application, the additional relief may not be relied upon. An application for exemptive relief should be submitted for consideration in those circumstances.

In those situations where relief was not granted on a “future-oriented” basis, the additional relief may continue to be relied upon only by those funds that were the subject of the exemptive relief order and/or decision document. This is again on the assumption that those existing funds will continue to operate in a manner similar to that described in the representations. Any new fund created by the fund manager in the future will need to apply for exemptive relief in order to be able to benefit from the additional relief.

Questions regarding this notice may be directed to:

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April 20, 2004