

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 valid¹.

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 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

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

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 at www.lautorite.qc.ca.

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 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.

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario
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Email: jstevenson@osc.gov.on.ca

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Tour de la Bourse
800, square Victoria
C.P. 246, 22 étage
Montreal, Quebec
H4Z 1G3
Fax: (514) 864-6381
Email: consultation-en-cours@lautorite.qc.ca

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.

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APPENDIX A

SUMMARY OF PUBLIC COMMENTS ON PROPOSED NATIONAL INSTRUMENT 81-107 AND COMMENTARY

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PART	TITLE
Part I	Background
Part II	National Instrument 81-107 <i>Independent Review Committee for Mutual Funds</i> (2004 Proposal) Comments in Response to Questions contained in Notice to 2004 Proposal
Part III	Other Comments

Summary of Comments

Background

On January 9, 2004, the CSA published for comment National Instrument 81-107 *Independent Review Committee for Mutual Funds* (2004 Proposal). The comment period expired April 9, 2004. We received submissions from the 43 commenters listed at the end of this table.

We have considered all comments received and wish to thank all those who took the time to comment.

The questions contained in the CSA Notice to the 2004 Proposal (2004 Notice) and the comments we received in response to them are summarized below. The question numbers below correspond to the question numbers in the 2004 Notice. Below the comments that respond to specific questions in the 2004 Notice, we have summarized the other comments we received on the 2004 Proposal.

		Comments	Responses
Part 1			
Section 1.2	<i>Mutual funds subject to Instrument</i>	01: Do you think this Instrument should apply either more broadly or more narrowly? If so, please explain why and in what manner.	
		<i>More broadly</i> Many mutual fund industry commenters urged us to have the 2004 Proposal apply to all publicly offered investment funds, as they equally share conflict of interest and self-	<i>CSA Response</i> <i>More broadly</i> We believe that conflicts of interest could exist in the management of all publicly offered investment funds.

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		<p>dealing issues and compete for the same investor.</p> <p>To exclude such products, we were told, would result in an unlevel playing field between competing products.</p> <p><i>Status Quo or more narrowly</i> One commenter observed that the mandatory imposition of an independent review committee (“IRC”) is not necessarily the best or most practical way to achieve enhanced investor protection.</p> <p><i>ETFs</i> Two commenters supported the 2004 Proposal’s exclusion of closed-end funds and mutual funds listed and posted for trading on a stock exchange (“ETFs”).</p> <p>Yet, one of these commenters told us that if we were to include ETFs in the 2004 Proposal, we need to take into account their nature and different distribution structure.</p> <p><i>Other products</i> One commenter expressed concern that an IRC is not appropriate for mutual funds distributed solely to portfolio managers for fully managed accounts managed by a registered adviser.</p> <p>Concern was also expressed by a few industry commenters that the 2004 Proposal is not appropriate for managers of small mutual funds, particularly those that employ a largely outsourced structure (e.g. custody, processing, valuation and portfolio management services) or have very few structural conflicts of interest.</p> <p>Still another commenter expressed reservations about the</p>	<p>As a result, we agree we should consider further expanding the applicability of the 2004 Proposal beyond publicly offered conventional mutual funds to include scholarship plans, labour-sponsored or venture capital investment funds, exchange-traded mutual funds and exchange-traded closed-end investment funds. We have asked for comment on this proposed approach in our notice.</p> <p>The Proposed Rule continues to exclude pooled funds and CAPs.</p> <p><i>Status Quo or more narrowly</i> After much consideration, we continue to believe that there are inherent conflicts of interest in the management of investment funds that could benefit from the independent perspective brought to bear on such matters by an IRC.</p> <p>We are, however, sensitive to the cost concerns of an IRC for smaller investment funds. We have again asked for comment in our notice on the inclusion of small funds in the Proposed Rule.</p>
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		<p>2004 Proposal being expanded to capture capital accumulation plans (“CAPs”).</p> <p>Another commenter told us the 2004 Proposal should not apply to products sold via an offering memorandum, labour-sponsored investment funds, nor any other pooled product or investment fund with an existing board of directors.</p>	
Part 2			
Section 2.4	<i>Independence</i>	02: Do you agree with a ‘principles’ based definition of independence? Are there alternatives?	
		<p>While we received support for a principles based definition of independence, there were differing opinions on the accompanying Commentary.</p> <p>One commenter told us not to undermine the integrity and flexibility of the definition by providing overly specific Commentary, while another urged us to consider more specific guidelines.</p>	<p><i>CSA Response</i> We continue to believe a ‘principles’ based definition of independence will provide the greatest flexibility in establishing IRCs.</p> <p>We agree with the commenter who told us not to undermine the definition by providing overly specific Commentary. We have revised the Commentary in the Proposed Rule accordingly.</p>
		03: Do you consider the definition of independence in subsections 2.4(2) and (3) appropriate?	
		<p>Our proposal to model the independence test in the 2004 Proposal on Multilateral Instrument 52-110 <i>Audit Committees</i> (“MI 52-110”) received a mixed response.</p> <p>While one commenter supported conformity with Section 2.4 of MI 52-110, another commenter told us that the concept of independence applicable to audit committees is excessive for the responsibilities of the IRC, and instead we should look to MI 58-101 <i>Disclosure of Corporate Governance Practices</i>. (“MI 58-101”).</p>	<p><i>CSA Response</i> We believe that we can describe the types of members we think would be appropriate through a ‘principles’ based definition of independence.</p> <p>Accordingly, the Proposed Rule no longer includes categories of prescribed material relationships (precluded persons), as found in MI 52-110 or proposed National Policy 58-201 <i>Corporate Governance Guidelines</i> (proposed NP 58-201).</p>

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		<p>Commenters with existing advisory or corporate board structures urged us to revise the definition of independence to permit members of existing advisory structures to act as members of the IRC. One commenter suggested we introduce a ‘materiality test’ as part of the definition so that the phrase ‘any relationship’ was qualified.</p> <p>Specifically, we were asked the following:</p> <ol style="list-style-type: none"> 1. To allow individuals that today act as the independent directors on the board of the fund manager to become the first members of the IRC, so long as these individuals have no other material relationships within the meaning of the 2004 Proposal, 2. To clarify Commentary 4 to allow independent directors of corporate mutual funds to act as the first members of the IRC, so long as these individuals have no other material relationships with the meaning of the 2004 Proposal, 3. To allow members of a mutual fund’s trust governance board to act as the first members of the IRC, so long as these individuals have no other material relationships with the meaning of the 2004 Proposal, 4. To allow independent directors of an affiliate to act as the first members of the IRC, so long as these individuals have no other material relationships with the meaning of the 2004 Proposal, and 5. To allow individuals that today act as members of IRCs (created for exemptive relief purposes) to act as the first members of the IRC, even though they have accepted a consulting fee. <p>A number of commenters also asked us to reconsider the concept of 100 percent independence for IRC members. We were directed to U.S. rules, as well as to academic literature, for discussions of the benefits of having non-independent</p>	<p><i>Who can act on the IRC</i></p> <p>We were persuaded by the commenters who urged us to allow the independent members of existing independent advisory boards, existing investment fund boards, and IRCs established for exemptive relief purposes, for example, to act as the first members of the IRC.</p> <p>The Proposed Rule now allows individuals with existing relationships with the investment fund, manager or an entity related to the manager (as defined in the Proposed Rule) to act on the IRC, provided they otherwise meet the ‘principles’ based definition of independence.</p>
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		<p>directors on a fund board. It was suggested we permit one-third non-independent members.</p> <p>We were told that 100 percent independence is not a substitute for active engagement on key issues by an experienced person whose interests are aligned with the interests of long-term investors. Also, that the applicant pool for ‘unrelated’ financially literate individuals to fill IRCs will make it challenging to recruit qualified people.</p> <p>Finally, we were urged to preclude as an IRC member a person with a direct or indirect material relationship with an investment adviser to the funds or any other significant supplier to funds, and to consider precluding persons with personal friendships with the manager.</p>	<p><i>Need for 100 percent independence</i> The focused role of the IRC exclusively on the oversight of a manager’s conflicts of interest leads us to continue to believe that all members of the IRC must be independent of the manager, investment fund and any entity related to the manager.</p> <p>We were persuaded, however, by the commenters who urged us to consider the benefits of non-independent directors on a board.</p> <p>Accordingly, the Commentary in the Proposed Rule now reinforces our view that the IRC is not prevented from meeting, or discussing matters with, the manager, representatives of management or other persons who may not be ‘independent’ as defined in the Proposed Rule, or from receiving oral or written submissions from such people.</p> <p>We continue to believe, however, that the independent members of the IRC should ultimately make their decisions in the absence of any representative of the manager or an entity related to the manager.</p>
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		<p>04: Commentary 4 describes certain categories of persons we consider to have a material relationship with the manager or the mutual fund. Do you agree with the categories of precluded persons? Are there other categories that should be added?</p>	
		<p>A number of industry commenters told us that Commentary 4 is overly specific and restrictive. They observed that it will disqualify most lawyers and accountants in firms with mutual fund manager clients even where the billings may be insignificant and the work is performed by other lawyers or accountants. One commenter further observed the mandatory language in Commentary 4 is inappropriate as the Commentary is not meant to have the force of law.</p> <p>These commenters urged us to introduce either a ‘materiality test’ or a de minimus threshold in Commentary 4, particularly as it refers to direct or indirect acceptance of “any consulting, advisory or other compensatory fee”.</p> <p>A number of commenters further told us that we should clarify the term “associate” in Commentary 4 so that family members who are not officers and directors of the manager, the mutual fund or an entity related to the manager will not be disqualified as prospective IRC members.</p> <p>Finally, one commenter suggested that the 2004 Proposal should specify the IRC’s responsibility to adopt policies on how members should conduct themselves if they are perceived to be in a conflict.</p>	<p><i>CSA Response</i></p> <p>We were persuaded by the commenters who told us the prescribed material relationships described in Commentary 4 were overly restrictive.</p> <p>Accordingly, the Proposed Rule no longer includes categories of prescribed material relationships (precluded persons) in the definition of independence and in the Commentary.</p> <p>While a “material relationship” may include the direct or indirect acceptance of fees, the Commentary to the Proposed Rule now specifies that only those relationships which could reasonably be perceived to interfere with the exercise of a member’s independent judgment, should be considered a “material relationship” within the definition of “independence”, barring membership on the IRC.</p> <p><i>IRC conduct</i></p> <p>The Commentary to the Proposed Rule now specifies our expectation that the IRC’s charter include policies and procedures on how members are to conduct themselves if in a conflict of interest, or perceived to be in a conflict of interest, with a matter being considered by the IRC.</p>

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		05: Is the ‘cooling off’ period in Commentary 4 an appropriate period? Too long? Too short?	
		<p>While one commenter told us a three year period was appropriate, many more told us they considered it too long. A number of commenters suggested a period of one year as an appropriate ‘cooling off’ period.</p> <p>We were urged by four commenters to introduce the “prescribed period” concept found in MI 52-110, so that individuals will only be considered to be non-independent if they have or have had a specified relationship during the prescribed period that begins after the 2004 Proposal becomes final.</p> <p>We were told that individuals should not be barred from acting as IRC members because they are tainted by relationships that pre-dated the 2004 Proposal.</p>	<p><i>CSA Response</i> Since categories of prescribed material relationships (precluded persons) are no longer included in the Proposed Rule, the ‘cooling off’ period previously specified in the 2004 Proposal has also been deleted.</p> <p>The Proposed Rule now allows individuals with existing relationships with the investment fund, manager or an entity related to the manager (as defined in the Proposed Rule) to act on the IRC, provided they meet the ‘principles’ based definition of independence.</p> <p>We would expect that a determination of whether an individual has a direct or indirect material relationship with the manager, investment fund, or an entity related to the manager in the Proposed Rule, to include a consideration of both the individual’s past and current relationships with these entities. This expectation is articulated in the Commentary of the Proposed Rule.</p> <p>We recognize that the ‘principles’ based definition of independence in the Proposed Rule has the effect of potentially barring an individual’s participation on an IRC for a relationship which extends beyond the previously prescribed ‘cooling off’ period. We consider this outcome appropriate.</p>
Section 2.8	<i>Liability</i>	06: We were told that without a limit on the liability of members of the independent review committee, insurance coverage for the members would be difficult to obtain. What are your views, given the responsibilities the IRC will have under this Instrument?	
		While one commenter remarked that the fact that the fund manager has final decision-making power would seem to	<p><i>CSA Response</i> Upon review and consultation, we believe insurance coverage for members of IRCs will be obtainable.</p>

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		<p>place most of the liability on the manager, other commenters told us that while obtainable at a high enough price, insurance coverage has become increasingly difficult to obtain and they expect coverage will continue to increase.</p> <p>One of these commenters further remarked that the broader the scope of conflicts overseen by the IRC, the more difficult or expensive it will likely be to obtain insurance coverage.</p> <p>Two other commenters told us that unlimited liability will likely mean much greater use and reliance by the IRC of professional advisers, which will increase costs of the IRC.</p>	<p>While we recognize that the novelty of the IRC structure may initially create added cost, we believe the focused mandate of the IRC, coupled with the existence of a number of independent advisory committees – including IRCs created in response to exemptive relief - will negate some of the costs associated with a new structure.</p> <p>To give guidance to potential IRC members (and potential insurers), we have revised the Proposed Rule to clarify the limits on the IRC’s mandate and its standard of care.</p>
		<p>07: Will potential members be deterred from sitting on the independent review committee without such a limitation?</p>	
		<p>Industry commenters unanimously told us that undefined liability and the uncertainty of availability of D&O insurance will be a strong deterrent to potential members of an IRC.</p> <p>One law firm commented that they would be reluctant to advise a client to join an IRC if there was no limit set on personal liability.</p> <p>Not surprisingly, we were urged by these commenters to somehow limit liability. One commenter remarked that the difference in potential liability of a member of an IRC and that of a director of an issuer is striking and not justifiable.</p> <p>One commenter suggested that the Commentary to the 2004 Proposal state that contractual limitations of liability for IRC members could be provided for in the trust indentures of mutual funds.</p>	<p><i>CSA Response</i></p> <p>We were sympathetic to the commenters who told us unlimited liability will act as a deterrent for potential members of an IRC. We engaged external legal counsel to assist us with this issue.</p> <p>As a result, the Proposed Rule has been revised to clarify the limits on the IRC’s mandate and its duty of care. We have been advised that these drafting changes (which use terminology similar to the CBCA) sufficiently limit the liability of members of the IRC to their mandate and increase the likelihood of a member’s ability to invoke the common law defences available to directors.</p>

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Part 3		
Section 3.2	<i>Changes to the Mutual Fund</i>	
		<p>08: We believe the changes to a mutual fund set out in section 3.2 involve conflicts of interest which can appropriately be referred to the independent review committee. Is this the right approach? Are there alternatives?</p>
		<p>Two commenters, one from industry and one an investor advocate, told us they agreed that the changes contemplated in Section 3.2 could give rise to, or at least give rise to the appearance of, a conflict of interest and therefore should be referred to the IRC.</p> <p>Yet we also heard from commenters who disagreed with our approach to refer these matters to the IRC :</p> <ol style="list-style-type: none"> 1. We were asked to either re-consider the types of fund changes that should require IRC referral or introduce a test of materiality into Section 3.2, 2. We were told that the IRC should not be involved where securityholders vote as they believed the IRC’s recommendation would not provide any meaningful additional protection to the investor. Alternatively, IRC involvement should preclude a securityholder vote, 3. It was suggested we delete Section 3.2 in its entirety, with most of the items more effectively handled by disclosure, while a securityholder vote remains for the rest. <p>Divergent views were also expressed on removing the securityholder vote in respect of certain fund changes. While some commenters supported the relaxation of the requirement to hold some securityholder meetings, others objected to the removal of what they perceived as one of so few investor rights, and the dilution of investor protection.</p> <p>The fund change we received the most response on was an increase of fees or expenses to the mutual fund.</p> <p>While one commenter supported referral to the IRC of increases in management fees, others told us referral to the</p>
		<p><i>CSA Response</i> <i>Mandatory referrals to the IRC</i></p> <p>We agree with the commenters who told us that the changes to a mutual fund contemplated in 3.2 of the 2004 Proposal (the ‘fundamental changes’ found in section 5.1 of National Instrument 81-102 Mutual Funds (“NI 81-102”)) could give rise to a conflict of interest, depending on the circumstances.</p> <p>Accordingly, the Proposed Rule no longer mandates referral to the IRC of the changes described in section 5.1 of NI 81-102 (section 3.2 of the 2004 Proposal is deleted). We acknowledge, however, that the definition of a “conflict of interest matter” in the Proposed Rule makes a referral to the IRC of any of these proposed changes possible. We believe this outcome is appropriate.</p> <p>We disagree with those commenters who told us IRC review of changes subject to a securityholder vote will not provide any meaningful additional investor protection.</p> <p>We continue to believe that the manager (and ultimately the investment fund and securityholders) can benefit from the independent perspective and input of an IRC on all decisions that have an inherent conflict of interest for the manager, including those decisions which are subject to a securityholder vote under Part 5 of NI 81-102.</p> <p>We would expect that the IRC’s determination on a conflict of interest matter subject to section 5.1 of NI 81-102 to be passed to securityholders for their consideration prior to voting. This view is articulated</p>

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	<p>IRC should not occur when the increase in fees involves a third party, or when it involves an allocation of expenses between funds.</p> <p>Still another commenter disagreed with our view that a change in a fee or expense is fundamental to the “commercial bargain” with investors. This commenter, and three others, told us that a manager should be allowed to increase or introduce a fee without a securityholder vote, provided investors have notice and are allowed to redeem without payment of any fees.</p> <p>These commenters further remarked that securityholder meetings for the approval of ongoing administrative matters are costly and not in the best interests of investors.</p> <p>Finally, one commenter suggested Section 3.2 additionally require the IRC to review a change in manager when the new manager is affiliated with the existing manager. This, it was remarked, represents a business conflict, since a fund sponsor is effectively choosing to realize higher operating margins by firing an external portfolio manager and hiring a related manager in its place.</p> <p>We also received comment on some technical drafting concerns with Section 3.2.</p> <p>First, three commenters remarked that the 2004 Proposal does not acknowledge the current exemptions contained in Part 5.3 of NI 81-102. These commenters submitted the 2004 Proposal should track the exemptions.</p> <p>Second, commenters told us that unlike NI 81-102, Section 3.2 does not specify “change in control” of a manager, only “change of manager”. They asked us to be consistent throughout the 2004 Proposal when referring to changes of manager and changes in control of manager.</p> <p>Third, one commenter urged us to adopt a more practical</p>	<p>in the Commentary to the Proposed Rule</p> <p><i>Removing a securityholder vote</i> We were persuaded by the commenters who told us they viewed the removal of the securityholder right to vote for certain changes to a mutual fund in section 5.1 of NI 81-102 as a dilution of investor protection.</p> <p>Accordingly, the consequential amendments to NI 81-102 which accompany the Proposed Rule removes only the securityholder vote for change of auditor and those mutual fund reorganizations or transfers of assets where the mutual funds are managed by the same manager or an affiliate, and meet the pre-approval criteria in section 5.6 of NI 81-102.</p> <p>After much consideration, we continue to believe that the remaining ‘fundamental changes’ under section 5.1 of NI 81-102 make up the ‘commercial bargain’ between investors and the mutual fund for which a securityholder vote must remain.</p>
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		<p>approach to address changes in control of a manager, remarking there are logistical problems with the requirement in NI 81-102 to give securityholders 60 days' notice.</p>	<p><i>Discrepancies with NI 81-102</i> We agree with the commenters who told us our drafting must be consistent with Part 5 of NI 81-102.</p> <p>Accordingly, the consequential amendments to NI 81-102 which accompany the Proposed Rule clearly refer to section 5.1. The exemptions in section 5.3 remain unchanged.</p> <p>We note, however, that the definition of a “conflict of interest matter” in the Proposed Rule makes a referral to the IRC of even the changes exempted from a securityholder vote in section 5.3 possible. We believe this is the right result as IRC oversight is intended to apply to any conflict of interest matter.</p> <p>Finally, we do not propose within the scope of this project to review the 60 day notice requirement in Part 5 of NI 81-102.</p>
		<p>09: Does the right to transfer free of charge to another mutual fund managed by the same manager need to be mandated or is it industry practice?</p>	
		<p>While three commenters supported the inclusion in the 2004 Proposal of the right to transfer free of charge in the situations noted, one commenter objected, stating that the right to transfer free of charge is a business decision of the fund complex, and is disclosed prior to an investor's investment.</p> <p>Of the commenters supportive of the right to transfer, one</p>	<p><i>CSA Response</i> The Proposed Rule no longer mandates a special right to transfer free of charge to another fund when the manager does not follow a recommendation by the IRC with respect to a change contemplated under section 5.1 of NI 81-102.</p> <p>Upon further consideration, our view is that securityholders should have the same protections and</p>

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		<p>remarked that the funds available to transfer to, or the investor’s objectives, may make the right to transfer an unsatisfactory option. This commenter suggested the 2004 Proposal require a limited period during which an investor can leave without penalty, including deferred sales charges. This sentiment was echoed by another commenter, who told us investors should not have to bear deferred sales charges if the 2004 Proposal is intended to permit them to redeem because of changes that the manager decides to make.</p> <p>Other commenters sought clarification of whether ‘transfer free of charge’ includes switch fees, even those charged by a dealer outside the control of the manager, and whether investors are also allowed to redeem and take cash. These commenters told us the 2004 Proposal should specify our intention.</p>	<p>remedies afforded to them for any management decision.</p> <p>The Proposed Rule now specifies that in instances where the manager intends to proceed without the positive recommendation of the IRC, the IRC has the discretion to require the manager to give immediate notice of its decision to proceed to the securityholders of the investment fund.</p> <p>The Proposed Rule now also requires that the IRC prepare a report to securityholders, at least annually, of events that have transpired for a relevant time period. Required to be in this report are any instances where a manager proceeded to act without the positive recommendation of the IRC.</p>
<p>Section 3.3</p>	<p><i>Inter-fund trades</i></p>	<p>10: Do you agree with our proposals for inter-fund trading (in particular, the scope of the provisions)? If not, please explain.</p>	
		<p>While one commenter commended us for being consistent with the framework under U.S. legislation for inter-fund trades, we also heard from a commenter who remarked that the provisions were overly prescriptive and inconsistent with the approach of the 2004 Proposal, as well as unnecessary in some instances, given other securities regulation designed to achieve transparency of securities held by portfolio managers.</p> <p>Still another commenter thought it was imprudent for us to give an exemption for these transactions.</p> <p>We received divergent views from commenters on the role of the IRC in inter-fund trades.</p>	<p><i>CSA Response</i> <i>Prescriptive nature of Rules</i></p> <p>We believe the inter-fund trading exemption in the Proposed Rule represents the minimum requirements necessary to mitigate the conflict of interest concerns inherent in such transactions, and satisfies the capital market objectives of market integrity.</p> <p>Accordingly, we do not believe that our approach to inter-fund trading is inconsistent with the approach of the Proposed Rule. Our view is that this provision will give managers much greater flexibility to make timely decisions to take advantage of perceived market opportunities.</p>

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		<p>While one commenter urged us to retain the IRC’s involvement, four others told us the IRC’s involvement was redundant and did not afford investors any additional protection, given the specific requirements in the 2004 Proposal and the industry, market and regulatory standards and practices that exist.</p> <p>Still two other commenters suggested that as an alternative to IRC review, the IRC approve all policies and business practices related to inter-fund trades, and then obtain assurances that the manager and portfolio manager are in compliance with those policies.</p> <p>We were also urged by a number of industry commenters to clarify that we are not mandating that inter-fund trades be reviewed by the IRC on a trade-by-trade basis. We were told that these trades involve timely decisions to take advantage of a perceived market opportunity.</p> <p>An investor commenter told us that the policies and procedures to effect inter-fund trades should not be left in Commentary but should be moved to Section 3.3. An industry commenter suggested a disclosure requirement in the mutual fund’s AIF of inter-fund trades.</p> <p>We received a number of general comments concerning the requirements in Section 3.3.</p> <p>One commenter asked why inter-fund trades are restricted to a particular fund family, rather than amongst fund families of the manager, while another asked us also permit inter-fund trading between “specified accounts”, as referred to in section 118 of the Ontario Act.</p>	<p><i>Role of the IRC</i></p> <p>We disagree with the commenters who told us the IRC’s role in reviewing a manager’s proposed inter-fund trades was redundant given the specific provisions already articulated.</p> <p>We continue to believe that the manager (and ultimately the investment fund and securityholders) can benefit from the independent perspective and input of an IRC on all decisions that have an inherent conflict of interest for the manager.</p> <p>The inter-fund trading exemption in the Proposed Rule relieves an investment fund from having to obtain the approval of the securities regulatory authorities or regulators, provided the IRC approves the transaction.</p> <p>The Proposed Rule and its Commentary clearly state that the IRC is permitted to give standing instructions (e.g., standing approvals) for an action or a category of actions.</p> <p>We remain satisfied that the written policies and procedures of the manager for inter-fund trades can remain in Commentary, since we expect the IRC to assess the adequacy and effectiveness of the manager’s policies and procedures as part of its approval process.</p> <p><i>Specific Requirements</i> <i>Inter-fund trades amongst fund families</i></p>
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		<p>Still another commenter asked how Section 3.3 applies to fixed income securities, and how it applies when no dealer is used.</p> <p>This commenter also remarked that paragraph 3.3(1)(c) seems to inappropriately discriminate against alternative trading systems (“ATs”) in favour of exchanges, and violates the ‘competitiveness’ principle embedded in section 5.2 of NI 21-101 Marketplace Operation (“NI 21-101”). It was suggested the 2004 Proposal allow mutual funds to trade as they see fit.</p> <p>In addition, the commenter asked for clarification of clause 3.3(1)(c)(iii), and what it means in subsection 3.3(2) for a trade to be exempt from NI 21-101 Marketplace Operation (“NI 21-101”). We were also asked why an exemption from section 6.1 and Part 8 of NI 23-101 Trading Rules (“NI 23-101”) is provided.</p>	<p>We were persuaded by the commenter who asked why inter-fund trades were restricted to a particular fund family. The Proposed Rule has been amended to allow inter-fund trades amongst fund families of the manager.</p> <p>We disagree, however, with the suggestion to allow inter-fund trades between specified accounts. Our comfort with the inter-fund trade exemption in the Proposed Rule stems from the protection we believe is afforded to securityholders by the review and approval of the trade by the IRC.</p> <p>Accordingly, we believe only investment funds subject to the Proposed Rule should be permitted to inter-fund trade under this provision.</p> <p><i>Applicability to fixed income securities and use of a dealer</i> We consider the inter-fund trade exemption in the Proposed Rule to apply to fixed income securities, and to specifically provide for the pricing and market transparency of such securities in now clauses (e)(ii) and (f)(iii) under subsection 6.1(1) of the Proposed Rule.</p> <p>Where a dealer is not involved in the inter-fund trade, we would expect the manager to report the trade to a dealer who will report it to an information processor. This is to occur only if the fixed income security is required to be reported under NI 21-101.</p> <p><i>Ability of investment funds to use ATs</i> Upon review, we have amended clause 6.1(1)(f)(i) of the Proposed Rule to require the purchase or sale to</p>
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		<p>Finally, we received a number of comments on the requirement that a transaction be “printed”.</p> <p>We were told by three commenters that the requirement to print potentially negates a significant portion, if not all, of the benefits to securityholders from the reduced transaction costs that would otherwise result from inter-fund trading.</p> <p>These commenters also told us a “print to page” requirement is unnecessary because it does not improve price discovery in the market since the price at which an inter-fund trade is occurring is already known, and the transaction does not “move the market” or is any real change of ownership from a market perspective.</p> <p>We were strongly urged by these commenters to re-evaluate the requirement in light of:</p> <ol style="list-style-type: none"> 1. no comparable requirement in the U.S. with respect to inter-fund trades, 2. U.S. mutual funds are prohibited from paying a commission on inter-fund trades, and 3. the opposite policy direction taken by the CSA in NI 62-103 Early Warning System and Related Take-Over Bid and Insider Reporting Issues (“NI 62-103”), where it is deemed irrelevant to the market which specific mutual fund or account holds the securities. The portfolio manager is seen as the one who is directing the accumulation of a large position in an issuer, or is reducing that position, and therefore must aggregate their holdings. <p>Another commenter recommended that we not use term “print” since the word is also commonly used to mean both “execute” and “report”. This commenter further asked what happens if a security is dual-listed and the foreign market is</p>	<p>be printed to a marketplace that executes trades of the security. Our view is that the marketplace cannot be set up for the mere purpose of printing these types of trade.</p> <p><i>Technical clarifications</i> Now clause 6.1(1)(f)(iii) of the Proposed Rule imports the information transparency requirements in Part 8 of NI 21-101 for trades in fixed income securities.</p> <p>The Proposed Rule now clarifies that the portfolio manager, not the trade, will be exempt from the provisions under NI 21-101 and from section 6.1 and Part 8 of NI 23-101. We consider these exemptions necessary because we view the inter-fund trades under the Proposed Rule to be trades on a marketplace.</p> <p><i>Printing Requirement to print</i> We continue to believe that to facilitate price discovery and market integrity, inter-fund trades must be transparent. Unlike NI 61-103, which is intended to capture the ‘directing mind’ of the reporting issuer, this provision is intended to facilitate price discovery.</p> <p>We disagree with those commenters who told us that the requirement to ‘print’ will significantly negate all of the benefits to securityholders of inter-fund trading. Upon review and consultation, we expect the costs to ‘print’ to be substantially lower than the costs normally associated with market transactions through a dealer.</p>
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		the best place to execute the trade.	<p><i>Terminology</i> We believe the term ‘print’ is readily understood in the context of inter-fund trading.</p> <p>In instances where a security is dual-listed, we would expect best execution, and that the purchase or sale comply with the requirements that govern transparency and trading where executed.</p>
		11: Should clause 3.3(1)(b)(1) refer to “the last sale price” or should it enable managers to trade within the bid/offer spread during the trading day?	
		<p>While one commenter told us that the clause should refer to the “closing price” of the relevant security on its primary exchange, another commenter suggested that the specifics of pricing be left to the IRC.</p> <p>Still another commenter told us to consider expanding guidelines/requirements for best price/execution to cover inter-fund trading.</p>	<p><i>CSA Response</i> Upon review, the Proposed Rule now refers to ‘closing sale price’.</p> <p>The Commentary to now section 6.1 of the Proposed Rule states our expectation that if price information is publicly available from a marketplace, newspaper or through a data vendor, for example, this will be the price chosen. If the price is not publicly available, we would expect an investment fund to obtain at least one quote from an independent, arms-length purchaser or seller, immediately before the purchase or sale.</p>
		12: Is the pricing referred to in paragraph 3.3(1)(b) appropriate for illiquid exchange-traded and foreign exchange-traded securities, over-the-counter equity securities and debt securities?	
		We received one comment on this question. We were told that the current market price for illiquid equity securities should be the closing price for those securities on their primary exchange.	<p><i>CSA Response</i> Upon review, we consider the average of the highest current bid and lowest current ask, as set out in the Proposed Rule, to be appropriate for illiquid securities.</p>
		13: Should the current market price of illiquid equity securities on an exchange be treated differently from over-the-	

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		counter equity securities?	
		We received no comments on this question.	<i>CSA Response</i> We have concluded the pricing should not be different.

Other Comments on the Rule

General Comments			
	<i>Support for Rule</i>		<i>CSA Response</i>
		<p>Support for the 2004 Proposal’s revised focus on conflicts of interest and the role of the IRC was divided almost unanimously among industry and investor commenters.</p> <p><i>Supportive</i> While one industry commenter told us the 2004 Proposal is not justified, as there is no evidence of widespread conflicts of interest adversely affecting investors, the vast majority of industry commenters supported our goal of enhanced investor protection and investor confidence through the use of independent oversight.</p> <p>Those supportive of the 2004 Proposal told us the focus on conflicts of interest targets the most appropriate area of governance oversight, and allows the IRC to focus on the very issues that are most important to investors. They also remarked that fund governance is not a panacea and they do not believe a very broad mandate will be more effective in protecting investor interests.</p> <p>One industry commenter told us they believe the IRC can be an important means of achieving objectivity and should provide a measured deterrent to both individuals and entities that seek to circumvent their fiduciary duties.</p>	<p>We believe an IRC, focused exclusively on conflicts of interest facing the manager, will provide independent review of an area that could benefit from independent oversight. We expect the role of the IRC to evolve with time and expect industry practices to develop to support and enhance this regime.</p> <p>We were persuaded, however, by the commenters who urged us to reconsider the parameters of the IRC’s authority.</p> <p>Accordingly, the Proposed Rule now requires the manager to obtain the approval of the IRC before proceeding with certain types of prohibited conflict of interest or self-dealing transactions (inter-fund trading, purchases of securities of related issuers and purchases of securities underwritten by related underwriters) that would otherwise require the approval of the securities regulatory authorities or regulators.</p> <p>Additionally, the Proposed Rule now explicitly gives the IRC the authority to communicate directly with the securities regulatory authorities or regulators, and requires the IRC to report instances where it finds (or has reasonable grounds to suspect) breaches of the</p>

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		<p><i>Opposed</i> Investor commenters were unanimous in their opposition to the 2004 Proposal’s revised focus on conflicts of interest and the role of the IRC. Many of these commenters urged us to withdraw the 2004 Proposal, saying that it undermines investor protection and erodes investor confidence in the safety and soundness of mutual funds.</p> <p>These commenters warned that without explicit authority to impose decisions and to forward concerns to regulators, the IRC will be ineffective in mitigating conflicts of interest. They told us they were disappointed and disturbed that the 2004 Proposal is “significantly gutted” from the Concept Proposal and does not go far enough.</p> <p>Two investor commenters told us the U.S. fund scandals had led to their “decreasing trust and faith” in those in industry fulfilling their fiduciary responsibilities and remarked that the industry should not be allowed to “police itself”.</p> <p>Objection to the 2004 Proposal was not exclusively from investors. An independent board of directors of a mutual fund also expressed concern for the reduced role of the IRC, stating it removes important protections for mutual fund investors.</p>	<p>matters under its review.</p>
	<p><i>Relationship to loosening product regulation</i></p>	<p>Support for our proposal to remove the existing self-dealing and conflict of interest prohibitions contained in NI 81-102 and provincial securities legislation was similarly divided among industry and investor comments.</p> <p>Some industry commenters supportive of the 2004 Proposal stressed that enhanced independent oversight must be coupled with harmonized product regulation, instead of being an ‘add-on’ to the existing regulatory regime. They told us that they need to review our proposed revisions to the existing product regime to quantify and comprehend the impact of the 2004 Proposal.</p>	<p><i>CSA Response</i> We continue to believe that existing conflict of interest prohibitions in securities regulation can, and should, be rethought with the introduction of a mandatory IRC. However, we were persuaded by those commenters who argued that introducing an IRC does not remove the need for the existing prohibitions on self-dealing and other related party transactions in securities legislation.</p> <p>As a result, the Proposed Rule is now drafted on the premise that the existing self-dealing and conflict of interest prohibitions in securities regulation will remain. For the manager to proceed with certain types</p>

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		<p>Two other commenters told us that to recognize the benefits demonstrated in the OSC’s cost-benefit analysis, existing conflict of interest prohibitions in securities regulation must be repealed contemporaneously with the 2004 Proposal coming into force.</p> <p>We were also asked to eliminate redundancy between the review responsibilities of the IRC and requirements of existing rules that will not be subject to regulatory relaxation.</p> <p>Investor commenters unanimously told us introducing an IRC does not remove the necessity for the existing prohibitions on self-dealing and other related party transactions in securities legislation. The fundamental problem of the 2004 Proposal, we were told, is the removal of existing prohibitions on related party transactions and replacing them with an IRC whose authority is non-binding.</p> <p>These commenters remarked that it is highly unlikely an IRC with no powers is a sufficient check or balance. One commenter said they had no problem with self-regulation being added to an existing regulatory structure but not instead of it.</p> <p>Concern was also expressed that the removal of existing prohibitions will not provide regulators with regulatory oversight, and may make it more difficult for investors to establish a manager’s breach of its fiduciary obligations.</p>	<p>of prohibited transactions without regulatory approval (inter-fund trading, purchases of securities of related issuers and purchases of securities underwritten by related underwriters), prior approval of the IRC must be obtained.</p> <p>These exemptions represent those conflicts of interest which we (in part, based on our experience to date with exemptive relief), believe can be appropriately dealt with by IRC approval and oversight. We expect that the types of prohibited conflict of interest matters dealt with in this manner will continue to evolve.</p>
	<p><i>Principles-based regulation</i></p>	<p>While some commenters commended us for our commitment to ‘principles’ based regulation, and for the 2004 Proposal’s “user-friendly” format, others expressed some concern regarding this regulatory approach.</p> <p>Four investor commenters remarked that at a time when the U.S. securities regulators are enforcing stricter regulation to deter abuses discovered in the U.S. mutual fund industry, it</p>	<p><i>CSA Response</i></p> <p>We agree with the commenters who told us they support a mix of ‘principles’ and ‘prescriptive’ regulation. While we continue to believe in more flexible regulation, the Proposed Rule now contains certain minimum requirements on the structure and functions of the manager, investment fund and the IRC, where we considered it appropriate.</p>

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		<p>was not appropriate for us to be relaxing rules or removing ourselves from the oversight of investment funds. Another commenter expressed concern for the message the 2004 Proposal sends to the investing public when confidence in the system already low.</p> <p>These commenters referred us to past reports which rejected relying solely on a principles-based approach to regulating conflicts of interest. They told us these concerns still exist, and that a combination of specific rules and principles would be effective.</p> <p>One commenter asked how we expected to enhance compliance efforts absent any explicit requirements against which to measure compliance.</p> <p>Still another commenter stated that without any evidence that a principles-based system is more effective, a more gradual shift to a principles-based regime – incorporating a mix of principles and rules - should occur.</p> <p>Industry commenters also expressed concern at the inclusion of large portions of the 2004 Proposal as Commentary. We were told mandatory or prohibitive language in Commentary is inappropriate because it is not intended to have the force of law.</p> <p>To provide certainty for fund managers and IRCs, these commenters asked that significant sections of Commentary be moved into the 2004 Proposal. One commenter remarked that matters considered important and necessary for the 2004 Proposal should be in the 2004 Proposal, not in Commentary.</p>	<p>The Commentary to the Proposed Rule has been amended to remove any mandatory or prohibitive language.</p>
	<p><i>Costs and Cost-Benefit Analysis (“CBA”)</i></p>	<p>A number of commenters told us that the cost-benefit analysis (the “CBA”) does not adequately address some of the significant cost implications of the 2004 Proposal, such as costs associated with the insurability and compensation of IRC members, the costs of professional advisers to the</p>	<p><i>CSA Response</i> We believe that investment funds and securityholders could benefit from the Proposed Rule, which is designed to more effectively deal with the conflicts of interest faced by the manager.</p>

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		<p>IRC, and the costs related to the inter-fund trading regime proposed. We were told that IRC candidates may gravitate to firms that offer high compensation and the most resources, making IRCs more costly.</p> <p>One commenter told us that if the responsibilities of the IRC could be limited to a more defined list of conflict situations, the costs incurred by the funds should be lower.</p> <p>Another commenter suggested that we consider the costs incurred by investment funds in the United States who have boards.</p> <p>It was also suggested that each of the provisions in the 2004 Proposal ought to have a cost-benefit analysis evaluation.</p> <p>A few commenters also questioned the cost versus benefit of introducing an IRC. We were asked to remain sensitive to the fact that the increasing impact of cost pressures on mutual funds will result in higher costs to investors and serve to reduce the overall competitiveness of the industry. One commenter told us it is not acceptable to burden lower to middle income investors (to whom the mutual fund industry provides investment opportunities) with increased costs and reduced performance.</p> <p>In response to industry’s cost concerns, one commenter, questioning the benefit of trailing commissions to investors, suggested fund managers abolish trailer fees to pay for the costs of an IRC.</p> <p>Finally, we were reminded by a number of commenters that small fund managers, who are less likely to be related to financial service providers, will benefit less from the mandatory imposition of an IRC.</p>	<p>Accordingly, while we recognize that the Proposed Rule will impose some additional costs on investment funds, we disagree with some of the cost concerns raised by commenters.</p> <p>Our view is that the focused mandate of the IRC and the current existence of a number of independent advisory committees, boards and IRCs (created voluntarily or in response to exemptive relief), will negate some of the insurance costs associated with an unknown structure.</p> <p>We also expect that the costs to ‘print’, a condition to inter-fund trading under the Proposed Rule, will be substantially lower than the costs normally associated with market transactions through a dealer.</p> <p><i>Small investment funds</i> Regardless of the size of the investment fund, conflicts of interest are inherent in the management of all investment funds. Small investment funds and their securityholders could benefit from the independent perspective brought to bear on such matters by IRC oversight.</p> <p>We are, however, sensitive to the cost concerns of an IRC for small investment funds.</p> <p>Under the Proposed Rule, we believe that with no structural conflicts of interest and fewer business conflicts of interest (where the investment fund employs a largely outsourced structure), the scope of IRC review could be much less burdensome than for the larger investment fund complexes, and therefore, less costly. For example, the mandate of the IRC of a small investment fund will be simpler, and less costly, than for a larger investment fund.</p>
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			<p>We have again asked for comment in our notice on the inclusion of small funds in the Proposed Rule and specifically, on the viewpoint articulated above.</p>
	<p><i>Educational Requirements for IRC members</i></p>	<p>Industry and investor commenters alike impressed upon us the need for minimum proficiency standards and ongoing education programs for IRC members. We were told “industry literacy standards”, particularly of capital markets and the mutual fund industry, were important.</p> <p>Commenters’ suggestions included that the CSA implement education standards, not unlike existing legislation for audit committees, and that regulators and industry set up education programs for new members of IRCs.</p> <p>One commenter suggested the statutory requirements of directors of incorporated companies should apply, while another told us that we should monitor the activities of IRCs until we are satisfied they are capable of appropriately discharging their responsibilities.</p>	<p><i>CSA Response</i></p> <p>We were persuaded by the commenters who urged us to consider specifying minimum education requirements for IRC members. We agree that to be effective, members of the IRC must understand the nature, operation, and business of both the manager and the investment fund, the role of the IRC, and the contribution individual members are expected to make.</p> <p>Accordingly, the Proposed Rule now sets out minimum standards for the orientation and continuing education the manager must provide to members of the IRC. We anticipate that industry practice standards may also develop in this area.</p>
	<p><i>Additional suggestions</i></p>	<p>We received a few additional suggestions.</p> <p>One commenter told us auditors could benefit from “independence” in their review, and suggested the 2004 Proposal impose separate audit firms for the fund manager and for its mutual funds.</p> <p>Another commenter suggested we require independent auditors to pass opinion on the internal controls of the manager.</p> <p>We were also provided with a list by an investor advocate of other investor protection initiatives the CSA should institute instead of the 2004 Proposal. Among them: a mutual fund investor protection fund, a prohibition on frequent trading, a requirement that fund companies publicly disclose their</p>	<p><i>CSA Response</i></p> <p><i>Auditor independence and advice to IRC</i></p> <p>The definition of a ‘conflict of interest matter’ in the Proposed Rule may, in certain instances, capture a manager’s decision to engage its auditor for the investment fund it manages. The Proposed Rule authorizes the IRC to employ independent counsel and other advisers it determines useful or necessary to carry out its role. We continue to believe a flexible approach to the IRC’s use of external advisers is appropriate.</p> <p><i>Other initiatives</i></p> <p>While not within the scope of the Proposed Rule, a number of the investor protection initiatives raised by this commenter are currently underway.</p>

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		proxy share voting policies, and a limit on soft dollar transactions.	
Part 1			
Section 1.3	<i>Multiple class mutual funds</i>	Two commenters questioned the desirability of introducing the use of terminology different from section 1.3 of NI 81-102.	<p><i>CSA Response</i> Upon review, we agree with these commenters. Accordingly, the Proposed Rule no longer references multiple class funds.</p> <p>The Proposed Rule would apply to multiple class mutual funds in the same manner as NI 81-102 applies such classes or series.</p>
Part 2			
Section 2.1	<i>Independent review committee for a mutual fund</i>	<p>While two commenters told us that they appreciated the flexibility provided to fund managers to structure an IRC that works best for the funds that it manages, another commenter remarked that the alternative structures suggested in the Commentary, except for a committee of individuals independent of the fund manager, will generally not be practicable options.</p> <p>Although one commenter asked that the Commentary clarify that a mutual fund may establish multiple IRCs if it wishes, another commenter told us multiple IRCs within the same mutual fund complex is undesirable because: there should be uniformity of policies and procedures for all funds managed by the same manager, fund expenses would increase if several IRCs were to exist, and it would compound anticipated difficulty for fund complexes to identify and attract suitable members for IRC.</p> <p>Two commenters also remarked that confidentiality and competition issues make it unlikely that fund managers would consider an IRC acting for two or more unrelated fund complexes.</p>	<p><i>CSA Response</i> <i>The structure and number of IRCs</i> We think it is important to provide flexibility to funds to determine how to best structure their IRC.</p> <p>With the Proposed Rule no longer including categories of precluded material relationships in the definition of ‘independence’ for IRC members, a manager is able to choose the independent members of an existing independent advisory board, an existing investment fund board, or IRC, for example, to act as the first members of the IRC under the Proposed Rule. These are practical options for funds with existing IRC-like structures.</p> <p>There may be instances where the manager would consider that the objectives or strategies of an investment fund or group of investment funds warrant a separate IRC. The Commentary to the Proposed Rule specifies that the manager may establish one IRC for all investment funds it manages, or establish an IRC for each of its investment funds, or groups of its investment funds.</p>

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		<p>One commenter urged us to explicitly permit in the 2004 Proposal (not Commentary) that an IRC of more than 3 members may delegate its responsibilities to a committee of at least 3 members, so that an entire ‘board’ is not liable for the decisions taken by the IRC.</p> <p>Another commenter remarked that the 2004 Proposal does not sufficiently delineate the required scope of reporting by, or decision-making authority of, an IRC in relation to existing governance structures (boards) already in place.</p> <p>We were also told by a commenter that they disagreed with our view that there was a large pool of potential IRC members.</p>	<p><i>The IRC’s relationship to existing structures</i> Upon review, we did not think it was necessary to explicitly permit the specific arrangement contemplated by the commenter.</p> <p>While the Proposed Rule sets out the reporting relationship between the manager and the IRC, we would expect the manager, in the course of selecting an IRC structure suitable for its investment funds, and when assisting in the development of the IRC’s charter, to consider any further reporting obligations the manager wants from the IRC.</p> <p><i>Applicant pool for IRC members</i> Upon review and consultation, we continue to believe that there will be a sufficient pool of potential IRC members.</p>
<p>Section 2.2 Section 2.3</p>	<p><i>Term of Office</i> <i>Initial Appointment</i> <i>Composition,</i> <i>Term of office</i> <i>and vacancies</i></p>	<p>One commenter disagreed with a maximum term of 5 years, suggesting IRC members be permitted to serve 7 years. This commenter also remarked that a member who has served the maximum allowable term should not be eligible for reappointment until two years have elapsed.</p> <p>We were also asked to specify a maximum number of years that can be served by any one director, with two commenters suggesting a 10 year cap, citing concern for members becoming entrenched both in viewpoints and the desire to stay.</p>	<p><i>CSA Response</i> While the Proposed Rule specifies a maximum 5 year term, it does not limit the number of terms that an IRC member may serve. We consider the members of the IRC, who appoint replacement members after the manager’s initial appointment, to be best-positioned to judge the effectiveness of a fellow member.</p> <p>We would expect the annual self-assessment and committee assessment by IRC members now required by the Proposed Rule to address whether the term of a member was problematic. We also believe that this is</p>

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		One commenter suggested the 2004 Proposal clarify how initial terms should be structured so as to achieve staggered terms.	an area where best practices will develop.
	<i>Appointments</i>	<p>Comments on appointments to the IRC were split into three groups.</p> <p>One group of comments supported the 2004 Proposal’s requirement for the IRC to appoint replacement members after the fund manager’s initial appointments. However, we were also told by one commenter that the 2004 Proposal should provide the manager with a forum to object such nominations, and another commenter remarked that the 2004 Proposal should provide for investors to participate in the appointment of IRC members.</p> <p>The second group of commenters disagreed with the approach in the 2004 Proposal. They told us that the fund manager should be solely responsible for all IRC appointments, since the best interests of the mutual fund ultimately lies with the fund manager, and the manager is as interested as securityholders in ensuring that an IRC is comprised of qualified, competent people.</p> <p>The third group of commenters remarked that the manager and IRC should appoint and remove members jointly.</p>	<p><i>CSA Response</i></p> <p>We believe the IRC’s appointment of members (after the manager’s initial appointment), is best-suited to foster an independent-minded IRC focused on the best interests of the investment fund. We consider the process of self-selection of the IRC to be consistent with good governance practices.</p> <p>Some commenters suggested the manager should have some involvement in the selection process and we agree.</p> <p>Accordingly, the Proposed Rule now requires appointments of members of the IRC to meet certain minimum nominating criteria, which we would expect the manager and IRC to develop together.</p> <p>The Commentary to the Proposed Rule further specifies our expectation that the IRC would consider the manager’s recommendation in selecting its members.</p>
Section 2.4	<i>Independence</i>		<i>CSA Response</i>
		<p>Many commenters asked us to clarify in Commentary 3 whether “material relationship” includes individuals who have an investment in the particular mutual fund. We were told such individuals otherwise qualified should not be prevented from becoming a member of an IRC, as ownership serves to align the interests of the IRC with the mutual funds.</p> <p>One commenter even suggested all IRC members be required to own securities in the mutual funds they review, equal to a minimum of one year’s fees, in order to align</p>	<p>As noted above, we believe that we can describe the types of members we think would be appropriate through a ‘principles’ based definition of independence.</p> <p>Accordingly, the Proposed Rule no longer includes categories of prescribed material relationships (precluded persons), as found in MI 52-110 or proposed NP 58-201.</p>

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		<p>their interests with those of securityholders.</p> <p>Two commenters disagreed with the 2004 Proposal permitting the board of a trust company acting as trustee for the fund to become members of the fund’s IRC. While another commenter supported this approach, still another told us that the board’s first responsibility is to the trust company, and stressed the importance of true independence of the manager.</p> <p>We were also asked by a commenter to specify in Commentary 6 whether an IRC should adopt policies and procedures requiring disclosure of a member’s and close relatives’ interests in the funds. The commenter remarked that IRC members should recuse themselves from discussions relating to funds in which they hold substantial interests.</p>	<p><i>Ownership of securities of the investment fund</i> While the Commentary specifies that a “material relationship” within the definition of “independence” may include ownership, we would expect only those relationships which might reasonably be perceived to interfere with the exercise of a member’s independent judgment to be considered material.</p> <p><i>Disclosure of interests</i> The Commentary to the Proposed Rule has been revised to specify our expectation that an IRC’s written charter include policies and procedures that describe how members of the IRC are to conduct themselves when in a conflict of interest, or perceived conflict of interest, with a matter being considered or about to be considered, by the IRC.</p> <p>We believe this is an area where best practices will develop.</p>
Section 2.5	<i>Responsibilities</i>		<i>CSA Response</i>
		<p>Two industry commenters told us that the requirement for the IRC to deliberate in the absence of management was impractical and unnecessary. They suggested the IRC should be allowed to decide whether to include or exclude representatives of the manager from its proceedings. Alternatively, one of these commenters told us that Commentary 2 should clarify that the IRC can meet with representatives of the manager or any entity related to the manager to discuss any matters before the IRC.</p>	<p><i>The IRC’s deliberations</i> Part 3 of the Proposed Rule now sets out the responsibilities of the IRC.</p> <p>Given the IRC’s focus on management decisions that involve a conflict of interest for the manager, we continue to believe that the IRC should make its decisions in the absence of any representative of the manager, or an entity related to the manager.</p>

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		<p>One commenter asked us to move the phrase “provide impartial judgement” to the Commentary, since the IRC members will be independent and their duty is to recommend what would be a “fair and reasonable result”.</p> <p>Another commenter told us that the criteria for review by the IRC of a matter referred to it should include that the proposed action by the manager is in the fund’s best interests.</p>	<p>However, in response to the comments, the Commentary now clearly reiterates our view that the IRC may meet with management or any person who is not considered ‘independent’ as defined in the Proposed Rule, to discuss any matter before the IRC.</p> <p><i>The IRC’s review and determination</i> Part 5 of the Proposed Rule now sets out the determination that the IRC must form in its review of conflict of interest matters.</p> <p>For the manager to proceed with certain types of prohibited transactions without regulatory approval (inter-fund trading, purchases of securities of related issuers and purchases of securities underwritten by related underwriters), the prior approval of the IRC must now be obtained.</p> <p>For any other proposed course of action by the manager that involves or may be perceived to involve a conflict of interest for the manager, we continue to believe a determination of the IRC of whether the action is a fair and reasonable result for the investment fund is appropriate.</p>
	<i>IRC’s charter</i>		<i>CSA Response</i>
		<p>Two commenters told us the 2004 Proposal should provide guidance on the CSA’s expectations as to the role, obligations and functions of the IRC, and that these responsibilities should be aligned with existing corporate governance standards for corporate boards.</p> <p>Another commenter expressed concern that the 2004 Proposal lacked specific parameters for the IRC’s mandate and responsibilities. This commenter told us permitting each</p>	<p>We were persuaded by the commenters who told us to set specific parameters around the IRC’s mandate and responsibilities, which form the basis of the IRC’s written charter.</p> <p>Accordingly, Part 3 of the Proposed Rule now sets out the functions we expect the IRC to fulfill. We consider many of the IRC’s obligations under this part – regular assessments, reporting obligations, for example – to be consistent with good governance</p>

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		<p>fund complex to set its own charter effectively grants self-regulatory powers to mutual funds, and makes a comparison of governance standards among mutual funds difficult.</p> <p>We were also told that if the concept of ‘shared’ IRCs remained, the Commentary should clarify that a separate charter for each fund family is necessary.</p> <p>Finally, one commenter remarked that the IRC’s adoption of a written charter setting out its mandate should not be interpreted to allow an IRC to unilaterally enlarge its mandate or powers beyond 2004 Proposal, without the fund manager’s consent.</p>	<p>practices.</p> <p>We believe the changes made in the Proposed Rule will ensure a minimum governance standard among all investment funds subject to the instrument, and a level of uniformity in IRC charters.</p> <p>In response to comments, the Commentary to the Proposed Rule has been revised to specify that we would expect an IRC of multiple fund families to prepare a separate charter for each fund family.</p> <p>The Proposed Rule has also been revised to state that any mandate of the IRC beyond the scope of the Proposed Rule must be by mutual agreement of the IRC and the manager.</p>
Section 2.6	<i>Standard of care</i>	<p>One commenter remarked that the standard of care for IRC members should be to act in the best interests of fund securityholders, since there may be instances where a mutual fund might stand to benefit from transactions that do not directly benefit securityholders.</p> <p>Another commenter also suggested that we delete Commentary 2 as it is unnecessary.</p>	<p><i>CSA Response</i></p> <p>We believe the standard of care for a member of the IRC when carrying out his or her function should be to act ‘in the best interests of the investment fund’. This standard is consistent with the manager’s standard of care and the standard of care expected of directors of corporate boards.</p> <p>The Commentary now describes our expectation that any consideration by the IRC of the best interests of the investment fund would, first and foremost, be a consideration of the best interests of the securityholders in the investment fund.</p>
Section 2.7	<i>Authority</i>	<p>One commenter asked us to give the IRC the authority to require indemnification by the fund manager or the fund under appropriate circumstances.</p>	<p><i>CSA Response</i></p> <p>We disagree that the IRC should have the authority to require the manager or investment fund to indemnify them.</p> <p>The Proposed Rule permits an investment fund and manager to indemnify and insure the members of the IRC, consistent with the CBCA. We believe this is an</p>

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		<p>As a technical matter, two commenters remarked that the 2004 Proposal must provide the mutual funds and the fund manager with an exemption from Part 5 of NI 81-102 (and corresponding Section 3.2 of the 2004 Proposal), for expenses related to compliance with the 2004 Proposal.</p>	<p>area where industry practice may develop.</p> <p><i>Technical concern</i> Upon review, we do not consider the expenses incurred by the introduction of the IRC in the Proposed Rule to be caught by section 5.1 of NI 81-102.</p> <p>Our view is that the purpose of section 5.1 is not to capture the costs associated with compliance by an investment fund of new regulatory requirements.</p>
	<p><i>Indirect compensation by the manager</i></p>	<p>While one industry commenter agreed with us that a fund manager’s direct or indirect compensation to the IRC would seriously undermine the independence of IRC members from the manager, an investor advocate told us that fund investors should not have to pay to keep managers honest; the costs of the IRC should be included in the services provided by the manager for its fees.</p> <p>Still another commenter told us that prohibiting indirect compensation by the manager to the IRC will not make the IRC more or less independent from a practical perspective.</p> <p>A large number of industry commenters remarked that preventing a manager from absorbing the costs of the IRC demonstrated our lack of understanding of how expenses are often charged to, and recovered from, mutual funds.</p> <p>These commenters explained that typically in fund companies there is a ‘pool’ of costs that are chargeable to the funds which are allocated between all of the funds managed by a manager. These costs are then added to the ‘direct’ costs charged to a fund and included in the management fee for that fund. In many cases, fund managers will absorb some expenses rather than passing them to the fund to maintain a management expense ration (“MER”) at a competitive level.</p>	<p><i>CSA Response</i> We were persuaded by the commenters who told us to allow the manager to indirectly pay (by absorbing the costs) at least some of the costs associated with the IRC. Particularly convincing to us were the comments that discussed the effect on the MER of smaller investment funds if they are not permitted to have the manager absorb the costs of the IRC.</p> <p>We are satisfied that the provisions in the Proposed Rule that require the IRC to set its own compensation, and mandate that the IRC be 100 percent “independent”, fosters an independent-minded IRC and avoids any undue manager influence. Accordingly, the Commentary to the Proposed now specifies a manager is not prohibited from reimbursing the investment fund for the fees and expenses incurred by the IRC.</p>

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		<p>We were told that if the 2004 Proposal prevents a manager from absorbing the costs of the IRC, the MERs of mutual funds will increase and depending on the size of the fund complex, the increases may be significant and negatively impact fund performance. This, we were told, is particularly relevant for smaller funds.</p>	
	<p><i>IRC setting compensation</i></p>	<p>Commenters had differing views on whether IRC members in setting their own compensation put themselves in a conflict of interest situation. Three commenters told us yes it did, while one commenter said it did not, although suggested we clarify this in the Commentary under Section 2.4.</p> <p>We also received varied opinions on whether IRC members should set their own compensation.</p> <p>Three commenters told us the fund manager should set the IRC’s compensation or have a veto power, as a ‘check’ on possible abuses by IRC members.</p> <p>Two other commenters suggested the IRC’s compensation be set jointly by the manager and the IRC.</p> <p>Another commenter remarked that another body should approve the IRC’s compensation.</p> <p>Alternatively, these commenters told us that if the IRC sets its own compensation, the compensation set, any rejection of the manager’s recommendation (for compensation and expenses), and the expenses incurred by the IRC for external advisers, should be subject to mandatory disclosure in the funds’ continuous disclosure documents.</p> <p>It was also suggested that the 2004 Proposal provide some guidance regarding the method by which compensation scales should be determined.</p>	<p><i>CSA Response</i> <i>Conflict of interest for the IRC</i> We do not believe that the IRC setting its own compensation will interfere with the exercise of a member’s independent judgment.</p> <p>The Commentary to the Proposed Rule now articulates this position.</p> <p><i>Setting its own compensation</i> We strongly believe that the IRC setting its own compensation will foster an independent-minded committee, and will avoid undue manager influence. This requirement is consistent with good governance practices, and we believe it will be an area where industry best practices develop.</p> <p>We agree, however, with those commenters who told us the manager should have a role in determining the IRC’s compensation, and that the compensation set by the IRC should be disclosed.</p> <p>Accordingly, the Proposed Rule now requires that (i) in setting its compensation and expenses, the IRC must consider the manager’s recommendation, and (ii) in the newly required annual report prepared by the IRC to securityholders, the IRC must disclose any instance where the IRC, in setting its compensation and expenses, did not follow the recommendation of the manager.</p> <p>The consequential amendments accompanying the</p>

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			<p>Proposed Rule set out additional prospectus disclosure requirements concerning the IRC’s compensation.</p>
<p>Section 2.8</p>	<p><i>Liability</i></p>	<p>Three commenters told us that the 2004 Proposal, not Commentary, must speak to the liability of members of the IRC. One of these commenters also remarked that the 2004 Proposal should provide that IRC members are protected by the “business judgment rule,” saying Section 2.6 may not provide adequate protection for a committee member.</p> <p>One commenter pointed out that the 2004 Proposal does not address manager liability. They told us it is unclear what liability the manager will incur if it follows the direction of the IRC to the detriment of the fund and investors, or how a manager’s liability will be affected if it does not follow the IRC’s direction but no harm to the fund or investor results.</p> <p>Another commenter strongly urged us to clearly establish the responsibility and accountability of the fund manager. This commenter suggested that the current standard of care in securities legislation be moved to the beginning of Part 3.</p>	<p><i>CSA Response</i> <i>Liability of IRC members</i></p> <p>The Proposed Rule now specifies that the investment fund and manager may indemnify and insure members of the IRC. For greater certainty, we have used terminology consistent with the Canada Business Corporations Act (CBCA).</p> <p>The Proposed Rule now also provides greater specificity of the limits on the IRC’s mandate and its duty of care. We have been advised by external counsel hired to assist us on the issue of liability, that these drafting changes (which mirror terminology used in the CBCA, where appropriate) will sufficiently limit the liability of members of the IRC to their mandate. It also increases the likelihood of a member’s ability to invoke the common law defences available to directors.</p> <p><i>Manager liability</i></p> <p>The Proposed Rule now contains a standard of care provision for the manager, which mirrors the statutory standard of care provision for managers found in some jurisdictions.</p> <p>The inclusion of this provision in the Proposed Rule emphasizes our view that the manager is ultimately responsible, and therefore liable, for the decisions it makes on behalf of the investment funds it manages.</p> <p>This is further highlighted in now Part 5 of the Proposed Rule which specifies that prior to referring a matter to the IRC, the manager must first decide on</p>

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			<p>the action it proposes to take, having regard to its duties under securities legislation.</p> <p>The Commentary to Part 5 of the Proposed Rule further states our position that a referral by the manager to the IRC of a proposed action in no way detracts from the manager’s statutory obligations.</p>
	<i>Insurance coverage for IRC negligence</i>	<p>A large number of industry commenters told us we must clarify if Commentary 2 is meant to exclude insurance coverage for an IRC member’s negligence. These commenters submitted a mutual fund should be permitted to purchase coverage for a breach of a standard of care, as permitted under the CBCA. We were told that in the absence of proficiency requirements and ongoing education standards, negligence and breach of standard of care are of concern.</p> <p>While one commenter remarked that if Director & Officer (“D&O”) insurance does not cover negligence, they saw no benefit to insurance, another commenter acknowledged that Commentary 2 is consistent with the OBCA.</p> <p>As an alternative to funds indemnifying or insuring IRC members for negligence, one commenter urged us to permit fund managers to purchase such insurance.</p>	<p><i>CSA Response</i></p> <p>As noted above, the Proposed Rule has been revised to permit an investment fund and/or the manager to indemnify and insure members of the IRC.</p> <p>We were persuaded by those commenters who told us we should permit insurance coverage of IRC members in a manner consistent with similar provisions in the CBCA. We have made this change.</p>
Section 2.9	<i>Proceedings</i>	<p>One commenter told us that the 2004 Proposal should require the IRC’s records to be available to investors upon request.</p> <p>Another commenter remarked that where an IRC is shared with another fund manager or managers, the maintenance of records may be problematic and cumbersome.</p>	<p><i>CSA Response</i></p> <p>The Proposed Rule does not require the IRC’s records to be made available to securityholders upon request. We believe this is consistent with governance practices of corporate boards.</p> <p>While we agree with the commenter who told us that recordkeeping may be troublesome where an IRC is shared with another manager or investment fund complex, we still believe it is feasible for managers to share an IRC.</p>

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<p>Section 2.10</p>	<p><i>Ceasing to be a member</i></p>	<p>While one commenter sought assurance that all individuals will cease to be members of an IRC in instances of a change of control of the manager, in addition to a change of manager, another commenter told us not to mandate a change of all IRC members in these circumstances.</p> <p>This commenter remarked that changing the IRC in such instances does not benefit investors because there is a lack of continuity, a new period where IRC members, appointed by manager, are not fully independent, and there are costs in educating new members. It was suggested that the 2004 Proposal require that on a change of manager or change of control of manager, that one-third of members of the new IRC be from the existing IRC.</p> <p>We also received comments on other factors that should warrant the removal of an IRC member in the 2004 Proposal.</p> <p>One commenter told us a manager should have the ability to remove an IRC member if the individual moves outside of the jurisdiction where the manager is located. Another remarked that IRC members should cease to be members if subject to regulatory or criminal sanctions.</p> <p>We were also told that an IRC member should not be able to sit as a member of an IRC of another fund complex, and should cease to be a member of an IRC if they join the board of directors of, or advisory committee to, another mutual fund manager or if they become a member of another IRC.</p> <p>One commenter remarked that the 2004 Proposal must provide the manager, as a last measure, some method for identifying and resolving situations of inappropriate and potentially harmful actions of IRC members. Another commenter echoed this, asking that we provide additional guidance in the Commentary for special meetings called by</p>	<p><i>CSA Response</i></p> <p>We agree with the commenter who told us that a change of control of the manager should cause individuals to cease to be members of an IRC. We have made this change.</p> <p>We continue to believe that a new manager should have the opportunity to appoint the first members of the fund’s IRC, having regard to the investment objectives and strategies it is proposing for the investment fund.</p> <p><i>Other factors warranting removal from the IRC</i></p> <p>Upon review of the circumstances suggested by commenters warranting a member’s removal from an IRC, we agree with the commenter who told us an individual should cease to be a member of the IRC if subject to regulatory or criminal sanctions. We have amended the Proposed Rule accordingly.</p> <p>We disagree, however, that removal of an IRC member, if the member moves outside the jurisdiction of the manager or if the member participates on a board or IRC of another manager, must be mandated in the Proposed Rule. We consider the members of the IRC to be best-positioned to assess a member’s ability to perform his or her function.</p> <p>We are satisfied that the Proposed Rule gives IRC members, and the manager, sufficient recourse to remove a member of the IRC who is no longer independent within the definition in the Proposed Rule.</p>
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		<p>the manager to remove a member of an IRC.</p> <p>We were also told by a commenter to remember that there is considerable time and expense associated with the procedural remedy contemplated in paragraph 2.10(2)(b).</p> <p>Finally, we were asked by a commenter to clarify why regulators want to be informed of a mass resignation and what we would do with this information.</p>	<p><i>The requirement to inform the regulator</i> We believe that the resignation, removal and disqualification of one or more IRC members may be an early warning sign of a larger, more systemic problem with the IRC or manager. Upon receipt and review of such information, our intention is to determine if further follow-up with the IRC or manager is warranted.</p> <p>We consider this approach to be consistent with the CSA’s increasing emphasis on continuous disclosure and compliance reviews.</p>
<p>Section 2.11</p>	<p><i>Disclosure not enough</i></p>	<p>We heard from a number of commenters on the 2004 Proposal’s proposition that disclosure is an effective deterrent for managers to follow an IRC’s recommendation.</p> <p>Investor commenters unanimously told us that disclosure of a manager’s noncompliance with an IRC’s recommendation is not an effective remedy or sufficient for robust investor protection. We were told that the disclosure will probably come too late and may not be specific enough. These commenters also said few investors will likely be aware of it, because of exemptive orders and proposed rules which contemplate many disclosure documents only upon request, and the size of current mutual fund prospectuses.</p>	<p><i>CSA Response</i> <i>The IRC’s lack of ‘teeth’</i> We were persuaded by those commenters who told us that disclosure of a manager’s noncompliance with an IRC recommendation should be more forthright, and that recommendations do not give the IRC the “teeth” needed to act as an effective investor protection mechanism.</p> <p>Accordingly, the Proposed Rule now requires that the manager obtain the approval of the IRC before proceeding with certain types of prohibited transactions (inter-fund trading, purchases of securities of related issuers and purchases of securities underwritten by related underwriters) that would</p>

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		<p>Still another commenter, an independent board of a mutual fund, said they viewed the IRC as having “very little power” and “teeth” and not in the best interests of securityholders. It was suggested that the IRC be required to report on its activities on an annual basis to securityholders.</p> <p>Two industry commenters similarly told us that we must strengthen the remedy to securityholders when the manager does not follow an IRC’s recommendation. One of these commenters suggested the 2004 Proposal require notice to securityholders, and a 30 day period after notice to redeem without charge (with no back-end load payment) if the IRC considers it warranted.</p> <p>Other suggestions we received to strengthen the IRC’s recommendations were:</p> <ol style="list-style-type: none"> 1. to give the IRC the power to remove a manager, 2. to allow the IRC to meet separately with regulators or law enforcement, and 3. to have the IRC report directly to fund securityholders at regularly scheduled securityholder meetings to enable securityholders to question management (and the IRC). 	<p>otherwise require the approval of the securities regulatory authorities or regulators.</p> <p>For all other proposed actions by the manager that involve a conflict of interest or a perceived conflict of interest for the manager (and which continue to be subject to an IRC recommendation), the Proposed Rule now gives the IRC the discretion to require the manager to give immediate notice to securityholders of its decision to proceed despite a negative recommendation of the IRC.</p> <p>In response to comments, the Proposed Rule now also requires the IRC to prepare a report directed to securityholders at least annually. The report must disclose any instance where the manager proceeded to act without the positive recommendation of the IRC.</p> <p>Additionally, the Proposed Rule now explicitly gives the IRC the authority to communicate directly with the securities regulatory authorities or regulators, and requires the IRC to report instances where it finds (or has reasonable grounds to suspect) breaches of the matters under its review.</p> <p><i>Specific suggestions to ‘strengthen’ the IRC</i> Except for the suggestion by one commenter to give the IRC the authority to remove the manager, we consider that the Proposed Rule captures the substance of the suggestions we received to improve the ‘teeth’ of an IRC recommendation. Namely, the ability of the IRC to directly communicate with securityholders and with the regulator.</p> <p>Our view is that the manager is fundamental to the</p>
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			<p>investor’s ‘commercial bargain’ with the investment fund, and accordingly, the IRC should not be able to remove the manager.</p>
	<p><i>Comments on the disclosure required</i></p>	<p>We also received a number of comments on what should be disclosed to investors and where.</p> <p>One commenter told us the disclosure contemplated in the 2004 Proposal could result in too much information being sent to investors, which will be confusing as well as costly and unproductive.</p> <p>Another commenter told us to delete the section entirely and move disclosure requirements to the amendments to NI 81-101 and NI 81-106.</p> <p>We were told by two commenters to introduce a ‘materiality’ threshold to disclosure of instances where the manager did not follow the IRC’s recommendation. One of these commenters further remarked that this materiality test should apply to all continuous disclosure regarding the IRC, noting that disclosure otherwise will be repetitive and become boilerplate and meaningless.</p> <p>One commenter asked that the requirement on the manager to disclose a report by the IRC if so directed by the IRC, be removed.</p> <p>We were also asked to not require duplicative disclosure in a fund’s prospectus and continuous disclosure documents.</p> <p>Finally, a commenter asked us to clarify that when IRC members change, it will not trigger an amendment to all fund prospectuses. They suggested that updated lists could be included on the websites of the manager and required in subsequent filing of prospectus.</p>	<p><i>CSA Response</i></p> <p>The consequential amendments accompanying the Proposed Rule now set out the disclosure we expect in the prospectus and continuous disclosure documents of the investment fund regarding the IRC.</p> <p>In response to the comments, care has been taken to avoid duplicative disclosure requirements.</p> <p>Contrary to the views of a few commenters, we consider every instance where the manager proceeds to act without the IRC’s positive recommendation to warrant disclosure.</p> <p>Accordingly, the Proposed Rule requires that the annual report to be prepared by the IRC disclose any instance where the manager proceeded to act despite a negative recommendation from the IRC. To avoid the concern of ‘boiler plate’ disclosure raised by a commenter, the Proposed Rule specifies only the minimum topics we believe the report must include.</p> <p>To address the concerns raised by commenters regarding the amount and cost of the disclosure contemplated, the Proposed Rule specifies that the IRC report be filed with the securities regulatory authorities or regulator, posted on the website of the investment fund/fund family/manager, and be available on request by the investor without cost.</p>

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Part 3			
Section 3.1	<i>Conflicts of interest</i>		
	<i>The test</i>	<p>Almost every commenter expressed an opinion on the test and scope of Section 3.1.</p> <p>While one commenter told us our principles-based definition of conflicts of interest was a realistic way to address the range of conflicts that are inherent in the manager-mutual fund relationship, another commenter remarked that Section 3.1 is too broad and ambiguous, and will be open to different interpretations.</p> <p>Still another commenter expressed concern that over time, the role of IRC will expand into matters that should be left to the manager.</p> <p><i>Limits to the ‘principles’ based test</i> A number of industry commenters strongly urged us to revise the test to contain a defined, but comprehensive, list of specific conflict referrals, in addition to the conflict of interest prohibitions in securities legislation.</p> <p>Yet other commenters told us to allow the IRC and fund manager define “conflicts of interest” in the IRC’s charter.</p> <p>Two commenters suggested we combine subsections 3.1(1) and (2) to create a simpler test, which introduces the concept of materiality; that is, only material interests or conflicts should be referred to the IRC. We were also told to be consistent with MI 52-110.</p> <p>It was also suggested by a commenter to permit a de minimis test for referral to the IRC in non-recurring situations in which there is a direct conflict, but where the potential cost and risk to the fund is small.</p>	<p><i>CSA Response</i> The purpose of the Proposed Rule is to ensure an independent perspective is brought to bear on the transactions and operations of an investment fund that have an inherent conflict of interest for the manager.</p> <p>We consider the principles-based definition of a ‘conflict of interest matter’ in the Proposed Rule to best capture the range of possible management decisions that may involve a conflict of interest for the manager.</p> <p>We would expect that any proposed course of action a manager considers to involve a conflict of interest, would similarly be caught by the test in the Proposed Rule.</p> <p>We continue to believe that the manager (and ultimately the investment fund and securityholders) could benefit from the independent perspective and input of an IRC on all decisions that may involve a conflict of interest for the manager. Therefore, none of the limitations suggested by commenters to the scope of the conflicts of interest caught by the 2004 Proposal have been adopted in the Proposed Rule.</p>

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		<p>Commenters also asked us to define what is meant by the word “matter”. We were told that matters should not include business decisions but situations where true conflicts of interest could arise. Examples: allocating securities amongst mutual funds in a family and other clients, seeking best execution, and entering into soft dollar arrangements.</p> <p>Still another commenter remarked that if the CSA’s intention is that all matters in Commentary 5 (related-party conflicts) be referable to the IRC, for certainty, Commentary 5 should be moved to the 2004 Proposal.</p> <p>One commenter remarked that the manager should retain the ability to refer any matter to the IRC that it views as a conflict of interest.</p> <p><i>The need to specify each step</i> We were told by three industry commenters that the 2004 Proposal should specify the specific steps expected of the fund manager when faced with a conflict of interest matter.</p> <p>A number of others also asked us to have the test specify that the IRC may approve the policies of the manager in advance, and that this will discharge the manager’s duty under Section 3.1, provided there is regular reporting for the IRC to satisfy itself that the fund manager is in compliance with its policies and procedures.</p> <p>Still other commenters remarked that the 2004 Proposal should require that the IRC review and approve in advance the policies relating to related party transactions.</p> <p><i>Independent auditor testing</i> While one commenter told us independent auditors should be required to pass opinion on the internal policies and procedures or controls of the manager, another commenter</p>	<p><i>The need to specify each step</i> We were persuaded by the commenters who told us to specify the steps expected of the manager and IRC when an action under consideration by the manager involves a conflict of interest. Accordingly, the Proposed Rule now sets out the procedure that the manager and IRC must follow in these circumstances.</p>
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	<p>suggested that the IRC be given the ability to investigate and test for potential areas of conflict, using an external auditor if desired.</p> <p><i>Specific wording in the test</i> One commenter asked us to consider replacing “question whether” with ‘consider’ in subsection 3.1(1), because the plain meaning of the wording suggests referrals to the IRC will only occur when there is uncertainty whether the fund manager is in a conflict situation.</p> <p>Three other commenters asked us to delete “different from” in subsection 3.1(2) because, they told us, many normal day-to-day business operations of the mutual fund appear to be caught by “different from”. These commenters remarked that only a situation in which a manager has an interest that “conflicts with” the best interests of the fund should be referred to the IRC.</p> <p><i>Portfolio manager conflicts</i> We were asked by a number of commenters to clarify in the 2004 Proposal how Section 3.1 applies to potential conflicts at a portfolio manager level, particularly when outsourced. It was suggested that either:</p> <ol style="list-style-type: none"> 1. the IRC have no role if the manager has discharged day-to-day decision making to an unrelated third party adviser, or 2. the Section should clarify that either that the fund manager has no obligation to monitor portfolio manager conflicts (especially unrelated portfolio managers), or, the fund manager must make reasonable inquiries of the portfolio managers of their policies and procedures to deal with any conflicts falling within a defined list. <p><i>Non-referrals of matters</i> We heard from both industry and investor commenters that</p>	<p>In response to the comments, the Proposed Rule now requires the manager to refer a proposed course of action to the IRC before proceeding to act, after having considered the action in regard to its duties under applicable laws and its written policies and procedures. The IRC must then review the action and make the applicable determination. If the IRC so chooses, it may give a standing instruction to the manager for an action or category of actions, subject to its ongoing oversight.</p> <p>Further, for any matter the manager must refer to the IRC, the manager must have established written policies and procedures, with IRC input, before proceeding to act on the matter.</p> <p><i>Independent auditor testing</i> We disagree with the commenters who told us that the 2004 Proposal should mandate an independent audit of the manager’s policies and procedures or controls.</p> <p>The Proposed Rule authorizes the IRC to employ independent counsel and other advisers it determines useful or necessary to carry out its role. We continue to believe a flexible approach to the IRC’s use of external advisers is desirable.</p> <p><i>Specific wording in the test</i> The definition of a ‘conflict of interest matter’ in now Section 1.3 of the Proposed Rule was drafted with the wording suggestions of commenters in mind.</p>
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		<p>the 2004 Proposal fails to provide a monitoring process, or penalty, for non-referral of matters, to ensure management upholds its obligations to refer conflicts to the IRC. These commenters also told us there is no guidance on what the IRC should do, if anything, if the fund manager refers very little to it for its review and consideration.</p>	<p><i>Portfolio manager conflicts</i> The Proposed Rule is intended to capture the conflicts of interest at the manager and portfolio manager level that may conflict with the manager’s duty to act in the best interests of the fund.</p> <p>For greater certainty, the definition of a ‘conflict of interest matter’ in the Proposed Rule specifies that any proposed action that is related to the operations of the investment fund that the manager, investment fund or portfolio manager is prohibited from proceeding with by a conflict of interest or self-dealing prohibition in securities legislation, is considered a ‘conflict of interest matter’ under this instrument (which must be referred to the IRC).</p> <p><i>Non-referrals of matters</i> We were persuaded by the commenters who expressed concern over how referrals to the IRC of conflict of interest matters would be ensured and enforced.</p> <p>As a result, the Proposed Rule now gives the IRC the authority to communicate directly with the securities regulatory authorities or regulators, and requires the IRC, on matters within the scope of its responsibility, to report a breach, or a reasonable suspicion of a breach, of securities legislation.</p>
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			<p>We consider these mechanisms to give the IRC sufficient recourse if it suspects non-referral of conflict of interest matters.</p>
	<p><i>Conflicts</i></p>	<p>Almost all industry commenters told us that the definition of “conflicts of interest” is too broad. Specifically, we were told that the description of “business conflicts” seems to catch almost all business decisions, and the Commentary’s “prescriptive, non-exhaustive list of potential conflicts” creates uncertainty, and that they disagree with many of the conflict matters listed in the Commentary.</p> <p>We were told that in instances where the fund manager is either related to or acts as the portfolio manager, back office service provider and trustee, it is possible that every service provided by the fund manager to the fund would fall under the scope of the IRC’s review.</p> <p>One commenter suggested that the IRC’s mandate to monitor all administration and management of the mutual funds risks creating a material relationship between the IRC and the manager.</p> <p>Three commenters questioned why marketing is considered a conflict in light of National Instrument 81-105 <i>Mutual Fund Sales Practices</i> (“NI 81-105”). One of these commenters remarked that the IRC should not assume a compliance/enforcement role with respect to specific rules or policies already in place.</p> <p>Other specific ‘conflicts’ we were told should be excluded from the scope of IRC review were:</p> <ol style="list-style-type: none"> 1. conflicts with third-party oversight, such as with fund auditors. 2. fee changes, since fees are disclosed in the prospectus and part of consensual commercial bargain, and 	<p><i>CSA Response</i></p> <p>We disagree with those commenters who expressed alarm at the broad definition of ‘conflicts of interest’ in the 2004 Proposal. The inherent, and often numerous, conflicts of interest that could arise in the management of an investment fund are precisely the matters we believe should be subject to the independent review and input of the IRC.</p> <p>We do not consider, as one commenter suggested, that the IRC’s role in the operations of the investment fund would impede a member’s ability to exercise independent judgment regarding the conflicts of interest facing the manager.</p> <p>We were, however, persuaded by those commenters who told us that the lists of potential conflicts in the Commentary to the 2004 Proposal creates uncertainty and serves to undermine the principles-based approach to a manager’s ‘conflicts of interest’.</p> <p>Accordingly, the non-exhaustive list of possible conflicts of interest in the Commentary has been removed in the Proposed Rule. As a result, we would expect the specific conflict examples raised by commenters to be looked at on a case-by-case basis.</p>

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		<p>3. the appointment of the manager of an affiliate as an adviser to the fund</p> <p>Yet, we were also asked by one commenter why the personal trading policies of the fund manager were not referenced in the list of business conflicts in the Commentary.</p> <p>This commenter also recommended that the listed potential conflict “Favouring certain investors to obtain or maintain their investment in the mutual fund” be expanded to better describe the CSA’s intentions.</p>	
	<i>Conflict Prohibitions in Securities Legislation</i>	<p>One commenter questioned the CSA’s intentions for dealing with the overlap of the conflict of interest prohibitions in the Ontario Act (and other applicable provincial statutes), since the Uniform Securities Legislation does not contain any part similar to Part XXI of the Ontario Act.</p> <p>This commenter recommended that we provide clear commentary about any decision to exempt mutual funds and their managers from the conflict of interest provisions in securities legislation to the extent they comply with the 2004 Proposal. We were also told the Commentary should be clear that the IRC is meant to reinforce the duty on the fund manager to act in the best interest of the fund, and that the manager must still abide by duty of care.</p>	<p><i>CSA Response</i> The Proposed Rule and accompanying consequential amendments to NI 81-102 specifically exempt investment funds from the statutory prohibitions that prevent those conflict of interest transactions that, we consider, can be addressed through IRC review and approval.</p> <p>The Notice to this Instrument and the Proposed Rule specify our intention that all prior exemptions granted from the conflict of interest and self-dealing provisions in securities legislation may no longer be relied on following the transition date.</p> <p>We continue to monitor the progress of the Uniform Securities Legislation. As it progresses, we expect to re-visit the conflict of interest prohibitions contained in our respective legislation and consider what prohibitions should be incorporated into rules governing investment funds.</p>
Section 3.2	<i>Changes to the mutual fund</i>	<p>One commenter, who told us IRC review will impose a longer time frame than currently to implement a change, asked that we shorten the notice period.</p>	<p><i>CSA Response</i> We do not propose within the scope of this project to review the 60 day notice requirement in Part 5 of NI 81-102. This may be an area that requires revisiting after we gain some experience with IRC reviews of matters under Part 5 of NI 81-102.</p>

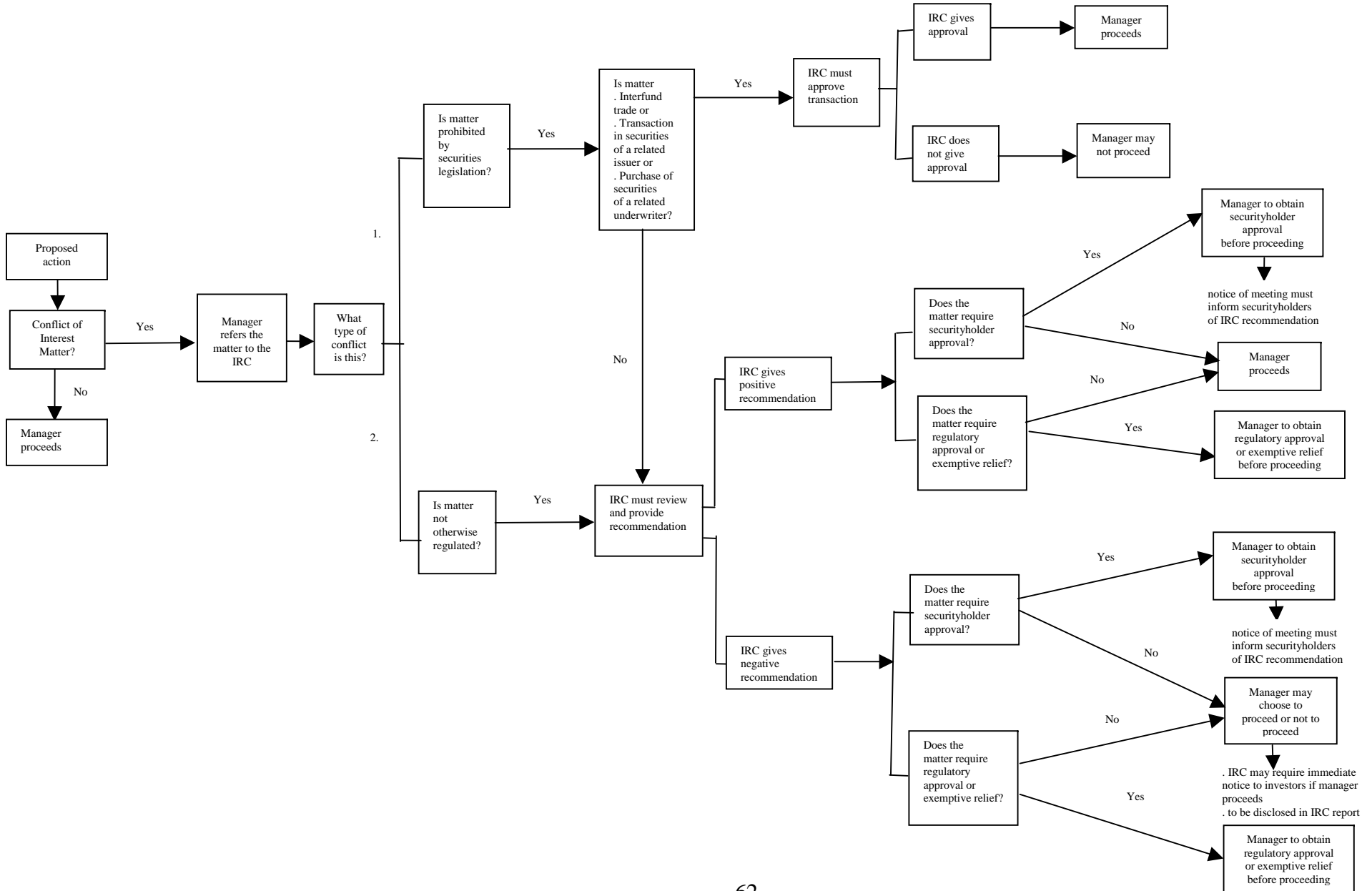
**Proposed NI 81-107 Independent Review Committee for Investment Funds
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<p>Section 3.4</p>	<p><i>Supporting information</i></p>	<p>We were told by a commenter that the authority of the IRC to direct the manager to convene a special meeting of securityholders to consider and vote ‘on a matter’ is unnecessary, unrealistic and too open for misuse. This commenter remarked it is not clear what securityholders would be voting on, and in circumstances where the IRC believes that the fund manager has breached or will breach its fiduciary standards, an IRC would more realistically follow different avenues, including resignation, public disclosure or contacting the applicable securities regulatory authorities.</p> <p>This commenter went on to say that the disclosure contemplated in section 2.11 is more effective than the IRC convening a meeting of securityholders, because it requires the fund manager to publicly explain why it did not follow the recommendation, as contemplated by the Rule.</p> <p>Two commenters also remarked that the 2004 Proposal provides no checks and balances or element of materiality on an IRC convening a meeting. They warned that the IRC could use the power to convene a meeting in a manner not contemplated by the CSA, and suggested the IRC be given guidance to consider the costs of holding such a meeting.</p> <p>It was also remarked that the Commentary is unclear if the IRC should rely on NI 54-101 <i>Communication with Beneficial Owners of Securities of a Reporting Issuer</i> in communications with securityholders or if the IRC has authority to independently contact securityholders.</p>	<p><i>CSA Response</i> <i>IRC ability to compel a meeting</i></p> <p>We were persuaded by those commenters who told us the authority of the IRC to direct the manager to convene a securityholder meeting is not an effective response if the IRC is concerned the manager is not acting appropriately.</p> <p>Accordingly, the Proposed Rule no longer gives the IRC the authority to direct the manager to convene a meeting of securityholders.</p> <p>Instead, in instances where a manager intends to proceed with a course of action without a positive recommendation by the IRC, the IRC now may, in its discretion, require the manager to notify securityholders at least 30 days before proceeding with the action.</p> <p>Notice of a manager proceeding without a positive recommendation of the IRC must also be reported by the IRC in its report to securityholders, to be prepared at least annually.</p> <p>In addition to notifying securityholders, the Proposed Rule now gives the IRC the authority to communicate directly with the securities regulatory authorities or regulators, and requires the IRC, on matters within the scope of its responsibility, to report a breach, or a reasonable suspicion of a breach, of securities legislation.</p>
<p>Section 4.1 Section 4.2</p>	<p><i>Exemptions</i> <i>Revocations of exemptions,</i> <i>waivers or</i></p>	<p>One commenter questioned our authority and ability of individual commissions to revoke individual orders granted by a securities commission or director, without individual</p>	<p><i>CSA Responses</i></p> <p>We are satisfied that we have the authority to notify, through the rule-making process, our intention to revoke orders that deal with the matters to be</p>

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	<i>approvals</i>	<p>notice to the recipient and a hearing. It was queried what exemption orders existed beyond the orders with embedded sunset clauses already.</p> <p>This commenter asked us to provide guidance in the Commentary that a fund manager may in fact stop relying on an order and consider itself no longer subject to the conditions to the order, once it has established an IRC and the IRC and the manager have agreed on a written charter.</p>	<p>regulated by the Proposed Rule.</p> <p>While many orders caught by our revocation contained ‘sunset’ provisions, others did not.</p> <p>The Commentary to the Proposed Rule has been revised to provide guidance on transitional issues (including reliance on existing orders) related to the Proposed Rule.</p>
Section 5.1	<i>Effective date</i>	<p>One commenter told us there should be a clear transition for disclosure obligations and mutual funds should not be expected to file an amendment to offering documents.</p> <p>We were also urged by this commenter to consider and prescribe in the 2004 Proposal a mechanism on how industry can deal with issues that arise due to past disclosure in offering documents. For example, how will existing securityholders be advised of the changes to Part 5 of NI 81-102.</p>	<p><i>CSA Response</i></p> <p>The Proposed Rule has been amended to clearly specify the transition for compliance with the Proposed Rule and its reporting obligations, etc.</p> <p>We are satisfied that the transitional dates provide sufficient flexibility to comply with the disclosure obligations of the Proposed Rule.</p> <p>We are also of the view that the changes contemplated to Part 5 of NI 81-102 – removing the requirement for a securityholder vote for a change of auditor and in instances of reorganizations and transfers of assets between mutual fund affiliates – do not necessitate a prescribed mechanism of disclosure.</p>

**Proposed NI 81-107 Independent Review Committee for Investment Funds
Appendix B
Decision Tree**



APPENDIX C
NATIONAL INSTRUMENT 81-101
MUTUAL FUND PROSPECTUS DISCLOSURE,
FORM 81-101F1 CONTENTS OF SIMPLIFIED PROSPECTUS AND
FORM 81-101F2 CONTENTS OF ANNUAL INFORMATION FORM
AMENDMENT INSTRUMENT

1. National Instrument 81-101 *Mutual Fund Prospectus Disclosure* is amended by this Instrument.
2. Section 1.1 is amended by:
 - (a) adding the following after the definition of “financial year”:

“independent review committee” means the independent review committee of the investment fund in compliance with National Instrument 81-107 *Independent Review Committee for Investment Funds*;” and
 - (b) adding the following after the definition of “multiple SP”:

“NI 81-107” means National Instrument 81-107 *Independent Review Committee for Investment Funds*;”.
3. Form 81-101F1 Contents of Simplified Prospectus is amended
 - (a) in Item 5 of Part A by:
 - (i) adding the following after subsection (3):

“(3.1) Briefly describe, under a separate sub-heading “Independent Review Committee”, the independent review committee of the mutual funds, including an appropriate summary of its mandate and responsibilities, its composition, that it prepares at least annually a report of its activities for securityholders which is available on the [mutual fund’s/mutual fund family’s] Internet site at [insert mutual fund’s Internet site address], or at your request, and at no cost, by contacting the [mutual fund/mutual fund family] at [insert mutual fund’s /mutual fund family’s e-mail address] and that additional information about the independent review committee, including the names of the members, is available in the mutual fund’s Annual Information Form.”; adding the following after subsection (5):
 - (ii) adding the following Instruction after Instruction (2):

“(6) Despite subsection (3.1), if the information required by subsection (3.1) is not the same for substantially all of the mutual funds described in the document, provide only that information that is the same for substantially all of the mutual funds and provide the remaining disclosure required by that subsection under Item 4(3.1) of Part B of this Form.”; and

(iii) adding the following Instruction after Instruction (2):

“(3) The information about the independent review committee should be brief. For instance, its mandate may in part be described as “reviewing, and providing input on, the manager’s written policies and procedures which deal with conflict of interest matters for the manager and reviewing such conflict of interest matters.” A cross-reference to the annual information form for additional information on the independent review committee and fund governance generally should be included.”.

(b) in Item 8 of Part A by adding the following after subsection 8.1(3) :

“(3.1) Under “Operating Expenses” in the table, include a description of the fees and expenses payable in connection with the independent review committee.” in Item 4 of Part B by adding the following after subsection (3):

(c) in Item 4 of Part B by adding the following after subsection (3):

“(3.1) Briefly describe, under a separate sub-heading “Independent Review Committee”, the independent review committee of the mutual funds, including an appropriate summary of its mandate and responsibilities, its composition, that it prepares at least annually a report of its activities for securityholders which is available on the [mutual fund’s/mutual fund family’s] Internet site at [insert mutual fund’s Internet site address], or at your request, and at no cost, by contacting the [mutual fund/mutual fund family] at [insert mutual fund’s /mutual fund family’s e-mail address] and that additional information about the independent review committee, including the names of the members, is available in the mutual fund’s Annual Information Form.”.

4. Form 81-101F2 Contents of Annual Information Form is amended

(a) in Item 4 by adding the following after subsection (2):

“(2.1) If the mutual fund has relied on the approval of the independent review committee and the relevant requirements of NI 81-107 to be exempted from any of the investment restrictions contained in securities legislation, including NI 81-102, provide details of the permitted exemptions.

(2.2) If the mutual fund has relied on the approval of the independent review committee to implement a reorganization with, or transfer of assets to, another mutual fund or to proceed with a change of auditor of the mutual fund as permitted by NI 81-102, provide details.”

(b) in Item 12 by deleting paragraph (1)(a) and substituting the following:

“(a) the mandate and responsibilities of the independent review committee and the reasons for any change in the composition of the independent

review committee since the date of the annual information form was last filed;

(a.1) any other body or group that has responsibility for fund governance and the extent to which its members are independent of the manager of the mutual fund;” and

(c) in Item 15 by deleting subsection (2) and substituting the following:

“(2) Describe any arrangements, including the amounts paid, the name of the individual and any expenses reimbursed by the mutual fund to the individual, under which compensation was paid or payable by the mutual fund during the most recently completed financial year of the mutual fund, for the services of directors of the mutual fund, members of an independent board of governors or advisory board of the mutual fund and members of the independent review committee of the mutual fund”.

5. This Instrument comes into force on [].

APPENDIX D
NATIONAL INSTRUMENT 81-102
MUTUAL FUNDS
AMENDMENT INSTRUMENT

1. National Instrument 81 102 Mutual Funds is amended by this Instrument.
2. Section 1.1 is amended by:

- (a) adding the following after the definition of “illiquid asset”:

““independent review committee” means the independent review committee of the investment fund in compliance with in National Instrument 81-107 *Independent Review Committee for Investment Funds*;

- (b) repealing the definition of “mutual fund conflict of interest investment restrictions” and substituting the following:

“mutual fund conflict of interest investment restrictions” means the provisions of securities legislation that

- (a) prohibit a mutual fund from knowingly making or holding an investment in any person or company who is a substantial security holder, as defined in securities legislation, of the mutual fund, its management company or distribution company;
- (b) prohibit a mutual fund from knowingly making or holding an investment in any person or company in which the mutual fund, alone or together with one or more related mutual funds, is a substantial security holder, as defined in securities legislation;
- (c) prohibit a mutual fund from knowingly making or holding an investment in an issuer in which any person or company who is a substantial security holder of the mutual fund, its management company or distribution company, has a significant interest, as defined in securities legislation;
- (d) prohibit a portfolio adviser or a registered person acting under a management contract from knowingly causing any investment portfolio managed by it to invest in, or prohibit a mutual fund from investing in, any issuer in which a responsible person, as defined in securities legislation, is an officer or director unless the specific fact is disclosed to the client and the written consent of the client to the investment is obtained before the purchase;
- (e) prohibit a portfolio adviser knowingly causing any investment portfolio managed by it to purchase or sell, or prohibit a mutual fund to purchase or sell, the securities of any issuer from or to the

account of a responsible person, as defined in securities legislation, an associate of a responsible person or the portfolio adviser; and

- (f) prohibit a portfolio adviser or a registered person acting under a management contract from subscribing to or buying securities on behalf of a mutual fund, where his or her own interest might distort his or her judgment, unless the specific fact is disclosed to the client and the written consent of the client to the investment is obtained before the subscription or purchase.”; and

- (c) adding the following after the definition of “mutual fund conflict of interest reporting requirements”:

“NI 81-107” means National Instrument 81-107 *Independent Review Committee for Investment Funds.*”.

- 3. Section 4.1 is amended by adding the following after subsection (3):

“(4) Subsection (1) does not apply to an investment in a class of securities of an issuer if, at the time of each investment

- (a) the independent review committee has approved the transaction under subsection 5.2(1) of NI 81-107;
- (b) for an investment in a class of equity securities of an issuer
 - (i) the distribution of the class of equity securities is made by prospectus filed with one or more securities regulatory authorities or regulators in Canada, and
 - (ii) the investment is made on a stock exchange on which the class of equity securities of the issuer are listed and traded;
- (c) for an investment in a class of debt securities of an issuer other than a class of debt securities issued or fully and unconditionally guaranteed by the government of Canada or the government of a jurisdiction
 - (i) neither the manager of the dealer managed mutual fund nor its associates or affiliates is
 - (A) the issuer of the securities, or
 - (B) a promoter of the issuer of the securities, and
 - (ii) the security has been given, and continues to have, an approved rating by an approved credit rating organization; and

- (d) no later than the time the dealer managed mutual fund files its annual financial statements, the manager of the dealer managed mutual fund files with the security regulatory authority or regulator the particulars of each investment made by the dealer managed mutual fund.”.

4. Section 4.2 is amended by adding the following after subsection (2):

“(3) Despite subsection (1), a dealer managed mutual fund may purchase a class of debt securities of an issuer from, or sell a class of a debt securities of an issuer to, the persons or companies referred to in paragraphs 1 to 4 of subsection (1) if, at the time of each transaction

- (a) the independent review committee has approved the transaction under subsection 5.2(1) of NI 81-107;
- (b) for a purchase or sale of a class of debt securities of an issuer other than a class of debt securities issued or fully and unconditionally guaranteed by the government of Canada or the government of a jurisdiction
 - (i) neither the manager of the dealer managed mutual fund nor its associates or affiliates is
 - (A) the issuer of the securities, or
 - (B) a promoter of the issuer of the securities; and
 - (ii) the security has been given, and continues to have, an approved credit rating by an approved credit rating organization; and
- (c) no later than the time the dealer managed mutual fund files its annual financial statements, the manager of the dealer managed mutual fund files with the security regulatory authority or regulator the particulars of each investment made by the dealer managed mutual fund.”.

5. Section 5.1 is amended by repealing paragraph 5.1(d).

6. Section 5.3 is amended

- (a) by adding the following after subsection 5.3(1):

“(2) Despite section 5.1, the approval of securityholders of a mutual fund is not required to be obtained for a change referred to in paragraph 5.1(f) if

- (a) the independent review committee has approved the reorganization or transfer of assets under subsection 5.2(1) of NI 81-107;

- (b) the mutual fund is being reorganized with, or its assets are being transferred to, another mutual fund to which this Instrument and NI 81-107 applies and that is managed by the manager, or an affiliate of the manager, of the mutual fund;
- (c) the reorganization or transfer of assets of the mutual fund will comply with the criteria in section 5.6;
- (d) the simplified prospectus of the mutual fund discloses that, although the approval of securityholders may not be obtained before making the change, securityholders will be sent a written notice at least 60 days before the effective date of the change; and
- (e) the notice referred to in paragraph (d) is actually sent 60 days before the effective date of the change.”; and

(b) by adding the following after section 5.3:

“5.3.1 Change of Auditor of the Mutual Fund - The auditor of the mutual fund may not be changed unless

- (a) the independent review committee approves the change of auditor under subsection 5.2(1) of NI 81-107;
- (b) the simplified prospectus of the mutual fund discloses that, although the approval of securityholders will not be obtained before making the change, securityholders will be sent a written notice at least 60 days before the effective date of the change, and
- (c) the notice referred to in paragraph (b) is actually sent 60 days before the effective date of the change.”.

7. Section 5.6 is amended by deleting subparagraph (1)(e)(i) and substituting the following:

“(i) by the securityholders of the mutual fund in accordance with paragraph 5.1(f), if not proceeding with the change in accordance with subsection 5.3(2), and”.

8. This Instrument comes into force on the [].

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

1. Companion Policy 81-102CP Mutual Funds is amended by this Instrument.
2. Part 3 is amended
 - (a) by adding the following paragraph under section 3.4:

“Subsection 2.5(7) of the Instrument provides that certain investment restrictions in securities legislation, as defined in the Instrument, do not apply to investments in other mutual funds made in accordance with section 2.5. For greater certainty, the CSA note that the exemptions provided for in this section apply only with respect to a mutual fund’s investments in other mutual funds, and not for any other investment or transaction.”; and

- (b) by adding the following after section 3.7:

“3.8 Prohibited Investments – (1) Subsection 4.1(4) permits a dealer managed mutual fund to make an investment otherwise prohibited by subsection 4.1(1) provided the independent review committee of the dealer managed mutual fund has approved the transaction under subsection 5.2(1) of NI 81-107. The CSA expects the independent review committee may contemplate giving its approval as a standing instruction, as contemplated in section 5.4 of NI 81-107.

(2) Subsection 4.2(3) permits a dealer managed mutual fund to purchase a class of debt securities of an issuer from, or sell a class of debt securities of an issuer to, the persons or companies referred to in paragraphs 1 to 4 of subsection 4.2(1) where the price payable for the security is not publicly available, provided the independent review committee has approved the transaction under subsection 5.2(1) of NI 81-107. The CSA expects the independent review committee may contemplate giving its approval as a standing instruction, as contemplated in section 5.4 of NI 81-107.

In providing its approval under paragraph 4.2(3)(a), the CSA expects the independent review committee to have satisfied itself that the price of the security is fair. This may be achieved by the independent review committee by considering the price of the security if listed by CanPx or TRACE, for example. Or, the independent review committee may satisfy itself by obtaining at least one quote from an independent, arm’s-length purchaser or seller, immediately before the purchase or sale.

3. Part 7 is amended by adding the following after section 7.4:

“7.5 Circumstances in Which Approval of Securityholders Not Required – (1) Subsection 5.3(2) of the Instrument provides that the mutual fund’s reorganization with, or transfer of assets to another mutual fund to which this Instrument and NI 81-107 applies and is managed by the manager or an affiliate of the manager of the mutual fund, may be carried out on the conditions described in the subsection without prior approval of the securityholders of the mutual fund.

(2) If the manager refers the change contemplated in subsection 5.3(2) to the mutual fund's independent review committee, and subsequently seeks the approval of the securityholders of the mutual fund, the CSA are of the view that the manager should include a description of the independent review committee's determination in the written notice to securityholders referred to in section 5.4 of this Instrument.

7.6 Change of Auditor – Section 5.3.1 of the Instrument requires that the independent review committee of the mutual fund give its prior approval to the manager before the auditor of the mutual fund may be changed.

7.7 Connection to NI 81-107 – There may be matters under section 5.1 that may also involve a conflict of interest matter under NI 81-107. The CSA are of the view that any matter under section 5.1 subject to review by the independent review committee should be referred by the manager to the independent review committee before seeking the approval of securityholders of the mutual fund. The CSA expects the manager to include in the written notice to securityholders referred to in subsection 5.4(2) of this Instrument a description of the independent review committee's determination.”.

4. This Instrument comes into force on [].

APPENDIX E

NATIONAL INSTRUMENT 81-106 INVESTMENT FUND CONTINUOUS DISCLOSURE AND FORM 81-106F1 CONTENTS OF ANNUAL AND INTERIM MANAGEMENT REPORT OF FUND PERFORMANCE AMENDMENT INSTRUMENT

1. National Instrument 81-106 Investment Fund Continuous Disclosure is amended by this Instrument.

2. Section 1.1 is amended by

(a) adding the following after the definition of “EVCC”:

“independent review committee” means the independent review committee of the investment fund in compliance with National Instrument 81-107 Independent Review Committee for Investment Funds;” and

(b) adding the following after the definition of “National Instrument 51-102”:

“National Instrument 81-107” means National Instrument 81-107 Independent Review Committee for Investment Funds;”.

3. Section 9.4 is amended by deleting paragraph (2)(f) and substituting the following:

“(f) Item 15 of Form 81-101F2 does not apply to an investment fund that is a corporation, except for the disclosure in connection with the independent review committee; and”.

4. Form 81-106F1 Contents of Annual and Interim Management Report of Fund Performance is amended by:

(a) in section 2.4 by adding the following after paragraph (e):

“(f) changes to the composition or members of the independent review committee of the investment fund.”; and

(b) in section 2.5 by adding the following Instruction after Instruction (3):

“(4) *If the investment fund has an independent review committee, state whether the investment fund has relied on the positive recommendation or approval of the independent review committee to proceed with the transaction, and provide details of any conditions or parameters surrounding the transaction imposed by the independent review committee in its positive recommendation or approval.*

This Instrument comes into force on [].

APPENDIX F

NATIONAL INSTRUMENT 13-101 SYSTEM FOR ELECTRONIC DOCUMENT ANALYSIS AND RETRIEVAL (SEDAR) AMENDMENT INSTRUMENT

1. National Instrument 13 101 System for Electronic Document Analysis and Retrieval (SEDAR) is amended by this Instrument.
2. Appendix A is amended by
 - (a) adding the following after Item 17 of part I B. :
 - “18. Report by Independent Review Committee”.
 19. Report by manager of Exempted Transactions –Transactions in securities of related issuers under NI 81-107
 20. Report by manager of Exempted Transactions – Part 4 of NI 81-102
 21. Notification by manager of non-compliance with a recommendation of the independent review committee”; and
 - (b) adding the following after Item 18 of part II B.(a):
 - “19. Report by Independent Review Committee”.
 20. Report by manager of Exempted Transactions –Transactions in securities of related issuers under NI 81-107
 21. Report by manager of Exempted Transactions – Part 4 of NI 81-102
 22. Notification by manager of non-compliance with a recommendation by the independent review committee”.
3. This Instrument comes into force on [].

APPENDIX G

NATIONAL INSTRUMENT 44-101 SHORT FORM PROSPECTUS DISTRIBUTIONS AND FORM 44-101F3 SHORT FORM PROSPECTUS AMENDMENT INSTRUMENT

1. National Instrument 44-101 Short Form Prospectus Distributions is amended by this Instrument.
2. Section 1.1 is amended
 - (a) by adding the following after the definition of “income from continuing operations”:

“independent review committee” means the independent review committee of the investment fund in compliance with National Instrument 81-107 *Independent Review Committee for Investment Funds*;”;

and
 - (b) by adding the following after the definition of “NI 52-107”:

“NI 81-107” means National Instrument 81-107 *Independent Review Committee for Investment Funds*;”.
3. Form 44-101F3 Short Form Prospectus is amended by adding the following after Item 21:

“Item 22 – Independent Review Committee

22.1 – Independent Review Committee

If not previously disclosed, for an investment fund, disclose a description of the independent review committee of the investment fund required by NI 81-107, including

 - (a) an appropriate summary of its mandate and responsibilities;
 - (b) its composition;
 - (c) that it prepares a report at least annually of its activities for securityholders which is available on the [investment fund’s/investment fund family’s] Internet site at [insert investment fund’s Internet site address], or at your request, and at no cost, by contacting the [investment fund/investment fund family] at [insert investment fund’s /investment fund family’s e-mail address] and that additional information about the independent review committee, including the names of the members, is available in the investment fund’s annual information form; and

(d) the fees payable to the independent review committee, including whether the investment fund pays all of the fees payable to the independent review committee and listing the main components of the fees.”

4. This Instrument comes into force on [].

APPENDIX H
NATIONAL INSTRUMENT 81-104
COMMODITY POOLS
AMENDMENT INSTRUMENT

1. National Instrument 81-104 Commodity Pools is amended by this Instrument.
2. Section 1.1 is amended by adding the following after the definition “Derivatives Fundamentals Course”:

“independent review committee” means the independent review committee of the investment fund in compliance with National Instrument 81-107 *Independent Review Committee for Investment Funds*”.
3. Section 9.2 is amended by adding the following after subsection 9.2(o):

“(p) provide the disclosure concerning the independent review committee of the commodity pool that is required to be provided by a mutual fund under
 - (i) subsection 3.1 of Item 5 of Part A of Form 81-101F1 Contents of Simplified Prospectus,
 - (ii) subsection 3.1 of Item 8 of Part A of Form 81-101F1 Contents of Simplified Prospectus,
 - (iii) subsections 2.1 and 2.2 of Item 4 of Form 81-101F2 Contents of Annual Information Form, and
 - (iv) subsection 2 of Item 15 of Form 81-101F2 Contents of Annual Information Form in connection with the independent review committee.”
4. This Instrument comes into force on [].