

**NOTICE OF PROPOSED CHANGES
TO
PROPOSED NATIONAL INSTRUMENT 81-104
AND COMPANION POLICY 81-104CP
COMMODITY POOLS**

Substance and Purpose of Proposed National Instrument and Companion Policy

Background

On June 27, 1997, the Canadian Securities Administrators (CSA) published for comment proposed National Instrument 81-104 Commodity Pools and proposed Companion Policy 81-104CP (the 1997 Draft NI and the 1997 Draft CP or the 1997 Drafts).

The CSA received one comment letter during the comment period for the 1997 Drafts (which ended on October 31, 1997). This comment letter focussed on one section of the 1997 Drafts and did not address any of the questions posed by the CSA in their publication of the 1997 Drafts for comment.

Since the end of the comment period, the CSA have concentrated on ensuring that the proposed National Instrument is appropriate for the regulation of commodity pools in Canada. CSA staff met with each sponsor or manager of the commodity pools managed and sold in Canada to ensure that the proposed regulatory regime addresses the regulatory issues associated with commodity pools, yet permits the continued viability of these specialized investment products. CSA staff also met with representatives of dealers who wish to be able to recommend commodity pools to their clients.

Additional written comments were received as a result of the CSA's efforts. A list of the commentators and a summary of their comments is attached as Appendix A to this Notice of Proposed Changes.

After considering these comments and continuing to assess the 1997 Drafts, the CSA are proposing amendments to the 1997 Drafts. The CSA are therefore publishing for a second time the proposed National Instrument and Companion Policy.

The proposed National Instrument and Companion Policy are a reformulation of Ontario Securities Commission Policy Statement No. 11.4 - Commodity Pools Programs (Policy 11.4), which they will replace. Through the proposed National Instrument, the CSA seek to regulate publicly offered commodity pools structured as mutual funds.

The proposed National Instrument and Companion Policy are initiatives of the CSA, and the proposed National Instrument is expected to be adopted as a rule in each of British Columbia, Alberta, Manitoba, Ontario, Nova Scotia and Newfoundland, as a Commission regulation in Saskatchewan and as a policy in all the other jurisdictions represented by the CSA. The proposed Companion Policy is expected to be implemented as a policy in all of the jurisdictions represented by the CSA.

This Notice of Proposed Changes summarizes the material changes made in the proposed National Instrument and Companion Policy from the 1997 Drafts. As described above, Appendix A to this Notice of Proposed Changes outlines the comments received in respect of the 1997 Drafts, together with the CSA responses. Further background and explanation of changes are contained in the footnotes contained in the proposed National Instrument and Companion Policy.

National Instrument 81-102 Mutual Funds and National Instrument 81-101 Mutual Fund Prospectus Disclosure

The proposed National Instrument is intended to regulate publicly offered commodity pools and is designed to act in conjunction with the mutual fund regulatory regime established by National Instrument 81-102 Mutual Funds (NI 81-102). NI 81-102 came into force on February 1, 2000. The proposed National Instrument will exempt commodity pools from provisions in NI 81-102 where deemed appropriate and will impose additional requirements on commodity pools where deemed necessary.

The new simplified prospectus disclosure regime for conventional mutual funds established by National Instrument 81-101 Mutual Fund Prospectus Disclosure (NI 81-101), which also came into force on February 1, 2000, does not apply to commodity pools. Commodity pools must file a prospectus using the mutual fund "long form" prospectus forms in force in the jurisdictions (in Ontario, Form 15 to the Regulation made under the Act) and currently must comply with Policy 11.4. The proposed National Instrument also imposes additional disclosure requirements.

Substance and Purpose of Proposed Instruments

As was proposed by the 1997 Draft NI, the proposed National Instrument is designed to replace Policy 11.4 and will regulate all publicly offered commodity pools, which are a specialized type of mutual fund that invest in, or use, commodities and/or derivatives beyond the scope permitted in NI 81-102. Commodity pools are subject to the ordinary mutual fund rules unless those rules are specifically excluded or varied by the proposed National

Instrument.

The underlying purpose for the regulation of commodity pools put forth by the proposed National Instrument and Companion Policy is discussed in the Notice published with the 1997 Drafts (the 1997 Notice). Additional background information is also provided in the 1997 Notice.

The purpose of the proposed Companion Policy is to state the views of the CSA on various matters relating to the proposed National Instrument. Terms used in the proposed Companion Policy that are defined or interpreted in the proposed National Instrument or a definition instrument in force in the jurisdiction and not otherwise defined in the proposed Companion Policy should be read in accordance with the proposed National Instrument or that definition instrument, unless the context otherwise requires.

Summary of Changes to the Proposed National Instrument from the 1997 Draft NI

This section describes changes made in the proposed National Instrument from the 1997 Draft NI. Changes of a minor nature, or those made only for purposes of clarification or drafting reasons are generally not discussed. Certain changes were made to ensure that the proposed National Instrument reflects the changes made by the CSA to NI 81-102 since that instrument's first publication for comment, also in June 1997.

For a detailed summary of the contents of the 1997 Draft NI, reference should be made to the 1997 Notice. Unless otherwise indicated, all section references in this section pertain to the proposed National Instrument.

Section 1.1

Changes to the definitions contained in section 1.1 of the proposed National Instrument reflect changes made to the operative sections.

The CSA changed the definition of "commodity pool" to better reflect and articulate the CSA's views on the nature of a commodity pool and how it differs from a conventional mutual fund. The CSA are of the view these changes are of a clarification nature only and do not change the substance of the definition or the types of investment products to which the proposed National Instrument applies.

Section 1.3

Subsection 1.3(2) is new. It excludes certain over-the-counter forwards and options from the "illiquid assets" restrictions of NI 81-102. Commodity pools are subject to the rule in NI 81-102 restricting mutual funds from investing more than 10 percent of their net assets in "illiquid assets" (as defined in NI 81-102¹). The term "public quotation" (used in the illiquid assets restrictions in NI 81-102) is proposed to be broadened for commodity pools. Subsection 1.3(2) of the proposed National Instrument expressly deems forwards and options traded on the interbank market for which there is a counterparty prepared to and capable of making a market to be those for which there is a "public quotation in common use" within the meaning of NI 81-102.

The change was made in response to a comment that the rules in NI 81-102 regarding "illiquid assets" might restrict the operations of a commodity pool. Commodity pools generally make extensive use of forwards and options traded on the interbank market in their investment strategies. The CSA agree, for commodity pools, derivatives that can be considered to be "liquid" in a non-technical sense in that they can be sold at any time should not be subject to the illiquid asset restrictions in NI 81-102.

Section 3.2

Section 3.2 has been modified to permit the issuance of units of a new commodity pool to those persons providing seed capital to the pool. Section 3.2 in the 1997 Draft NI technically prohibited the issuance of any units in the new pool, including units issued to the promoters or manager of the pool, until subscriptions aggregating not less than \$500,000 were received. This was an unintended result and the modification corrects the technical prohibition.

Section 3.3

Section 3.3 is new. It imposes on new commodity pools a direct prohibition on commencing distribution until the subscriptions described in the prospectus, together with the payment for the securities subscribed for, have been received. This provision corresponds to section 3.2 of NI 81-102.

Part 4 of the 1997 Draft NI

¹ "Illiquid asset" means (a) a portfolio asset that cannot be readily disposed of through market facilities on which public quotations in common use are widely available".

Part 4 of the 1997 Draft NI has been deleted from the proposed National Instrument. The 1997 Draft NI incorporated the Policy 11.4 prohibition on commodity pools paying fees to their advisers and managers if those parties or their affiliates received, directly or indirectly, brokerage commissions from trades made by the commodity pools. This prohibition reflected the concern that a manager would “churn” (that is, increase asset turnover) in order to earn additional brokerage commissions. Comments were received which questioned the rationale for this prohibition, especially in the case where a manager has delegated the investment decisions to an unrelated portfolio adviser.

The CSA have reconsidered Part 4 of the 1997 Draft NI and deleted the prohibition on the basis that commodity pools should be treated in a similar manner to conventional mutual funds unless a reason exists to treat them differently. Investors in commodity pools can evaluate the performance of their investments in commodity pools and redeem those investments if the pool is not performing after all expenses and fees (including brokerage commissions) are paid.

Part 4 (formerly, Part 5 of the 1997 Draft NI)

Part 5 of the 1997 Draft NI has been renumbered as Part 4. Part 4 of the proposed National Instrument contains the proficiency and supervisory requirements for participating dealers selling commodity pools. The proficiency requirements for both salespersons and supervisors of those salespersons have been changed from the 1997 Draft NI in response to comments.

The 1997 Draft NI departed from the dual registration provisions outlined in Policy 11.4 that necessitated both the salesperson and the dealer selling a commodity pool interest to be registered under the *Commodity Futures Act* (Ontario) and the *Securities Act* (Ontario). As mentioned in the 1997 Notice, staff of the Ontario Securities Commission (OSC) currently administer Policy 11.4 to require only that the participating dealer be registered under both statutes. The 1997 Draft NI proposed increased proficiency standards for salespersons and their supervisors rather than dual registration of the participating dealer for reasons that are outlined in the 1997 Notice.

Two exams offered by the Canadian Securities Institute were proposed in the 1997 Draft NI. The 1997 Draft NI required salespersons to pass the Canadian Futures Examination and their supervisors to pass the Canadian Commodity Supervisors Examination. Since 1997, the Canadian Futures Examination has been split into two parts: the Derivatives Fundamentals Course and the Futures Licensing Course.

In response to the comments received on Part 5 of the 1997 Draft NI and after reviewing the Derivatives Fundamentals Course, the CSA are of the view that the regulatory approach to ensure increased proficiency for salespersons selling commodity pools and their supervisors will be achieved by requiring these individuals to successfully attain a passing grade in the Derivatives Fundamentals Course.

Section 12.3 of the proposed National Instrument delays the coming into force of the new proficiency requirements until six months after the effective date of the proposed National Instrument. The Derivatives Fundamentals Course is a self-study course which is to be written within 12 months of enrollment. The CSA expect that the six month delay will allow those salespersons and supervisors affected to complete the new proficiency standard without incurring undue hardship.

Part 6 of the 1997 Draft NI

The CSA have deleted Part 6 of the 1997 Draft NI. Part 6 of the 1997 Draft NI brought forward provisions from Policy 11.4 which dealt with liability of investors in a commodity pool structured as a limited partnership. The CSA re-considered whether they need to make rules in this area and concluded that the statutory and common law applicable to limited partnerships should prevail. Accordingly Part 6 has been deleted, but the CSA have addressed the questions surrounding limited partnerships through an expanded discussion in the proposed Companion Policy and expanded disclosure requirements. Subsection 3.1 (4) of proposed Companion Policy now highlights the CSA's views that pools should be structured so as to limit the liability of securityholders to the amount initially invested. Paragraph 10.2(1) of the proposed National Instrument sets out the enhanced disclosure requirements.

Part 6

Part 6 is new and sets out the parameters for managers of commodity pools who propose to charge an incentive fee to commodity pools. Part 6 modifies the requirements in section 7.1 of NI 81-102 relating to incentive fees charged to commodity pools. An incentive fee is a fee paid by a mutual fund which is based on some measure of performance of the manager of that mutual fund.

The 1997 Draft NI required commodity pools and their managers to comply with section 7.1 of NI 81-102 without any modification. Section 7.1 of NI 81-102 permits a manager to charge a mutual fund an incentive fee, among other requirements, so long as the fee is calculated with reference to a representative benchmark or index that reflects the market

sectors in which the fund invests.

Commodity pool managers commented that no benchmark or index exists in respect of commodity pools that would meet the requirements in section 7.1 of NI 81-102. The CSA noted this issue in the 1997 Notice. Also, commentators claimed that without the ability to charge an incentive fee, managers of commodity pools would be at a significant disadvantage in attracting successful commodity futures advisers to sub-manage the assets of commodity pools. These commentators point out that, particularly, United States-based commodity futures advisers expect to be compensated based on performance.

The CSA are of the view that the performance of fund managers for the purposes of incentive fee calculations must be measured against the performance of an appropriate objective benchmark or index. However, in recognition of the difficulties in determining an appropriate benchmark or index for commodity pools, the CSA propose that commodity pool managers may levy an incentive fee in respect of commodity pools, in circumstances no other appropriate benchmark exists, where the pools' performance is benchmarked against the 90-day Canadian or United States government treasury bill rate. One rationale for permitting this benchmark is that commodity pools generally hold 60 percent to 80 percent of their assets in treasury bills (as cover for derivatives transactions).

The CSA have considered the issues of incentive fees charged to commodity pools very carefully and have determined that incentive fees charged to commodity pools should be regulated in the fashion proposed by the proposed National Instrument. However, the CSA are aware that commodity pools require specialized management that may only be available if the portfolio adviser or manager receives compensation that is based on the performance of that adviser or manager, without regard to an objective benchmark or index. The CSA are seeking specific comment on whether alternatives exist to section 6 of the proposed National Instrument.

Section 9.4

Section 9.4 is new and requires commodity pools to file and deliver a modified statement of portfolio transactions. Section 9.1 of the proposed National Instrument clarifies that commodity pools must comply with applicable securities legislation regarding financial statements except as varied by the proposed National Instrument.

Section 9.4 will require a commodity pool's statement of portfolio transactions to contain summary disclosure of all trades, through listing on an aggregate basis all purchases and sales of each contract (or investment) entered into by the pool during the applicable quarter.

The CSA believe that this aggregate disclosure will help investors evaluate the level of trading activity, the trading patterns and the types of contracts traded by the pool. The statement gives information on asset turnover and can be used to analyse the liquidity of the positions traded by the pool.

The CSA propose this change in response to comments received, questioning the rationale for requiring commodity pools to prepare full statements of portfolio transactions in the form required by securities legislation. The CSA agree that the current form of a statement of portfolio transactions would not give meaningful information to an investor in a commodity

pool (due to extensive use of derivatives and higher levels of asset turnover). The modified statement mandated by section 9.4 is designed to address this concern.

Section 10.2 (formerly, section 10.3 of the 1997 Draft NI)

Clause 10.2(g) of the proposed National Instrument will require a commodity pool to provide in its prospectus past performance disclosure in the format contemplated by NI 81-101 for conventional mutual funds, modified for commodity pools. Commodity pools will be required to disclose: (1) in a bar chart, the quarterly returns of the pool (conventional mutual funds show these returns on an annual basis); (2) the performance of the pool in a line graph as compared to the 90-day Canadian or US treasury bill rate (conventional mutual funds must use an "appropriate broad based securities market index"; and (3) the annual compound returns of the pool for the 10, five, three and one year periods ended on December 31. The CSA believe that these graphic and numerical presentations of past performance will help investors evaluate a pool's average returns over a period of time and the volatility of the pool's returns on a quarterly basis.

The CSA are of the view that these graphic depictions of a commodity pool's performance over time will give investors a sense of the inherent risks associated with investing in these investment vehicles. The CSA have not required at this time, that either conventional mutual funds or commodity pools provide investors with a standardized and accepted measure of risk. Since commodity pools are specialized mutual funds with a very different risk profile to conventional mutual funds, as described below, the CSA seek specific comment on whether a standardized risk measure should be disclosed by commodity pools.

Subclause 10.2(1)(ii) has been added. As outlined above, Part 6 of the 1997 Draft NI which dealt with loss of limited liability for securityholders of a commodity pool organized as a limited partnership has been deleted from the proposed National Instrument. Subclause 10.2(1)(ii) has been added to alert investors to any issues related to limited partnerships. The

- C CSA ask commentators for their views on whether this disclosure should be included also on the front page of the prospectus for a commodity pool.

Section 10.3 of the 1997 Draft NI

Clause 10.3(e) of the 1997 Draft NI has been deleted. The 1997 Draft NI required (as did Policy 11.4) a commodity pool to disclose whether the proposed fees charged by the portfolio adviser to the pool are higher or lower than those charged to other pools that are advised by the portfolio adviser, together with any information concerning brokerage charges to those other pools that the pool considers relevant.

Similarly, clause 10.3(g) of the 1997 Draft NI has been deleted. The 1997 Draft NI required a commodity pool with a history of less than three years to disclose the total return of the portfolio adviser (or manager, as the case may be) for all other commodity pools for which the portfolio adviser has acted in that capacity for a specified time period.

The CSA believe that no continuing regulatory purpose exists to require the above disclosure, which the CSA notes is not required of conventional mutual funds. Instead, the CSA propose clause 10.2(g), which they consider more meaningful and relevant disclosure.

- C *Section 11.2 of the 1997 Draft NI*

The CSA have deleted section 11.2 of the 1997 Draft NI in order to conform the exemptive provisions to the comparable provisions contained in NI 81-102.

Summary of Changes to the Proposed Companion Policy from the 1997 Draft CP

This section describes the material changes made to the proposed Companion Policy from the 1997 Draft CP. Changes made in order to ensure that the proposed Companion Policy conforms to the proposed National Instrument are not described here. For a detailed summary of the contents of the 1997 Draft CP, reference should be made to the 1997 Notice. Unless otherwise indicated, all section references in this section of this Notice of Proposed Changes pertain to the proposed Companion Policy.

Section 2.2

- C Section 2.2 is new. The CSA discuss the use of derivatives by commodity pools and clarify that commodity pools are excluded from the rules of NI 81-102 governing specified derivatives, but remain subject to the other investment restrictions in NI 81-102. For

example, commodity pools remain subject to the restrictions on purchasing securities on margin and the prohibition on selling securities short.

Specific Questions of the CSA

In addition to welcoming submissions on any provision of the proposed National Instrument and the proposed Companion Policy, the CSA seek comment on the three matters referred to below.

Incentive Fees

As noted above, Part 6 of the proposed National Instrument addresses the levying of incentive fees against assets of commodity pools when no benchmark or index exists that would meet the requirements in section 7.1 of NI 81-102. The CSA seek comment on whether the proposed National Instrument should completely exempt commodity pools from the operation of section 7.1 of NI 81-102 and require only disclosure of the incentive fee and the basis on which it is calculated. In responding to this issue, commentators should address whether disclosure alone would provide consumers with enough information to make informed decisions and whether market forces would be able to adequately regulate incentive fees charged by commodity pools. In other words, why should commodity pools be treated differently in this respect than conventional mutual funds? The CSA note that the primary regulatory purpose in mandating a benchmark or index is to ensure that investors will be able to properly assess whether the fees being charged in respect of their investment are appropriate having regard to the performance of the pool. The CSA have traditionally required that a manager of mutual funds inform investors that it will attempt to out-perform a specified recognized and widely used benchmark or index and if it does so, it will be entitled to fees based on that performance. Will investors be able to make informed decisions about the performance of the commodity pool's performance without any measure of performance?

Risk Measures

The CSA are proposing that commodity pools provide in their prospectuses, graphic depictions of past performance which are consistent with the requirements for conventional mutual funds set out in NI 81-101. The CSA seek specific comment on whether commodity pools are sufficiently different from conventional mutual funds in their risk profile to warrant the CSA requiring disclosure of a standardized measure of risk. Commentators believing that this disclosure would be appropriate should explain which measure would be appropriate, with a focus on whether this risk measure would be comprehensible to the average

commodity pool investor. Does a common measure of risk exist in the commodity pool industry in Canada? In the United States?

Risk of Loss of Limited Liability

The proposed National Instrument requires that a commodity pool address the possibility of loss of limited liability in specialized circumstances in its prospectus. Is this risk sufficiently important and material that front page disclosure should be given?

Comments

Interested parties are invited to make written submissions with respect to the proposed National Instrument and Companion Policy. Submissions received by August 4 , 2000 will be considered.

Submissions should be sent to all of the Canadian securities regulatory authorities listed below in care of the Ontario Securities Commission, in duplicate, as indicated below:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
The Manitoba Securities Commission
Ontario Securities Commission
Office of the Administrator, New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland
Securities Registry, Government of the Northwest Territories
Registrar of Securities, Government of the Yukon Territory
Registrar of Securities, Government of Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario M5H 3S8
E-mail: jstevenson@osc.gov.on.ca

Submissions should also be addressed to the Commission des valeurs mobilières du Québec as follows:

Claude St. Pierre, Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square
Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montréal, Québec H4Z 1G3
E-mail: claudestpierre@cvmq.com

A diskette containing the submissions (in DOS or Windows format, preferably WordPerfect) should also be submitted. As securities legislation in certain provinces requires that a summary of written comments received during the comment period be published, confidentiality of submissions cannot be maintained.

Comments may also be sent via e-mail to the above noted e-mail addresses of the respective Secretaries of the OSC and to the Commission des valeurs mobilières du Québec, and also to any of the individuals noted below at their respective e-mail addresses.

Questions may be referred to any of:

Noreen Bent
Senior Legal Counsel
British Columbia Securities Commission
(604) 899-6741
or 1-800-373-6393 (in B.C.)
E-mail: nbent@bcsc.bc.ca

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DATED: June 2, 2000.

APPENDIX A

Summary of Comments Received on Proposed National Instrument 81-104 Commodity Pools and Proposed Companion Policy 81-104CP Commodity Pools and Response of the Canadian Securities Administrators

In June 1997, the Canadian Securities Administrators (CSA) released for public comment proposed National Instrument 81-104 Commodity Pools (the 1997 Draft NI) and proposed Companion Policy 81-104CP Commodity Pools (the 1997 Draft CP). During the comment period which ended on October 31, 1997, the CSA received one comment letter from Meighen Demers.

As outlined in the Notice of Proposed Changes, since no comments were received during the comment period that addressed the issues raised by the CSA in the 1997 Notice, the CSA considered it important to contact each of the existing commodity pools in Canada to ensure that the proposed regulatory regime for commodity pools is appropriate and reflects the commodity pool industry in Canada. As a result of that contact, the CSA received additional written comments from:

1. AGF Management Limited
2. The Di Tomasso Group
3. Dorsey & Whitney LLP on behalf of Friedberg Mercantile Group
4. Fogler, Rubinoff on behalf of Friedberg Mercantile Group
5. Merrill Lynch Canada Inc.
6. Mondiale Asset Management Ltd.
7. Russell & DuMoulin

Copies of the comment letters may be viewed at the office of Micromedia Limited, 20 Victoria Street, Toronto, Ontario (416) 312-5211 or 1- (800) 387-2689; the office of the British Columbia Securities Commission, 200-865 Hornby Street, Vancouver, British Columbia (604) 899-6660; the office of the Alberta Securities Commission, 10025 Jasper Avenue, Edmonton, Alberta (780) 427-5201; and the office of the Commission des valeurs mobilières du Québec, Stock Exchange Tower, 800 Victoria Square, 22nd floor, Montréal, Québec (514) 940-2150.

The CSA have considered the comments received on the 1997 Drafts and thank all commentators for providing their comments.

The attached Table contains a summary of all comments received, together with the response of the CSA to those comments.

Note: In this Table, "1997 Draft" means the proposed version of NI 81-104 and Companion Policy 81-104CP published for comment in June 1997; "Revised NI" means the proposed revised version of NI 81-104 and Companion Policy 81-104CP; "CSA" means the Canadian Securities Administrators.

	1997 Draft Reference	Revised NI Reference	Comment	CSA Response
1.	Definition of "illiquid asset" in NI 81-102	S . 1.3(2)	Commodity pools should be permitted to invest in inter-bank forwards and options for which there is a counterparty prepared to and capable of making a market without regard to whether these transactions are restricted by the "illiquid assets" rules provided for in NI 81-102.	Change made. Subsection 1.3(2) of the proposed National Instrument excludes interbank forwards and options for which there is a counterparty prepared to and capable of making a market from the definition of "illiquid asset" for commodity pools.
2.	Definition of "underlying market exposure" in the 1997 draft of NI 81-102	N/A	The definition of "underlying market exposure" in the June 1997 published draft of NI 81-102 does not include all derivative instruments that may be used by a commodity pool. As a result, the look-through provision used to calculate concentration in one issuer for the concentration restriction will not operate to include all derivatives that may be used by a commodity pool.	The final version of NI 81-102 addresses this discrepancy. The term "underlying market exposure" was replaced by the term "underlying interest of that specified derivative" in subsection 2.1(3) of NI 81-102.

	1997 Draft Reference	Revised NI Reference	Comment	CSA Response
3.	S. 1.3	DELETED	Section 1.3 of the 1997 Draft should be clarified to ensure that all references to "permitted derivatives" in NI 81-102 are read as references to "specified derivatives" for commodity pools.	The comment was addressed in the final version of NI 81-102 which only uses the term "specified derivatives". All references to "permitted derivatives" were removed from the final rule.
4.	S. 2.1	S. 2.1	The 10 percent concentration restriction should not apply to commodity pools. The use of leverage will cause a commodity pool to easily exceed the 10 percent concentration restriction. This result would not be consistent with a commodity pool's ability to leverage and speculate. E.g., a commodity pool with net assets of \$1 million that purchases forward contracts with market exposure of \$300,000 (30 percent of the net assets) may only need to deposit \$12,000 margin (2 to 4 percent of underlying market exposure).	No change made. The 10 percent concentration restriction in s. 2.1(1) of NI 81-102 restricts commodity pools from investing in <i>any one issuer</i> more than 10 percent of the net assets of the pool. Commodity pools should not use leverage to gain more than 10 percent exposure to any one issuer. The general rules applicable to mutual funds should apply to commodity pools. The concentration restriction would not preclude a commodity pool from exposing more than 10 percent of its net assets to a <i>commodity</i> (such as gold).
5.	S. 3.2(1)(a) & (b)	S. 3.2(1)(a) & (b)	Clause 3.2(1)(b) forbids the issuance of any units prior to receiving subscriptions aggregating not less than \$500,000. This prohibition precludes the issuance of units for the seed capital money invested.	Clause 3.2(1)(b) was amended to reflect this comment.
6.	S. 3.2(2)	S. 3.2(2)	The prohibition on removal of the initial seed capital (until the commodity pool is terminated or dissolved) is not necessary if the commodity pool is well established and has grown very large.	No change made. The CSA believe that the seed capital should remain in the commodity pool for the duration of the commodity pool's existence.

	1997 Draft Reference	Revised NI Reference	Comment	CSA Response
7.	S. 4.1	DELETED	No restrictions should be placed on a commodity pool's ability to pay a management fee to parties receiving or participating, directly or indirectly, in brokerage commissions. In addition, a manager not acting as portfolio adviser to the commodity pool will not control portfolio turnover (or "churning" activities) – as a result, the conflict of interest provision should not apply to a manager that does not provide portfolio advice.	The prohibition was removed. Commodity pools are now treated in a like manner to conventional mutual funds on this issue. Investors can evaluate the performance of the commodity pool after management and brokerage fees are paid and can redeem units if the net returns of the pool are not acceptable.

	1997 Draft Reference	Revised NI Reference	Comment	CSA Response
8.	5.1	4.1	<p>The Canadian Securities Institute ("CSI") proficiency courses proposed in the 1997 Draft for salespersons and supervisors are not appropriate courses. The courses aim at proficiency requirements for those trading in individual futures accounts. Commodity pools differ from the individual futures accounts as the pools are professionally managed by advisers with the requisite <i>proficiency and experience</i>. Also, the qualifications suggested are rare, particularly for representatives of mutual fund dealers. Since the distribution channels will be limited, a majority of the public in Canada will be deprived of an opportunity to participate in commodity pools. Why impose additional proficiency requirements for commodity pools, when no such additional specialized knowledge is mandated for conventional mutual funds specializing in niche markets, for example, or using derivative instruments.</p>	<p>Section 4.1 has been changed. The additional proficiency requirements for both the salesperson and the supervisor would be to successfully complete the Derivatives Fundamentals Course offered by the CSI. This course provides a knowledge base in derivatives that the CSA believes is appropriate for anyone seeking to sell commodity pools. This course reflects the additional knowledge required to sell a professionally <i>managed commodity pool</i> which uses derivatives to create leverage and to speculate. A six month transitional period is proposed in respect of this requirement.</p>
9.	5.1	4.1	<p>The additional proficiency requirements for selling commodity pools should not apply to SRO members as their general requirements are higher.</p>	<p>Changes described above made. SRO members are not exempt at present from the requirements described above. The CSA are of the view that SRO members should also have specialized knowledge about derivatives to sell commodity pools, notwithstanding the additional courses they take.</p>

	<i>1997 Draft Reference</i>	<i>Revised NI Reference</i>	<i>Comment</i>	<i>CSA Response</i>
10.	5.1	4.1	The proposed National Instrument should include an exemptive relief provision for proficiency requirements.	No change necessary. Applications for exemptive relief from provisions of the proposed National Instrument can be made under section 11.1.
11.	Pt 5	Pt 4	It is difficult for the mutual fund dealer to monitor whether the dealer or salesperson selling a pool is properly registered. The National Instrument should provide clear direction that the onus to ensure proper registration is on the salesperson. Clear liability for the failure to comply must be set out explicitly in the National Instrument or by reference to a stated provision.	No changes were made. The CSA do not believe that the proposed National Instrument regulating commodity pools should restate or contribute to the existing penalties for non-compliance with registration requirements.
12.	S.7.1	S. 7.1	Is it intended that a change in [redemption] policy is a material change, requiring a unitholder meeting if the policy is amended?	The proposed National Instrument permits commodity pools to set redemption policies that are consistent with, if not, less restrictive than previous policy statements. Each commodity pool must determine how it will comply with the National Instrument once it comes into force and must decide for itself what approvals it must seek and obtain.
13.	S. 7.3	S. 7.3	Supports allowing commodity pools additional time to redeem units (i.e. 15 days rather than 3 days for conventional mutual funds). Is the "15 days" business days or calendar days?	The 15 days are calendar days.

	1997 Draft Reference	Revised NI Reference	Comment	CSA Response
14.	Pt 7 & 8	Pt 7 & 8	Rationale for reducing the time periods for redemptions (30 days to 15 days) and frequency of calculation of the NAV (once per week to daily) is clear and acceptable. However, these changes will result in significant back-office system changes; will require time and money; and may be difficult for some distributors to implement.	Commodity pools facing undue hardship should seek exemptive transitional relief once the National Instrument comes into force. However, commodity pools have been given a long period of notice of these proposed changes (since June 1997) in which to change their affairs. Any commodity pool seeking exemptive transitional relief should explain why this lengthy period of notice has not been sufficient.
15.	Pt 9.2	Pt 9.2	The requirement for quarterly interim financial statements is not appropriate. It is onerous and costly. A quarterly investment update should be substituted for quarterly interim financial statements.	No changes made. Due to the ability for commodity pools to use leverage and their inherent volatility, the CSA believe that semi-annual financial statements are not sufficient. Also, the quarterly interim statements are not required to be audited statements and costs associated with such audits do not need to be incurred on a quarterly basis.
16.	S 9.4	S 9.4	Preparing and filing of statements of portfolio transactions and statements of investment portfolio are of no utility to investors in a commodity pool.	Section 9.4 of the proposed National Instrument incorporates a revised statement of portfolio transactions for commodity pools. The statement will provide aggregate disclosure of the contracts purchased and sold by the commodity pool during the period. This information will allow investors to evaluate the level of leverage used, the turnover of assets and level of liquidity of the contracts being traded. The regulations applicable to mutual funds and Statements of Investment Portfolio are proposed to apply to commodity pools.

	1997 Draft Reference	Revised NI Reference	Comment	CSA Response
17.	(New)	S. 6.1	<p>In requiring compliance with section 7.1 of NI 81-102, a commodity pool manager must base an incentive fee charged to a commodity pool on the pool's performance relative to a representative benchmark. There is no such representative benchmark for a highly leveraged investment fund such as a commodity pool. The current requirement would preclude the use of incentive fees by commodity pool managers in Canada. If Canadian commodity pool managers are precluded from charging incentive fees, this fact would impact on the availability of top-ranked U.S. commodity trading advisers and the viability of commodity pools in Canada. The U.S. model allows for incentive fees to be charged without regard to a benchmark, if the fees are fully described to the investors.</p> <p>As 65 - 80 percent of a commodity pool's assets are generally invested in treasury bills, a government treasury-bill rate would be consistent with section 7.1 of NI 81-102. A treasury-bill rate benchmark is easily measurable and applicable to all types of commodity pools.</p>	<p>Section 6.1 was added to the proposed National Instrument. Section 6.1 permits a commodity pool to pay an incentive fee based on performance, where the pool's performance is based on a 90-day Canadian or US government treasury-bill rate benchmark, if a more appropriate benchmark is not available.</p>

	1997 Draft Reference	Revised NI Reference	Comment	CSA Response
18.	S. 6.8 of NI 81-102	S. 6.8 of NI 81-102	Section 6.8 of NI 81-102 is not broad enough to accommodate all types of derivatives that commodity pools might use. Section 6.8 of NI 81-102 should be broadened in the proposed National Instrument to accommodate all types of derivatives that a commodity pool might use. Commentator focussing on section 6.8 of the June 1997 version of NI 81-102.	No changes made. The CSA believe that the custodial provisions do accommodate the expanded use of derivatives by commodity pools. Changes made to section 6.8 of NI 81-102 since the June 1997 publication.

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**NATIONAL INSTRUMENT 81-104
COMMODITY POOLS**

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**NATIONAL INSTRUMENT 81-104
COMMODITY POOLS¹**

PART 1 DEFINITIONS, APPLICATION AND INTERPRETATION

1.1 Definitions²

(1) In this Instrument

"commodity pool" means a mutual fund, other than a precious metals fund, that has adopted fundamental investment objectives³ that permit it to use or invest in

(a) specified derivatives in a manner that is not permitted by National Instrument 81-102 Mutual Funds, or

¹ This proposed National Instrument is based on OSC Policy 11.4 ("Policy 11.4"), reformulated as a national instrument. This proposed Instrument is expected to be adopted as a rule in British Columbia, Alberta, Manitoba, Newfoundland, Ontario and Nova Scotia, as a Commission regulation in Saskatchewan, and as a policy in all other jurisdictions represented by the CSA.

This is the second publication for comment of the proposed National Instrument, and amends the draft published in June 1997 (the "1997 Draft"). Amendments to the 1997 Draft have been made as the result of comments received on that draft and as the result of further consideration of this Instrument by the CSA. Amendments have also been made to ensure that this draft relates properly to National Instrument 81-102 ("NI81-102"), which came into force on February 1, 2000. Substantive amendments from the 1997 Draft are discussed in the footnotes to this Instrument or the notice published with this Instrument.

² A national definition instrument has been adopted as National Instrument 14-101 Definitions. It contains definitions of certain terms used in more than one national instrument. National Instrument 14-101 also provides that a term used in a national instrument and defined in the statute relating to securities of the applicable jurisdiction, the definition of which is not restricted to a specific portion of the statute, will have the meaning given to it in that statute, unless the context otherwise requires. National Instrument 14-101 also provides that a provision or a reference within a provision of a national instrument that specifically refers by name to a jurisdiction, other than the local jurisdiction, shall not have any effect in the local jurisdiction, unless otherwise stated in the provision.

³ The term "fundamental investment objectives" is defined in NI81-102 as "the investment objectives of a mutual fund that define the fundamental nature of the mutual fund and define the fundamental investment features of the mutual fund that distinguish it from other mutual funds." The intent of the use of these words is to define a commodity pool as a mutual fund that is primarily defined by its use of derivatives or commodities in a manner different from what is permitted by NI81-102.

- (b) physical commodities in a manner that is not permitted by National Instrument 81-102;

"Derivatives Fundamentals Course" means a course prepared and conducted by the Canadian Securities Institute and so named by that Institute as of the date that this Instrument comes into force, every predecessor to that course, and every successor to that course that does not narrow the scope of the significant subject matter of the course; and

"precious metals fund" means a mutual fund that has adopted fundamental investment objectives, and received all required regulatory approvals, that permit it to invest in precious metals or in entities that invest in precious metals and that otherwise complies with National Instrument 81-102.

- (2) Terms defined in National Instrument 81-102 and used in this Instrument have the respective meanings ascribed to them in National Instrument 81-102.

1.2 Application - This Instrument applies only to

- (a) a commodity pool that
 - (i) offers, or has offered, securities under a prospectus for so long as the commodity pool remains a reporting issuer, or
 - (ii) is filing a preliminary prospectus or its first prospectus; and
- (b) a person or company in respect of activities pertaining to a commodity pool referred to in paragraph (a) or pertaining to the filing of a prospectus to which subsection 3.2(1) applies.

1.3 Interpretation

- (1) Each section, part, class or series of a class of securities of a commodity pool that is referable to a separate portfolio of assets is considered to be a separate commodity pool for purposes of this Instrument.

- (2) In relation to the application to commodity pools of the illiquid asset tests contained in National Instrument 81-102, the term "public quotation" in section 1.1 of National Instrument 81-102 includes any quotation of a price for foreign currency forwards and foreign currency options in the interbank market.

PART 2 INVESTMENT RESTRICTIONS AND PRACTICES

- 2.1 Investment Restrictions and Practices** - Paragraphs 2.3(d), (e), (f), (g) and (h) and sections 2.7, 2.8 and 2.11 of National Instrument 81-102 do not apply to a commodity pool.⁴

PART 3 NEW COMMODITY POOLS

- 3.1 Non-Application** - Sections 3.1 and 3.2 of National Instrument 81-102 do not apply to a commodity pool.

3.2 New Commodity Pools

- (1) No person or company shall file a prospectus for a newly established commodity pool unless

⁴ Commodity pools are subject to the investment restrictions and practices contained in NI81-102 except those pertaining to commodities and derivatives. This provision excludes the application of NI81-102 to commodity pools in respect of the following matters:

- | | |
|-------------------------|---|
| paragraph 2.3(d) | - prohibition on purchase of gold certificates other than permitted gold certificates |
| paragraph 2.3(e) | - prohibition on purchase of gold or permitted gold certificates in excess of 10 percent of assets |
| paragraph 2.3(f) | - prohibition on purchase of physical commodities |
| paragraph 2.3(g) | - prohibition on purchase of specified derivatives other than in compliance with sections 2.7 to 2.11 of NI81-102 |
| paragraph 2.3(h) | - prohibition on purchase of specified derivatives having an underlying interest of a physical commodity other than gold |
| sections 2.7, 2.8, 2.11 | - general rules respecting specified derivatives use; section 2.9 will apply to commodity pools so that commodity pools will have the benefit of that provision if they use derivatives for hedging purposes. |

- (a) an investment of at least \$50,000 in securities of the commodity pool has been made, and those securities are beneficially owned, before the time of filing by
 - (i) the manager, a portfolio adviser, a promoter or a sponsor of the commodity pool,
 - (ii) the directors, officers or shareholders of any of the manager, a portfolio adviser, a promoter or a sponsor of the commodity pool, or
 - (iii) any combination of the persons or companies referred to in subparagraphs (i) and (ii); and
 - (b) the prospectus of the commodity pool states that the commodity pool will not issue securities other than those referred to in paragraph (a) unless subscriptions aggregating not less than \$500,000 have been received by the commodity pool from investors other than the persons and companies referred to in subparagraphs (i) and (ii) of paragraph (a) and accepted by the commodity pool.
- (2) A commodity pool shall not redeem, repurchase or return any amount invested in, a security issued upon an investment in the commodity pool referred to in paragraph (1)(a) except as part of the dissolution or termination of the commodity pool.

3.3 Prohibition Against Distribution - If a prospectus of a commodity pool contains the disclosure described in paragraph 3.2(1)(a), the commodity pool shall not distribute any securities unless the subscriptions described in that disclosure, together with payment for the securities subscribed for, have been received.⁵

⁵ This provision is new and corresponds to section 3.2 of N181-102, which imposes a direct prohibition on a mutual fund in respect of the initial capitalization requirements of the mutual fund.

PART 4 PROFICIENCY AND SUPERVISORY REQUIREMENTS

4.1 Proficiency and Supervisory Requirements

- (1) No registered salesperson, partner, director or officer of a principal distributor or participating dealer shall trade in a security of a commodity pool on behalf of the principal distributor or participating dealer unless that individual
 - (a) has received at least a passing grade for the Derivatives Fundamentals Course; or
 - (b) meets the proficiency standards applicable to trading in securities of commodity pools required by a self-regulatory organization to which the individual, or his or her organization, is a member if the securities regulatory authority or regulator has completed any required review, approval or non-disapproval of the regulatory instrument of the self-regulatory organization that establishes those proficiency standards.⁶
- (2) No principal distributor or participating dealer shall trade in a security of a commodity pool in the local jurisdiction⁷ unless
 - (a) the principal distributor or participating dealer has designated an individual located in the local jurisdiction to

⁶ The CSA have changed the proficiency standards required for individuals trading in securities of commodity pools from the 1997 Draft. The CSA now are proposing that such individuals have completed the Derivatives Fundamentals Course or any relevant SRO requirements. These standards will ensure adequate knowledge of commodity pool products by persons engaged in their sale, without imposing requirements that are excessively difficult to satisfy.

⁷ The term "local jurisdiction" is defined in National Instrument 14-101 Definitions. The definition is "in a national instrument adopted or made by a Canadian securities regulatory authority, the jurisdiction in which the Canadian securities regulatory authority is situate". The term "jurisdiction" is defined in National Instrument 14-101 Definitions as meaning a province or territory of Canada, except when used in the term foreign jurisdiction. The term "Canadian securities regulatory authorities" is defined in National Instrument 14-101 Definitions as meaning the securities commissions or similar regulatory authorities set out in an appendix to that instrument.

be responsible for the supervision of trades of securities of commodity pools in the local jurisdiction; and

- (b) the individual referred to paragraph (a) has received at least a passing grade for the Derivatives Fundamentals Course.
- (3) Despite subsection (2), but subject to compliance with securities legislation,⁸ a principal distributor may agree to act as principal distributor of a commodity pool and may trade in securities of a commodity pool if all trades are effected through a participating dealer that satisfies the requirements of subsection (2).

PART 5 TERMINATION OF AGREEMENTS

- 5.1 Termination of Agreements** - A commodity pool shall not enter into an agreement retaining any person or company to provide services to it unless the retainer is terminable by the commodity pool without penalty with no more than 60 days' notice.

PART 6 INCENTIVE FEES

- 6.1 Incentive Fees** - The benchmark or index to be used by a commodity pool in relation to the calculation or payment of fees to which paragraph 7.1(a) of National Instrument 81-102 applies shall be the average yield of either 90-day Government of Canada treasury bills or 90-day Government of the United States of America treasury bills during the relevant period if there is no benchmark or index known to the commodity pool that satisfies the requirements of that paragraph.⁹

⁸ The term "securities legislation" is defined in National Instrument 14-101 Definitions as meaning the particular statute and legislative instruments of the local jurisdiction set out in an appendix to that instrument and will generally include the statute, regulations and, in some cases, the rules, forms, rulings and orders relating to securities in the local jurisdiction.

⁹ The CSA are proposing that commodity pools follow the same rules for incentive fees as conventional mutual funds, as set out in National Instrument 81-102. However, the CSA recognize that there may not always be benchmarks that form appropriate bases for comparison with the performance of the commodity pool; in those circumstances, this Instrument requires the commodity pool to use the 90-day Government of Canada or the 90-day Government of the

PART 7 REDEMPTION OF SECURITIES OF A COMMODITY POOL

7.1 Frequency of Redemptions - If disclosed in its prospectus, a commodity pool may include, as part of the requirements established under subsection 10.1(2) of National Instrument 81-102, a provision that securityholders of the commodity pool shall not have the right to redeem their securities for a period up to six months after the date on which the receipt is issued for the initial prospectus of the commodity pool.

7.2 Required Notice of Redemption - Despite section 10.3 of National Instrument 81-102, a commodity pool may implement a policy providing that a person or company making a redemption order for securities shall receive the net asset value for those securities determined, as provided in the policy, on the first or second business day after the date of receipt by the commodity pool of the redemption order.

7.3 Payment of Redemption Proceeds - The references in subsection 10.4(1) of National Instrument 81-102 to "three business days" shall be read as references to "15 days" in relation to commodity pools.

PART 8 CALCULATION OF NET ASSET VALUE

8.1 Non-Application - Subsections 13.1(1) and (2) of National Instrument 81-102 do not apply to a commodity pool.

8.2 Calculation of Net Asset Value - The net asset value of a commodity pool shall be calculated at least once each business day.

PART 9 CONTINUOUS DISCLOSURE - FINANCIAL STATEMENTS

9.1 Variation of Securities Legislation - The provisions of securities legislation that pertain to the filing, content and sending to securityholders of financial statements for mutual funds are varied for commodity pools to the extent described in this Part.

United States treasury bill yield as a comparison.

9.2 Interim Financial Statements

- (1) Instead of filing and delivering interim financial statements on a semi-annual basis, a commodity pool shall, within 60 days of the date to which they are made up, file and deliver to each securityholder whose last address as shown on the books of the commodity pool is in the local jurisdiction, interim financial statements
 - (a) if the commodity pool has not completed its first financial year, for the periods commencing with the beginning of that financial year and ending nine, six and three months before the date on which that year ends; and
 - (b) if the commodity pool has completed its first financial year, for the periods beginning at the end of its last completed financial year and ending three, six and nine months after the end of the last completed financial year, together with, if applicable, comparative statements to the end of each of the corresponding periods in the last completed financial year.
- (2) Despite paragraph (1)(a), a commodity pool is not required to prepare, file or deliver interim financial statements for a period that is less than three months in length.

9.3 Income Statements - In addition to any other matters required by securities legislation, the income statement forming part of the interim financial statements of a commodity pool shall include

- (a) the total amount of realized net gain or net loss on positions liquidated during the period;
- (b) the change in unrealized net gain or net loss on open positions during the period;
- (c) the total amount of net gain or net loss from all other transactions in which the commodity pool engaged during the period, including interest;

- (d) the total amount of all incentive fees paid during the period; and
- (e) the total amount of all brokerage commissions paid during the period.

9.4 Statements of Portfolio Transactions¹⁰

- (1) A statement of portfolio transactions of a commodity pool shall provide disclosure, in the form of the table in subsection (2), of the aggregate total volume and total value or nominal value of all purchase and sale transactions of the commodity pool for
 - (a) each security, by class or series, purchased or sold by the commodity pool during the period;
 - (b) each physical commodity, purchased or sold by the commodity pool during the period; and
 - (c) each derivative, by type of contract and underlying interest, for which a derivatives transaction was entered into by the commodity pool during the period.

- (2) The table contemplated by subsection (1) shall be in the following form:

	Total Volume	Total Value or Nominal Value
Purchases		
Sales		

PART 10 PROSPECTUS DISCLOSURE

¹⁰ This provision permits a commodity pool to provide summary disclosure of its trading activities in a statement of portfolio transactions, rather than have to disclose particulars of every trade, as would otherwise be required under securities legislation. The CSA are satisfied that summary disclosure in this context provides investors with an adequate overview of the trading activity of the commodity pool for the period to which the statement relates.

10.1 Front Page Disclosure - In addition to any other requirements of securities legislation, the front page of a preliminary prospectus and prospectus of a commodity pool shall

- (a) state, in substantially the following words:

" You should carefully consider whether your financial condition permits you to participate in the [commodity pool]. The securities of the [commodity pool] are [highly] speculative and involve a high degree of risk. You may lose a substantial portion or even all of the money you place in the [commodity pool].

The risk of loss in trading [nature of instruments to be traded by the commodity pool] can be substantial. In considering whether to participate in the [commodity pool], you should be aware that trading [nature of instruments] can quickly lead to large losses as well as gains. Such trading losses can sharply reduce the net asset value of the [commodity pool] and consequently the value of your interest in the [commodity pool]. Also, market conditions may make it difficult or impossible for the [commodity pool] to liquidate a position.

The [commodity pool] is subject to certain conflicts of interest.

The [commodity pool] will be subject to the charges payable by it as described in this prospectus that must be offset by revenues and trading gains before an investor is entitled to a return on his or her investment. It may be necessary for the [commodity pool] to make substantial trading profits to avoid depletion or exhaustion of its assets before an investor is entitled to a return on his or her investment.";

- (b) state, for the initial prospectus of a commodity pool, in substantially the following words:

" The [commodity pool] is newly organized. The success of the [commodity pool] will depend upon a number of conditions that are beyond the control of the [commodity pool]. There is a

substantial risk that the goals of the [commodity pool] will not be met.";

- (c) state, if the promoter, manager, or a portfolio adviser of the commodity pool has not had a similar involvement with any other commodity pool, in substantially the following words:

" The [promoter], [manager] [and/or] [portfolio adviser] of the [commodity pool] has not previously operated any other publicly offered commodity pools [or traded other accounts].";

- (d) state, if the commodity pool will execute trades outside of Canada, in substantially the following words:

" Participation in transactions in [nature of instrument to be traded by the commodity pool] involves the execution and clearing of trades on or subject to the rules of a foreign market.

None of the Canadian securities regulatory authorities or Canadian exchanges regulate activities of any foreign markets, including the execution, delivery and clearing of transactions, or has the power to compel enforcement of the rule of a foreign market or any applicable foreign laws. Generally, any foreign transaction will be governed by applicable foreign law. This is true even if the foreign market is formally linked to a Canadian market so that a position taken on the market may be liquidated by a transaction on another market. Moreover, such laws or regulations will vary depending on the foreign country in which the transaction occurs.

For these reasons, entities such as the commodity pool that trade [nature of instrument to be traded by the commodity pool] may not be afforded certain of the protective measures provided by Canadian legislation and the rules of Canadian exchanges. In particular, funds received from customers for transactions may not be provided the same protection as funds received in respect of transactions on Canadian exchanges.";

- (e) state, immediately after the statements required by paragraphs (a), (b), (c), and (d), in substantially the following words:

" These brief statements do not disclose all the risks and other significant aspects of investing in the [commodity pool]. You should therefore carefully study this prospectus, including a description of the principal risk factors at page [page number], before you decide to invest in the [commodity pool.]";

- (f) if applicable, state that the tax consequences to the commodity pool or its securityholders are not certain; and
- (g) state that the commodity pool is a mutual fund but that certain provisions of securities legislation designed to protect investors who purchase securities of mutual funds do not apply.

10.2 Prospectus Disclosure - In addition to any other requirements of securities legislation, the preliminary prospectus and prospectus of a commodity pool shall

- (a) disclose the fundamental investment objectives and strategy of the commodity pool, and how specified derivatives are or will be used in connection with those objectives and that strategy;
- (b) disclose any limitation on the use of specified derivatives by the commodity pool contained in the constating documents, or forming part of the fundamental investment objectives or investment strategy, of the commodity pool;
- (c) disclose the risks associated with the use or intended use by the commodity pool of specified derivatives and the policies and practices of the commodity pool to manage those risks;
- (d) disclose any existing or potential conflicts of interest between the commodity pool and any promoter, manager, adviser, dealer, broker, any of their respective associates or affiliates, or any of the officers, directors or partners of any of the foregoing, and the steps that will be taken to alleviate any existing or potential conflicts of interest;
- (e) disclose whether an affiliate of the manager or of a portfolio adviser of the commodity pool receives or will receive brokerage commissions arising from trades of the commodity pool;

- (f) disclose if the commodity pool will be wound up without the approval of securityholders if the net asset value per security falls below a certain predetermined level, and, if so, the net asset value per security at which this will occur;
- (g) provide the disclosure concerning the past performance of the commodity pool that is required to be provided by a mutual fund under Item 11 of Part B of Form 81-101F1 Contents of Simplified Prospectus, except that
 - (i) the past performance of the commodity pool in the bar chart prepared in accordance with Item 11.2 of Part B of Form 81-101F1, shall show quarterly, non-annualized, returns of the commodity pool over the period provided for in Item 11.2, rather than annual returns, and
 - (ii) the commodity pool shall, in the disclosure required by Items 11.3 and 11.4 of Part B of Form 81-101F1, compare its performance to that of the average yield of either 90-day Government of Canada treasury bills or 90-day government of the United States treasury bills for the relevant periods, rather than to "one or more broad-based market indices" as otherwise required by those Items, and shall provide disclosure and discussion concerning the average yield of those treasury bills, to the extent possible, in the manner required by Items 11.3 or 11.4 for broad-based market indices;
- (h) include a statement that how the commodity pool performed in the past does not necessarily indicate how it will perform in the future;
- (i) describe the financial reporting that is required of the commodity pool;
- (j) in addition to the front page disclosure required by paragraph 10.1(g), disclose that certain provisions of securities legislation designed to protect investors who purchase securities of mutual funds do not apply to the commodity pool, and disclose the implications of this;

- (k) describe the redemption procedures and requirements of the commodity pool, making specific reference to the adoption of any policies established under this Instrument or National Instrument 81-102;
- (l) disclose, in the "Risk Factor" section of the prospectus, any information that may bear on the securityholder's assessment of risk associated with an investment in the commodity pool, including
 - (i) the risk associated with those commodity pools structured as trusts that purchasers of the securities offered may become liable to make an additional contribution beyond the price of the securities, and
 - (ii) any risks associated with the loss of limited liability of a limited partner of a commodity pool that is structured as a limited partnership; and
- (m) disclose the details of compliance of the commodity pool with the requirements of sections 3.2 and 3.3 of this Instrument.¹¹

10.3 Financial Statements

- (1) A preliminary prospectus and prospectus of a commodity pool shall contain the financial statements of the commodity pool for the time periods that are required by the securities legislation applicable to issuers other than mutual funds.
- (2) The financial statements required by subsection (1) shall be prepared in accordance with the requirements of Part 9.

¹¹ The CSA have deleted from the disclosure requirements paragraph 10.3(g) of the 1997 Draft, which required disclosure of the "track record" of the portfolio adviser and manager of the commodity pool for the previous three years if the pool itself had a history of less than three financial years, and paragraphs 10.3(e) and (i) of the 1997 Draft, which required the prospectus to, in effect, compare the brokerage expenses and portfolio management fees paid by the commodity pool to what was paid by other pools. These paragraphs, which were based on provisions in Policy 11.4, have been deleted as inconsistent with the general rules applicable to the regulation of mutual funds.

PART 11 EXEMPTION

11.1 Exemption

- (1) The regulator¹² or the securities regulatory authority¹³ may grant an exemption to this Instrument, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.
- (2) Despite subsection (1), in Ontario, only the regulator may grant such an exemption.

PART 12 EFFECTIVE DATE AND TRANSITIONAL

12.1 Effective Date - This Instrument comes into force on ●, 2000.

12.2 Prospectus Disclosure - The prospectus of a commodity pool for which a receipt is obtained before the date that this Instrument comes into force is not required to comply with the disclosure requirements of this Instrument.

12.3 Delayed Coming into Force - Despite section 12.1, Part 4 does not come into force until ●, 2001 [6 months after the date contained in section 12.1].¹⁴

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¹² The term "regulator" is defined in National Instrument 14-101 Definitions as meaning, in a local jurisdiction, the person set out in an appendix to that instrument opposite the name of the local jurisdiction.

¹³ The term "securities regulatory authority" is defined in National Instrument 14-101 Definitions as meaning, for a local jurisdiction, the securities commission or similar regulatory authority set out in an appendix to that instrument opposite the name of the local jurisdiction.

¹⁴ The CSA are proposing to delay the effective date of Part 4 of this Instrument, which prescribes proficiency standards for persons involved in trading, or supervising the trading of, securities of commodity pools, in order to allow market participants adequate time to obtain any required qualifications.

**COMPANION POLICY 81-104CP TO NATIONAL INSTRUMENT 81-104
COMMODITY POOLS**

PART 1 PURPOSE

- 1.1 Purpose** - The purpose of this Policy is to clarify how National Instrument 81-104 (the "Instrument") integrates with National Instrument 81-102 Mutual Funds, and to bring certain matters relating to the Instrument to the attention of persons or companies involved with the establishment or administration of commodity pools.

PART 2 GENERAL STRUCTURE OF THE INSTRUMENT

2.1 Relationship to Securities Legislation Applicable to Mutual Fund Instruments

- (1) The term "commodity pool" is defined in the Instrument as a mutual fund that is permitted to use or invest in specified derivatives and physical commodities beyond what is permitted by National Instrument 81-102. Commodity pools are subject to the ordinary mutual fund rules unless those rules are specifically excluded. Therefore, the Instrument contains only those provisions that are specific to commodity pools, and provisions applicable to all mutual funds, including commodity pools, are contained in National Instrument 81-102.

- (2) Persons involved with the establishment or administration of a commodity pool are referred to the following rules:
 1. National Instrument 81-102. That National Instrument contains general rules concerning the operation of mutual funds, all of which are applicable to commodity pools except as excluded by specific provisions of the Instrument.
 2. The securities legislation relating to mutual funds of the jurisdictions in which a prospectus for the commodity pool will be filed. For example, commodity pools are subject to the financial statement reporting requirements for mutual funds, except as varied or supplemented in the Instrument.
 3. The prospectus requirements of the securities legislation of a jurisdiction applicable to long form issuers generally, and mutual funds in particular. National Instrument 81-101

Mutual Fund Prospectus Disclosure states that commodity pools may not use the prospectus disclosure system created by that National Instrument.

- 2.2** **Derivatives Use** - The regime implemented by the Instrument is designed to allow commodity pools considerable freedom in entering into derivatives transactions. Commodity pools are not subject to sections 2.7 and 2.8 of National Instrument 81-102, which contain most of the rules governing specified derivatives used by mutual funds. Commodity pools, however, remain subject to the main investment restrictions and rules governing investment practices contained in National Instrument 81-102 that do not relate directly to derivatives or commodity transactions. In particular, commodity pools remain subject to paragraphs 2.6(b) and (c) of National Instrument 81-102, which prohibit mutual funds from purchasing securities on margin or selling securities short, unless permitted by sections 2.7 or 2.8 of that National Instrument. These provisions allow a commodity pool to purchase securities on margin or sell securities short only to the extent that a pool would be considered to do so when entering into a specified derivatives transaction in compliance with the requirements of sections 2.7 or 2.8 of National Instrument 81-102.

PART 3 LIMITED LIABILITY

3.1 Limited Liability

- (1) Mutual funds generally are structured in a manner that ensures that investors are not exposed to the risk of loss of an amount more than their original investment. The CSA consider this a very important and essential attribute of funds. This is especially important in the context of commodity pools. One of the most important rationales for the existence of commodity pools is that they enable investors to invest indirectly in certain types of derivative products, particularly futures and forwards, without putting more than the amount of their investment at risk. A direct investment in some derivative products could expose an investor to losses beyond the original investment.
- (2) Mutual funds structured as corporations do not raise pressing liability problems because of the limited liability regime of corporate statutes.

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- (3) Mutual funds structured as limited partnerships may raise some concerns about the loss of limited liability if limited partners participate in the management or control of the partnership. The statute and case law concerning when limited partners can lose their limited partner status, including the Quebec Civil Code, varies from province to province. Therefore, paragraph 10.2(l) of the Instrument requires each commodity pool to disclose risks associated with the loss of limited liability of a limited partner that has invested in a commodity pool structured as a limited partnership; proper compliance with this requirement will involve disclosure of risks associated with the jurisdictions in which the prospectus is filed. Mutual funds structured as trusts may also raise liability issues in some contexts. Paragraph 10.2(l) of the Instrument also requires disclosure of risks associated with the structuring of a commodity pool as a limited partnership or as a trust in relation to the possibility that purchasers of commodity pool securities may become liable to make an additional contribution beyond the price of the securities.
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- (4) The CSA expect that commodity pools will be structured in a manner that provides as much assurance as possible to their securityholders that securityholders will not be at risk for more than the amount of their original investment. The CSA recommend that commodity pool promoters and managers consider other ways, apart from the structuring of a pool, to limit the liability of securityholders. For example, commodity pools could attempt to enter into contracts only if the other party to the agreement agreed to limit recourse under the agreement to the assets of the pool. In addition, managers of commodity pools structured as limited partnerships should consider whether a securityholder meeting could cause limited partners to lose limited liability status.

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