

Notice and Request for Comment

Changes to Proposed National Instrument 81-106 *Investment Fund Continuous Disclosure*, Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance* (the Form) and Companion Policy 81-106CP *Investment Fund Continuous Disclosure* (Second Publication) and Related Amendments

Introduction

We, the Canadian Securities Administrators (CSA), are publishing for comment revised versions of proposed National Instrument 81-106 *Investment Fund Continuous Disclosure* (the Rule), Form 81-106F1 *Contents of Annual and Interim Management Report of Fund Performance* (the Form) and the Companion Policy 81-106CP *Investment Fund Continuous Disclosure* (the Policy). The Rule and the Form are together referred to as the Instrument.

We are also publishing for comment:

- changes to proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*, Form 81-101F1 *Contents of Simplified Prospectus*, Form 81-101F2 *Contents of Annual Information Form*, and Companion Policy 81-101CP *Mutual Fund Prospectus Disclosure* (second publication);
- changes to Proposed Amendments to National Instrument 81-102 *Mutual Funds* and Companion Policy 81-102CP *Mutual Funds* (second publication);
- changes to proposed amendments to National Instrument 13-101 *System For Electronic Document Analysis and Retrieval (SEDAR)* (second publication);
- proposed amendments to National Instrument 51-102 *Continuous Disclosure Obligations*;
- proposed amendments to National Instrument 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency*;
- proposed amendments to Multilateral Instrument 81-104 *Commodity Pools*;
- proposed revocation of National Instrument 54-102 *Interim Financial Statement & Report Exemption*;
- proposed rescission of National Policy 27 *Canadian Generally Accepted Accounting Principles*, National Policy 31 *Change of Auditor of a Reporting Issuer*, National Policy 50 *Reservations in an Auditor's Report*, and National Policy 51 *Changes in the Ending Date of a Financial Year and in Reporting Status*; and
- in some jurisdictions, certain local amendments.

The Instrument is expected to be adopted as a rule in each of British Columbia, Alberta, Manitoba, Ontario and Nova Scotia, as a commission regulation in Saskatchewan and Quebec, and as a policy in all other jurisdictions represented by the CSA.

Background

On September 20, 2002, we published for comment the first version of the Instrument and Policy (the 2002 Proposal). For additional background information on the 2002 Proposal, as well as a detailed summary of its contents, please refer to the notice that was published with those versions.

Substance and Purpose

The Rule will:

- harmonize continuous disclosure (CD) requirements among Canadian jurisdictions;
- replace most existing local CD requirements;

The Instrument sets out the obligations of investment funds with respect to financial statements, annual information forms (AIFs) for investment funds that do not have a current prospectus, management reports of fund performance, material change reporting, information circulars, proxies and proxy solicitation, delivery obligations, proxy voting disclosure and certain other CD-related matters. The Instrument prescribes the form of the management reports.

If all necessary government approvals are obtained, we expect the Instrument to be effective on December 31, 2004. As such, the filing deadlines for financial statements, management reports of fund performance and AIFs in the Instrument will be mandatory for financial years ending on or after December 31, 2004.

In some jurisdictions, including Ontario and Quebec, the Instrument addresses certain non-reporting investment fund obligations such as financial statement requirements. Non-reporting investment funds will not have these requirements in other jurisdictions such as British Columbia, Alberta and Manitoba. The Instrument also does not address CD obligations for reporting issuers that are not investment funds. These reporting issuers are regulated by National Instrument 51-102 *Continuous Disclosure Obligations* which came into force on March 30, 2004.

Purpose and Summary of the Companion Policy

The purpose of the Policy is to assist users in understanding and applying the Instrument and to explain how we will interpret or apply certain provisions of the Instrument. It contains discussion and explanations primarily relating to:

- filing and delivery obligations under the Instrument
- the requirements for financial statements under the Instrument
- presentation of financial information
- application of Canadian GAAP
- auditors and the auditor's reports
- independent valuations
- proxy voting disclosure
- the use of plain language in documents filed under the Instrument.

Summary of Written Comments Received by the CSA

During the comment period, we received 56 submissions on the 2002 Proposal. A summary of the comments received, together with our responses, is contained in Appendix B to this notice. We also conducted a survey of investors about what kind of information they would find useful in investment fund reports. The survey results are also in Appendix B.

After reviewing the comments received and further considering the Instrument and Policy, we are proposing a number of amendments to the 2002 Proposal.

Summary of Changes to the Proposed Instrument and Policy

See Appendix A for a description of the material changes made to the 2002 Proposal.

Anticipated Costs and Benefits

We believe that the considerations set out in the notice accompanying the 2002 Proposal that justify any incremental costs of complying with the Instrument are still valid. We also believe that the revisions to the Instrument should reduce its potential incremental cost, given the decreased reporting and delivery requirements.

Related Amendments

National Amendments

Changes to the proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (NI 81-101) are set out in Appendix C to this Notice.

Changes to the proposed amendments to National Instrument 81-102 *Mutual Funds* (NI 81-102) are set out in Appendix D to this Notice.

Changes to the proposed amendments to National Instrument 13-101 *System For Electronic Document Analysis and Retrieval (SEDAR)* (NI 13-101) are set out in Appendix E to this Notice.

The CSA is separately publishing for comment proposed amendments to Multilateral Instrument 81-104 *Commodity Pools* (MI 81-104) which are set out in Appendix F to this Notice; National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102) which are set out in Appendix G to this Notice; and National Instrument 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency* (NI 52-107) which are set out in Appendix H to this Notice.

The CSA is proposing to revoke National Instrument 54-102 *Interim Financial Statement & Report Exemption* (NI 54-102) when the Instrument comes into force.

The CSA is proposing to rescind National Policy 27 *Canadian Generally Accepted Accounting Principles* (NP 27), National Policy 31 *Change of Auditor of a Reporting Issuer* (NP 31), National Policy 50 *Reservations in an Auditor's Report* (NP 50), and National Policy 51 *Changes in the Ending Date of a Financial Year and in Reporting Status* (NP 51) when the Instrument comes into force.

Local Amendments

We propose to amend or repeal elements of local securities legislation and securities directions, in conjunction with the implementation of the Instrument. The provincial and territorial securities regulatory authorities may publish, or may have published, these local changes or proposed changes separately in their local jurisdictions. Any proposed consequential amendments to rules or regulations in a particular jurisdiction can be found in the version of 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 Instrument, we have not relied on any significant unpublished study, report or other written materials.

Request for Comments

We welcome your comments on the changes to, or this version of the Instrument, the Policy and related amendments.

Please submit your comments on the Instrument, the Policy and the related amendments to NI 81-101, NI 81-102 and NI 13-101 in writing on or before July 27, 2004. Comments on the proposed amendments to MI 81-104, NI 51-102 and NI 52-107, the proposed revocation of NI 54-102, and the proposed rescission of NP 27, NP 31, NP 50 and NP 51 must be submitted in writing on or before August 26, 2004. (The comment period for local amendments or rules varies. See Appendix I as applicable.) If you are not sending your comments by email, a diskette containing the submissions (in Windows format, Word) should also be sent.

Address your submission 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
Office of the Administrator, New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

Deliver your comments **only** to the addresses that follow. Your comments will be forwarded to the remaining CSA member jurisdictions.

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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.

Questions

Please refer your questions to any of:

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The text of the proposed Rule, Form and Policy follows or can be found elsewhere on a CSA member website.

May 28, 2004

APPENDIX A

SUMMARY OF CHANGES TO THE PROPOSED INSTRUMENT

The Rule

Part 1 Definitions and Applications

Section 1.1

- We have removed the definitions of “fair value” and “market value” from the Instrument. Investment funds are to use the definitions of “fair value” and “market value” as set out in the CICA Handbook.
- We modified the definition of “current value” to indicate that investment funds should always use market value, but when market value is unavailable, fair value can be applied. With respect to the requirement to value restricted securities in accordance with section 13.4 of NI 81-102, we recognize that there are certain problems with this and have therefore deleted this aspect of the definition until further study is completed in the area of valuation. The Instrument also no longer specifically addresses the valuation of derivatives, which will also be included in the proposed further study of valuation issues.
- We have expanded the definition of “interim period” and added the definition of “transition year”. These changes were required as a result of the addition of change in year-end provisions to Part 2 of the Instrument.
- We have replaced the term “significant change” with “material change”, but the concept has not changed. The definition of manager in this context has been clarified to include persons acting in a similar capacity to management. Consequential amendments will be made to NI 81-102, section 1.1 definitions and to sections 5.1(g), 5.6(1)(g), 5.7(d) and 15.9(2), as well as to NI 81-102CP, to reflect these changes.
- We have added a definition of “manager” and “group scholarship plan” as a result of comments received.
- We have deleted the definition of restricted shares as the restricted share disclosure requirements in NI 51-102 no longer apply to investment funds.
- There are two definitions of “non-redeemable investment fund”. The Rule contains the definition proposed in the Uniform Securities Act (and included in NI 51-102) and the definition currently used in Ontario (which is included for consistency with other proposed changes to Ontario legislation). The two definitions are not intended to be substantively different, and we intend them to apply to the same types of issuers. We are interested in your comments on both definitions.
- Subsection 1.1 has also been revised to eliminate certain defined terms used in the Instrument that have been defined in securities legislation elsewhere as set out in subsection 1.3(2) of the Instrument. Also eliminated are certain defined terms that are no longer used in the Instrument, such as “subject securities” and “formal valuation”.

Section 1.2

- The application provisions have been modified to indicate that in some jurisdictions, the Instrument does not apply to investment funds that are non-reporting issuers.

Section 1.3

- We have removed subsections 1.3(3), (4) and (5) as “affiliates”, “subsidiaries” and “control person or company” are no longer used in the Instrument.

Sections 2.6 to 2.8

- We have added sections 2.6 to 2.8 which discuss acceptable accounting principles, acceptable auditing standards and acceptable auditors. These sections correspond to Part 3 of NI 52-107.

Part 2 Annual Financial Statements and Part 3 Interim Financial Statements (Now Part 2 – Financial Statements and Part 5 – Delivery of Financial Statements and Management Reports of Fund Performance)

Sections 2.2(1) and 3.2(1) (now Part 5)

- We have maintained the requirement to deliver financial statements only on request. However, we recognize that National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer* (NI 54-101) is difficult to implement for investment funds, so we have modified the delivery requirements. The Instrument now proposes that an investment fund will send financial statements to investors in accordance with instructions received or deemed to have been received from investors. These instructions may come from standing instructions obtained the first time an investment fund accepts a purchase order from an investor after this Instrument comes into force or from a solicitation of current investors for standing instructions as to the delivery of these documents going forward.

If the investment fund has received standing instructions, it must send an annual reminder to those securityholders indicating their current election and instructions as to how to change that election if they wish. Investment funds unable to follow this regime are required to provide their investors with a request form each year asking them which documents, if any, they wish to receive.

New Section 5.5 Web-sites

- We have also added the requirement that continuous disclosure documents be posted on an investment fund’s web-site no later than the date the documents are filed to ensure that there is additional access to the financial information.

Section 2.3(1)(d) and 3.3(d) (now 2.1 and 2.3)

- We clarified the contents of the financial statements to require that only the statement of investment portfolio is to be included in the financial statements, not the summary of investment portfolio. The summary of investment portfolio is now part of the management report of fund performance and the requirements have been modified to include only the top 25 investments.

Section 3.3(a) (now 2.3 (a))

- We amended this subsection with respect to the statement of net assets as at the end of an interim period to reflect section 1751 of the CICA Handbook.

Section 3.4 (now 2.5)

- The Instrument now requires that the directors of an investment fund or the manager or trustee of an investment fund approve both interim and annual financial statements rather than just reviewing the interim statements. Part 17 of NI 81-102 will be repealed.

New Sections 2.9 Change in Year End and 2.10 Change in Legal Structure

- Part 2 of the Instrument has been amended to include provisions relating to changes in year-end. Section 4.8 of NI 51-102 is now applicable to investment funds with modifications to address the investment fund issues that come out of only having six-month interim financial statements rather than quarterly statements.
- With respect to changes in corporate structure that will impact on an investment fund's continuous disclosure obligations, the Instrument now requires notice to securities authorities of any change that would have the effect of changing the continuous disclosure obligations of the investment fund.

New Section 2.11 Exemption and Requirements for Mutual Funds that are Non-Reporting Issuers

- The Rule has been changed to clarify the filing and delivery requirements of financial statements for "pooled funds" (mutual funds that are non-reporting issuers) in certain jurisdictions. The Rule continues to impose the requirement to prepare and deliver financial statements to investors of non-reporting mutual funds, but the requirement to file the financial statements has been removed.

New Section 2.12 Disclosure of Auditor Review of Interim Financial Statements

- The Rule has been amended to require interim financial statements to be accompanied by a notice if they have not been reviewed by the auditor. This requirement is consistent with subsection 4.3(3) of NI 51-102.

Part 4 Financial Disclosure Requirements and Part 7 Specific Financial Statement Requirements (Now Part 3 – Financial Disclosure Requirements)

- To reflect the fact that the Instrument applies to investment funds that are not mutual funds, disclosure requirements for short positions have been added to the various financial statements.

Subsections 4.4(4) 7 and 9 (now 3.5(6))

- We removed the requirement to disclose the credit rating of the counterparty.

Section 4.4 (now 3.5)

- We have moved the former definition of "designation" of a security to the statement of investment portfolio and have clarified the minimum disclosure requirements for individual securities of the investment fund.
- New subsection 3.5(2) now establishes that disclosure of a long portfolio should be segregated from the disclosure of the short portfolio.

Section 4.5 (*now 3.3*)

- New item 6 clarifies the disclosure of distributions in the statement of changes in net assets. This disclosure should show, separately, distributions from net investment income, realized gains on portfolio securities and return of capital.

Sections 7.2(1) and 7.3 (*now 3.9 and 3.10*)

- We removed the requirement to disclose the counterparty.

Part 5 Annual Management Report of Fund Performance and Part 6 Quarterly Management Report of Fund Performance (Now Part 4 – Management Reports of Fund Performance)

- Investment funds that are reporting issuers are now only required to prepare and file management reports on a semi-annual basis, namely one annual and one interim report each year. This is a significant change from the quarterly reporting originally contemplated by the Instrument.

Sections 5.2 and 6.2 (*now Part 5*)

- We have maintained the requirement to deliver management reports of fund performance only on request. However, we recognize that NI 54-101 is difficult to implement for investment funds, so we have modified the delivery requirements. The delivery requirements for the management reports of fund performance are the same as for financial statements.

New Section 4.3 Filing of Annual Management Reports of Fund Performance for an Investment Fund that is a Group Scholarship Plan.

- We have modified the Instrument so that group scholarship plans will only be required to prepare and file an annual management report of fund performance and not an interim management report of fund performance.

Section 6.4 (*now 4.5*)

- The Instrument now requires that the directors of an investment fund or the manager or trustee of an investment fund approve both interim and annual management reports of fund performance rather than approving the annual reports and just reviewing the interim reports.

New Part 6 – Quarterly Portfolio Disclosure

- This Part introduces the requirement that, on a quarterly basis, investment funds, with the exception of group scholarship plans and non-reporting investment funds, prepare a summary of investment portfolio and calculate the total net asset value of the fund. This information is to be made available to investors on request. Investment funds must also post this information on their web-site within 45 days of the end of the period to which the disclosure applies. This requirement replaces the quarterly management report of fund performance. However, we are of the view that certain information should be available to investors on a more frequent basis than semi-annually. Section 7.5 of 81-101CP will be deleted.

Part 8 General Provisions (Now found in Part 3, Part 7 and Part 8)

Section 8.5 (now 3.12)

- The disclosure has been modified to provide greater detail of the information to be included in the summary of scholarships and units outstanding. The Instrument now requires the reconciliation of the total balances of the principal amounts and the accumulated income to the statement of net assets and a reconciliation of the statement of scholarship awards to the statement of operations. In addition if the plan has matured, it will have to provide a separate statement or schedule describing the educational assistance payments paid per unit to qualified beneficiaries under the plan.

Part 9 Formal Valuations (now found in Part 8 – Independent Valuations for Labour Sponsored or Venture Capital Funds)

- The determination of the independence of the valuator is now dealt with in the Policy rather than in the Instrument.
- The British Columbia Securities Commission is now proposing to participate in this part of the Instrument. After further considering the relevant provincial legislation governing labour sponsored funds in British Columbia, and assessing initiatives being considered by its Ministry of Competition, Science and Enterprise, the BCSC believes that these proposals will enhance labour sponsored fund disclosure and will provide BC investors with relevant information about their investments. The Instrument will also apply to certain venture capital corporations in British Columbia.

Part 10 Annual Information Form (now Part 9)

Section 10.1(2) (now 9.2)

- We have clarified this clause to limit the requirement to file an annual information form (AIF) under this Instrument to those investment funds which are not currently in distribution and which are not required by corporate law to hold an annual meeting of their securityholders.

New Part 10 – Proxy Voting Disclosure for Securities Held

- The Instrument now requires an investment fund to establish policies and procedures it will follow in determining whether and how to vote on any matter for which it has received proxy materials. Investment funds will now be required to disclose, in their AIF, a summary of their proxy voting policies and procedures and indicate how a complete copy of these policies can be obtained. Investment funds will also be required to maintain a proxy voting record on an annual basis and to make it available on request. After consultation with industry, we are now proposing that funds disclose 100% of their proxy votes to securityholders.

Part 13 Restricted Share Disclosure Requirements

- This part has been deleted as the restricted share disclosure requirements in NI 51-102 no longer apply to investment funds.

New Part 14 – Calculation of Net Asset Value

- The Instrument now provides guidance about the calculation of net asset value (NAV), including frequency and reporting currency. This Part clarifies that the accounting principles applied in calculating NAV must be in accordance with generally accepted accounting principles. A limited exemption (applicable in only some jurisdictions) from this requirement is proposed for labour sponsored funds that have a deferred asset relating to past sales commissions that have been paid out of fund assets. This exemption permits a labour sponsored fund to continue to defer and amortize this deferred asset until the end of the remaining amortization period. This Part provides guidance as to when portfolio and capital transactions must be reflected in the calculation of the NAV. NI 81-102, Parts 13 and 17 and 81-102CP, Part 12 will be deleted.

New Part 15 – Calculation of Management Expense Ratio

- This Part establishes the parameters as to how the management expense ratio (MER) must be calculated and what may or may not be included in this calculation for disclosure purposes. The Instrument also clarifies that if the MER is disclosed to the public, it must be calculated in accordance with this Part.

The calculation of MER has been changed (from NI 81-102) so as to *exclude* all non-optional fees, charges and expenses paid directly by investors in connection with the holding of securities of the investment fund.

Consequential amendments were made to section 13.2 of 81-101F1 and section 1.1 of NI 81-102, the definition of management expense ratio, to reflect these new requirements. Part 16 of NI 81-102 and Part 14 of 81-102CP will be deleted.

Part 15 Financial Statements – General (now Part 7 – Financial Disclosure - General)

Section 15.2(2) (now 7.2(2))

- The delivery requirement for documents requested has been changed from within three business days of receipt of request to the later of the filing deadline and 10 days after receipt of the request. This change is consistent with NI 51-102.

Part 16 Additional Filing Requirements and Part 17 Filing of Material Contracts (now Part 16)

- The section on filing of material contracts has been amended to be consistent with NI 51-102.

New Section 16.3

- The Instrument now requires an investment fund to file a report with respect to any matters voted on, following a securityholder meeting.

Part 18 Transition and Part 20 Effective Date (now Part 18 – Effective Date and Transitional)

New Sections 18.3 and 18.4

- With respect to shortening the timelines for filing, we are proposing to have a transitional year where the timelines for the annual and interim financial statements and management reports of fund performance will be 120 days after year end and 60 days after period end respectively. The AIF filing requirement will be set at 120 days after year end.

New section 18.6

- This section establishes a deadline for the revocation of all prior exemptions granted with respect to an investment fund's continuous disclosure obligations that are inconsistent with the Instrument.

The Form

Part A – Instructions and interpretation

Paragraph 5 (now paragraph (c))

- The Form no longer requires that the sections of the management reports be presented in the order outlined in the Form. The only requirement is that the stipulated headings and subheadings be used.

Part B – Content Requirements for Annual Management Report of Fund Performance

Item 1 – First Page Disclosure

- The first page disclosure has been modified to reflect changes in the Instrument. Securityholders will now be informed as to how to obtain the investment fund's proxy voting record or quarterly portfolio disclosure, in addition to the financial statements and management reports.

Item 2 – Management Discussion of Fund Performance

- We have removed the requirement to disclose changes in the results of operations of the investment fund from the previous financial year as this is being provided elsewhere. Also there will no longer be the requirement in the management reports to disclose a fund's proxy voting as this is to be provided for by other means.
- The provision of forward-looking information is now optional.

Item 3 – Financial Highlights

- In the Financial Highlights, we have now clarified that per unit values are to be calculated on the basis of the weighted average units outstanding over the financial year.
- Exchange-traded investment funds must provide their closing market price.
- The number of investments held must now be disclosed.

- Instructions have been added to provide guidance in determining the appropriate portfolio turnover rate when an investment fund acquires the assets of another investment fund in exchange for its own shares.
- We have now provided a modified table of Financial Highlights for group scholarship plans in order to provide information that is more relevant to their investors.

Item 4 – Past Performance

- The Form now requires that where an investment fund holds short portfolio positions, the bar chart should show separately the annual total returns for both long and short positions in addition to the overall total return.
- Investment funds are required to provide their best and worst returns for any six month period. A discussion of the events surrounding these best and worst periods may be included at the option of the investment fund.
- In the annual compound returns table, investment funds are now required to include a broad based securities market index and provide a discussion of the relative performance of the fund to the index. At their discretion, investment funds may also include one or more narrowly based market indices (or a blend of indices) for benchmarking purposes.
- If an investment fund holds short positions, they must show separately the annual compound returns for both the long and the short portfolio positions in addition to the overall annual compound returns.
- With respect to group scholarship plans, year by year returns and annual compound returns must now be calculated based on the group scholarship plan's total portfolio adjusted for cash flows.

Item 5 – Summary of Investment Portfolio

- In response to the comments received, we have amended the Form requirements for the summary of investment portfolio. Investment funds will now be required to disclose the top 25 long positions and the top 25 short positions held by the investment fund, expressed as a percentage of the net assets of the investment fund. We have removed the 5% threshold requirement.

Part C – Content Requirements for Interim Management Report of Fund Performance

Item 1 – First Page Disclosure

- Front page disclosure requirements have been added. Securityholders will now have to be informed of how to obtain the investment fund's proxy voting record or quarterly portfolio disclosure as well as the financial statements and management reports on the front page of the interim reports.

The Policy

- The Policy has been amended to reflect the changes to the Instrument. In particular:
 - the discussion of the interrelationship of the financial statements with Canadian GAAP has been expanded to include a discussion of the impact that the new Handbook section 1100 – Generally Accepted Accounting Principles has on investment funds;
 - guidance has been added relating to the new delivery requirements in the Instrument;
 - guidance has been added, including an appendix, to assist issuers in applying the change in year-end provisions in the Instrument;
 - a discussion of incentive arrangements has been added;
 - a discussion of the proxy voting disclosure for securities held by the investment fund has been added;
 - guidance has been provided for when the net asset value per security of the investment fund is being published;
 - guidance has been added to assist in the calculation of the management expense ratio.
- The Policy clarifies the application of the Instrument to group scholarship plans and pooled funds.