

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

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

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.

"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.

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

(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

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. |

- (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.

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.

⁵ This provision is new and corresponds to section 3.2 of NI81-102, which imposes a direct prohibition on a mutual fund in respect of the initial capitalization requirements of the mutual fund.

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

- (2) No principal distributor or participating dealer shall trade in a security of a commodity pool in the local jurisdiction unless
 - (a) the principal distributor or participating dealer has designated an individual located in the local jurisdiction to 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, 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

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.

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.

bills during the relevant period if there is no benchmark or index known to the commodity pool that satisfies the requirements of that paragraph.

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.

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 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 Transactions

- (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

10.1 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

context provides investors with an adequate overview of the trading activity of the commodity pool for the period to which the statement relates.

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.

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.

PART 11 EXEMPTION

11.1 Exemption

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.

- (1) The regulator or the securities regulatory authority 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.

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.

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].

**NATIONAL INSTRUMENT 81-104
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