

## CONSOLIDATED UP TO 28 September 2009

*This consolidation is provided for your convenience and should not be relied on as authoritative*

### Introduction

*This National Instrument (the Instrument) contains both rules and accompanying commentary on those rules. The Canadian Securities Administrators (the CSA or we), have made these rules under authority granted by the securities legislation of their jurisdiction.*

*The commentary may explain the implications of a rule, offer examples or indicate different ways to comply with a rule. It may expand on a particular subject without being exhaustive. The commentary is not legally binding, but it does reflect the views of the CSA. Commentary always appears in italic type and, outside of this introduction, is titled "Commentary".*

### Part 1 Definitions and application

#### 1.1 Investment funds subject to Instrument

- (1) This Instrument applies to an investment fund that is a reporting issuer.
- (2) In Québec, this Instrument does not apply to a reporting issuer organized under
  - (a) an Act to establish the Fonds de solidarité des travailleurs du Québec (F.T.Q.) R.S.Q., chapter F-3.2.1;
  - (b) an Act to establish Fondation, le Fonds de développement de la Confédération des syndicats nationaux pour la coopération et l'emploi (R.S.Q., chapter F-3.1.2); and
  - (c) an Act constituting Capital régional et coopératif Desjardins (R.S.Q., chapter C-6.1).

## Commentary

1. *This Instrument applies to all publicly offered mutual funds and non-redeemable investment funds. Investment funds subject to this Instrument include:*
  - *labour sponsored or venture capital funds;*
  - *scholarship plans;*
  - *mutual funds and closed-end funds listed and posted for trading on a stock exchange or quoted on an over-the-counter market; and*
  - *investment funds not governed by National Instrument 81-102 Mutual Funds (NI 81-102).*
2. *This Instrument does not regulate mutual funds that are not reporting issuers (commonly referred to as pooled funds), for example, mutual funds that sell securities to the public only under capital raising exemptions in securities legislation.*

## 1.2 Definition of “conflict of interest matter”

In this Instrument, “a conflict of interest matter” means

- (a) a situation where a reasonable person would consider a manager, or an entity related to the manager, to have an interest that may conflict with the manager’s ability to act in good faith and in the best interests of the investment fund; or
- (b) a conflict of interest or self-dealing provision listed in Appendix A that restricts or prohibits an investment fund, a manager or an entity related to the manager from proceeding with a proposed action.

## Commentary

1. *Section 5.1 of this Instrument requires that a manager refer all conflict of interest matters to the independent review committee (IRC).*
2. *The CSA do not consider the ‘reasonable person’ test described in paragraph (a) to capture inconsequential matters. It is expected that, among the factors the manager will look to for guidance to identify conflict of interest matters caught by this Instrument, will be industry best practices. The CSA expect, however, each manager to consider the nature of its investment fund operations when*

*making its decisions about which conflict of interest matters it faces for the funds it manages.*

3. *The types of conflicts of interest faced by the portfolio manager or portfolio adviser (or sub-adviser) or any other entity related to the manager this Instrument captures relate to the decisions made on behalf of the investment fund that may affect or influence the manager's ability to make decisions in good faith and in the best interests of the investment fund. This Instrument is not intended to capture the conflicts of interest at the service provider level generally.*

*The CSA expect the manager to consider whether a particular portfolio manager or portfolio adviser or any other 'entity related to the manager' would have any conflicts of interest falling within the definition.*

*For example, paragraph (a) might, depending on the circumstances, capture these conflicts of the portfolio manager or portfolio adviser:*

- *portfolio management processes for the investment fund, including allocation of investments among a family of investment funds; and*
- *trading practices for the investment fund, including negotiating soft dollar arrangements with dealers with whom the adviser places portfolio transactions for the investment fund.*

4. *The CSA contemplate that an 'entity related to the manager' will have its own policies and procedures to address any conflicts of interest in its operations. It is expected the manager will make reasonable inquiries of these policies and procedures. The conflicts of interest facing these entities, including any third party portfolio manager or portfolio adviser, may affect, or be perceived to affect, the manager's ability to make decisions in the best interests of the investment fund. The manager is expected to refer such conflicts to the IRC under this Instrument.*

5. *For greater certainty, paragraph (b) requires that a 'conflict of interest matter' includes any course of action that the investment fund, the manager or an entity related to the manager would otherwise be restricted or prohibited from proceeding with because of a conflict of interest or self-dealing prohibition in securities legislation. These include the types of transactions described under subsection 5.2(1) of this Instrument.*

### 1.3 Definition of “entity related to the manager”

In this Instrument, “entity related to the manager” means

- (a) a person or company that can direct or materially affect the direction of the management and policies of the manager or the investment fund, other than as a member of the independent review committee; or
- (b) an associate, affiliate, partner, director, officer or subsidiary of the manager or of a person or company referred to in paragraph (a).

#### *Commentary*

1. *The CSA consider an ‘entity related to the manager’ in paragraph (a) to include:*

- *the portfolio manager or portfolio adviser (or sub-adviser) of the investment fund, including any third party portfolio manager or portfolio adviser;*
- *the administrator of a scholarship plan; and*
- *any person or company that can materially direct or affect the manager’s management or policies, including through contractual agreements or ownership of voting securities.*

### 1.4 Definition of “independent”

- (1) In this Instrument, a member of the independent review committee is “independent” if the member has no material relationship with the manager, the investment fund, or an entity related to the manager.
- (2) For the purposes of subsection (1), a material relationship means a relationship which could reasonably be perceived to interfere with the member’s judgment regarding a conflict of interest matter.

#### *Commentary*

1. *Under subsection 3.7(3), all members of the IRC must be independent of the manager, the investment fund and entities related to the manager. The CSA believe that all members must be independent because the principal function of the IRC is to review activities and transactions that involve inherent conflicts of interest between an investment fund and its manager. Given this role, it is important that the members of the IRC are free from conflicting loyalties.*

2. *While the members of the IRC should not themselves be subject to inherent conflicts or divided loyalties, the CSA recognize that there may be inherent conflicts relating to inter-fund issues where a single IRC acts for a family of investment funds. In those cases, this Instrument requires members to conduct themselves in accordance with their written charter and in accordance with the standard of care set out in this Instrument.*

*The CSA do not consider the IRC's ability to set its own reasonable compensation to be a material relationship with the manager or investment fund under subsection 1.4(1).*

3. *A material relationship referred to in subsection 1.4(1) may include an ownership, commercial, charitable, industrial, banking, consulting, legal, accounting or familial relationship. The CSA expect managers and IRC members to consider both past and current relationships when determining whether a material relationship exists.*

*For example, depending on the circumstances, the following individuals may be independent under section 1.4:*

- an independent member of an existing advisory board or IRC of an investment fund;*
- an independent member or former independent member of the board of directors, or of a special committee of the board of directors, of an investment fund;*
- a former independent member of the board of directors, or special committee of the board of directors, of the manager;*
- an individual appointed as a trustee for an investment fund; and*
- an independent member of the board of directors, or of a special committee of the board of directors, of a registered trust company that acts as trustee for an investment fund.*

*By way of further example, the CSA consider it unlikely that the following individuals would be independent under section 1.4:*

- a person who is or has recently been an employee or executive officer of the manager or investment fund; and*
- a person whose immediate family member is or has recently been an executive officer of the manager or investment fund.*

*The CSA also consider that it would be rare that a member of the board of directors, or special committee of the board of directors, of a manager could be 'independent' within the meaning of this Instrument. One such example of when a member of the board of directors of a manager could be 'independent' may be "owner-operated" investment funds, sold exclusively to defined groups of investors, such as members of a trade or professional association or co-operative organization, who directly or indirectly, own the manager. In the case of these investment funds, the CSA view the interests of the independent members of the board of directors of the manager and investors as aligned.*

### **1.5 Definition of "inter-fund self-dealing investment prohibitions"**

In this Instrument, "inter-fund self-dealing investment prohibitions" means the provisions listed in Appendix B that prohibit

- (a) a portfolio manager from knowingly causing any investment portfolio managed by it to purchase or sell, or
- (b) an investment fund from purchasing or selling,

the securities of an issuer from or to the account of a responsible person, an associate of a responsible person or the portfolio manager.

### **1.6 Definition of "manager"**

In this Instrument, "manager" means a person or company that directs the business, operations and affairs of an investment fund.

#### *Commentary*

1. *The CSA are of the view that the term 'manager' should be interpreted broadly.*

*The term "manager" is intended to include a group of members on the board of an investment fund or the general partner of an investment fund organized as a limited partnership, where it acts in the capacity of 'manager'/decision-maker.*

2. *The CSA have, in connection with prospectus reviews, on occasion encountered investment funds structured in unusual ways. The CSA may examine an investment fund if it seems that it was structured to avoid the operation of this Instrument.*

## **1.7 Definition of “standing instruction”**

In this Instrument, “standing instruction” means a written approval or recommendation from the independent review committee that permits the manager to proceed with a proposed action under section 5.2 or 5.3 on an ongoing basis.

## **Part 2 Functions of the manager**

### **2.1 Manager standard of care**

A manager in exercising its powers and discharging its duties related to the management of the investment fund must

- (a) act honestly and in good faith, and in the best interests of the investment fund; and
- (b) exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

#### *Commentary*

1. *This section introduces a required standard of care for managers in certain jurisdictions and is intended to create a uniform standard of care provision for managers of investment funds subject to this Instrument.*

### **2.2 Manager to have written policies and procedures**

- (1) Before proceeding with a conflict of interest matter or any other matter that securities legislation requires the manager to refer to the independent review committee, the manager must
  - (a) establish written policies and procedures that it must follow on that matter or on that type of matter, having regard to its duties under securities legislation; and
  - (b) refer the policies and procedures to the independent review committee for its review and input.
- (2) In establishing the written policies and procedures described in subsection (1), the manager must consider the input of the independent review committee, if any.
- (3) The manager may revise its policies and procedures if it provides the independent review committee with a written description of any significant changes for the independent review committee’s review and input before implementing the revisions.

## Commentary

1. Section 2.2 contemplates that a manager should identify for each investment fund the conflict of interest matters it expects will arise and that will be required to be referred to the IRC under section 5.1, and review its policies and procedures for those matters with the IRC.

Section 2.2 further requires the manager to establish policies and procedures for other matters it expects will arise and that will be required by securities legislation to be referred to the IRC, for example, certain reorganizations and transfers of assets between related mutual funds under Part 5 of NI 81-102.

2. A manager is expected to establish policies and procedures that are consistent with its obligations to the investment fund under securities legislation to make decisions in the best interests of the fund. Paragraph (1)(a) is intended to reinforce this obligation.

A manager that manages more than one investment fund may establish policies and procedures for an action or category of actions for all of the investment funds it manages. Alternatively, the manager may establish separate policies and procedures for the action or category of actions for each of its investment funds, or groups of its investment funds.

However structured, the CSA expect the written policies and procedures the manager establishes to be designed to prevent any violations by the manager and the investment fund of securities legislation in the areas that this Instrument addresses, and to detect and promptly correct any violations that occur.

3. A manager is expected to follow the policies and procedures established under this section. In referring a matter to the IRC under section 5.1, the CSA expect the manager to inform the IRC whether its proposed action follows its written policies and procedures on the matter.

If an unanticipated conflict of interest matter arises for which the manager does not have a policy and procedure, the CSA expect the manager to bring the matter and its proposed action to the IRC for its review and input at the time the matter is referred to the IRC.

4. Small investment fund families may require fewer written policies and procedures than large fund complexes that, for example,



*have conflicts of interest as a result of affiliations with other financial service firms.*

### **2.3 Manager to maintain records**

A manager must maintain a record of any activity that is subject to the review of the independent review committee, including

- (a) a copy of the policies and procedures that address the matter;
- (b) minutes of its meetings, if any; and
- (c) copies of materials, including any written reports, provided to the independent review committee.

#### *Commentary*

1. *This section is intended to assist the CSA in determining whether the manager is adhering to this Instrument, and in identifying weaknesses in the manager's policies and procedures if violations do occur. The CSA expect managers to keep records in accordance with existing best practices.*
2. *A manager is expected under this section to keep minutes only of any material discussions it has at meetings with the IRC or internally on matters subject to the review of the IRC.*

*The CSA do not view this section or this Instrument as preventing the IRC and manager from sharing record keeping and maintaining joint records of IRC and manager meetings.*

3. *The CSA expect a manager to keep records of the actions it takes in respect of a matter referred to the IRC. This includes any otherwise restricted or prohibited transactions described in subsection 5.2(1) for which the manager requires the IRC's approval under Part 6 of this Instrument or under Part 4 of NI 81-102.*

### **2.4 Manager to provide assistance**

- (1) When a manager refers to the independent review committee a conflict of interest matter or any other matter that securities legislation requires it to refer, or refers its policies and procedures related to such matters, the manager must
  - (a) provide the independent review committee with information sufficient for the independent review committee to properly carry out its responsibilities, including

- (i) a description of the facts and circumstances giving rise to the matter;
  - (ii) the manager's policies and procedures;
  - (iii) the manager's proposed course of action, if applicable; and
  - (iv) all further information the independent review committee reasonably requests;
- (b) make its officers who are knowledgeable about the matter available to attend meetings of the independent review committee or respond to inquiries of the independent review committee about the matter; and
  - (c) provide the independent review committee with any other assistance it reasonably requests in its review of the matter.
- (2) A manager must not prevent or attempt to prevent the independent review committee, or a member of the independent review committee, from communicating with the securities regulatory authority or regulator.

### **Part 3 Independent review committee**

#### **3.1 Independent review committee for an investment fund**

An investment fund must have an independent review committee.

##### *Commentary*

1. *A manager is expected to establish an IRC using a structure that is appropriate for the investment funds it manages, having regard to the expected workload of that committee. For example, a manager may establish one IRC for each of the investment funds it manages, for several of its investment funds, or for all of its investment funds.*
2. *This Instrument does not prevent investment funds from sharing an IRC with investment funds managed by another manager. This Instrument also does not prevent a third party from offering IRCs for investment funds. Managers of smaller families of investment funds may find these to be cost-effective ways to establish IRCs for their investment funds.*

### 3.2 Initial appointments

The manager must appoint each member of an investment fund's first independent review committee.

### 3.3 Vacancies and reappointments

- (1) An independent review committee must fill a vacancy on the independent review committee as soon as practicable.
- (2) A member whose term has expired, or will soon expire, may be reappointed by the other members of the independent review committee.
- (3) In filling a vacancy on the independent review committee or reappointing a member of the independent review committee, the independent review committee must consider the manager's recommendations, if any.
- (4) A member may not be reappointed for a term or terms of office that, if served, would result in the member serving on the independent review committee for longer than 6 years, unless the manager agrees to the reappointment.
- (5) If, for any reason, an independent review committee has no members, the manager must appoint a member to fill each vacancy as soon as practicable.

#### *Commentary*

1. *Consistent with the manager's role to appoint the first members of an IRC, if at any time the IRC has no members, the manager will also appoint the replacement members. The CSA anticipate that the circumstances contemplated in subsection (5) will occur rarely, such as in the event of a change of manager or change in control of the manager. In these circumstances, managers should consider their timely disclosure obligations under securities legislation.*
2. *The manager may suggest candidates and may provide assistance to the IRC in the selection and recruitment process when a vacancy arises. Subsection (3) requires the IRC to consider the manager's recommendation, if any, when filling a vacancy or reappointing a member of the IRC.*

*The CSA believe that allowing the IRC to select its own members and decide the term a member can serve will foster independent-*

*mindful committees that will be focused on the best interests of the investment fund. The CSA also consider the members of the IRC to be best-positioned to judge the manner in which a prospective member can contribute to the effectiveness of the IRC.*

3. *The maximum term limit of 6 years specified in subsection (4) for a member to serve on an investment fund's IRC is intended to enhance the independence and effectiveness of the IRC. An IRC may reappoint a member beyond the maximum term, but only with the agreement of the manager.*

### **3.4 Term of office**

The term of office of a member of an independent review committee must be not less than 1 year and not more than 3 years, and must be set by the manager or the independent review committee, as the case may be, at the time the member is appointed.

#### *Commentary*

1. *To ensure continuity and continued independence from the manager, the CSA recommend that the terms of all IRC members be staggered.*

### **3.5 Nominating criteria**

Before a member of the independent review committee is appointed, the manager or the independent review committee, as the case may be, must consider

- (a) the competencies and skills the independent review committee, as a whole, should possess;
- (b) the competencies and skills of each other member of the independent review committee; and
- (c) the competencies and skills the prospective member would bring to the independent review committee.

#### *Commentary*

1. *Section 3.5 sets out the criteria the manager and the IRC must consider before appointing a member of the IRC. Subject to these requirements, the manager and the IRC may establish nominating criteria in addition to those set out in this section.*

### 3.6 Written charter

- (1) The independent review committee must adopt a written charter that includes its mandate, responsibilities and functions, and the policies and procedures it will follow when performing its functions.
- (2) If the independent review committee and the manager agree in writing that the independent review committee will perform functions other than those prescribed by securities legislation, the charter must include a description of the functions that are the subject of the agreement.
- (3) In adopting the charter, the independent review committee must consider the manager's recommendations, if any.

#### *Commentary*

1. *The CSA expect the written charter to set out the necessary policies and procedures to ensure the IRC performs its role adequately and effectively and in compliance with this Instrument. An IRC acting for more than one investment fund may choose to establish a separate charter for each fund. Alternatively, an IRC may choose to establish one charter for all of the investment funds it oversees or groups of investment funds.*
2. *The IRC should consider the specific matters subject to its review when developing the policies and procedures to be set out in its charter.*
3. *Without discussing all of the policies and procedures that may be set out in the written charter, the CSA expect that the written charter will include the following:*
  - *policies and procedures the IRC must follow when reviewing conflict of interest matters,*
  - *criteria for the IRC to consider in setting its compensation and expenses and the compensation and expenses of any advisors employed by the IRC,*
  - *a policy relating to IRC member ownership of securities of the investment fund, manager or in any person or company that provides services to the investment fund or the manager,*
  - *policies and procedures that describe how a member of the IRC is to conduct himself or herself when he or she faces a conflict of interest, or could be perceived to face a conflict of*

*interest, with respect to a matter being considered or to be considered by the IRC,*

- *policies and procedures that describe how the IRC is to interact with any existing advisory board or board of directors of the investment fund and the manager, and*
  - *policies and procedures that describe how any subcommittee of the IRC to which has been delegated any of the functions of the IRC, is to report to the IRC.*
4. *The manager and the IRC may agree that the IRC will perform functions in addition to those prescribed by this Instrument and elsewhere in securities legislation. This Instrument does not preclude those arrangements, nor does this Instrument regulate those arrangements.*

### **3.7 Composition**

- (1) An independent review committee must have at least three members.
- (2) The size of the independent review committee is to be determined by the manager, with a view to facilitating effective decision-making, and may only be changed by the manager.
- (3) Every independent review committee member must be independent.
- (4) An independent review committee must appoint a member as Chair.
- (5) The Chair of an independent review committee is responsible for managing the mandate, and responsibilities and functions, of the independent review committee.

#### *Commentary*

1. *To ensure its effectiveness, a manager should consider the workload of the IRC when determining its size. The CSA expect that the manager will seek the input of the IRC prior to changing the size of the IRC.*
2. *The CSA anticipate that the Chair of the IRC will lead IRC meetings, foster communication among IRC members, and ensure the IRC carries out its responsibilities in a timely and effective manner.*

*The CSA expect the IRC Chair will be the primary person to interact with the manager on issues relating to the investment fund. An IRC Chair and the manager may agree to have regular*

*communication as a way for the IRC Chair to keep informed of the operations of the investment fund between meetings, and of any significant events relating to the investment fund.*

3. *The requirement that all members of the IRC be independent does not preclude the IRC from consulting with others who can help the members understand matters that are beyond their specific expertise, or help them understand industry practices or trends, for example.*

### **3.8 Compensation**

- (1) The manager may set the initial compensation and expenses of an independent review committee that is appointed under section 3.2 or subsection 3.3(5).
- (2) Subject to subsection (1), the independent review committee must set reasonable compensation and proper expenses for its members.
- (3) When setting its compensation and expenses under subsection (2), the independent review committee must consider
  - (a) the independent review committee's most recent assessment of its compensation under paragraph 4.2(2)(b); and
  - (b) the manager's recommendations, if any.

#### *Commentary*

1. *This section permits the manager to determine the amount and type of compensation and expenses the IRC members will initially receive. To avoid undue influence from the manager, subsection (2) requires that, subsequent to the initial setting of compensation and other than in the unusual circumstance described in subsection 3.3(5), members of the IRC have the sole authority for determining their compensation. The Instrument permits the manager to recommend to the members of the IRC the amount and type of compensation to be paid, and requires the IRC to consider that recommendation.*
2. *The CSA expect the IRC and the manager to decide the IRC's compensation in a manner consistent with good governance practices. Among the factors the IRC and manager should consider when determining the appropriate level of compensation are the following:*

- *the number, nature and complexity of the investment funds and the fund families for which the IRC acts;*
  - *the nature and extent of the workload of each member of the IRC, including the commitment of time and energy that is expected from each member;*
  - *industry best practices, including industry averages and surveys on IRC compensation; and*
  - *the best interests of the investment fund.*
3. *The CSA expect that the IRC and the manager will discuss any instance where the IRC disagrees with the manager's recommendations under paragraph (3)(b), in an attempt to reach an agreement that is satisfactory to both the IRC and the manager.*

### **3.9 Standard of care**

- (1) Every member of an independent review committee, in exercising his or her powers and discharging his or her duties related to the investment fund, and, for greater certainty, not to any other person, as a member of the independent review committee must
- (a) act honestly and in good faith, with a view to the best interests of the investment fund; and
  - (b) exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.
- (2) Every member of an independent review committee must comply with this Instrument and the written charter of the independent review committee required under section 3.6.
- (3) A member of the independent review committee does not breach paragraph (1)(b), if the member exercised the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances, including reliance in good faith on
- (a) a report or certification represented as full and true to the independent review committee by the manager or an entity related to the manager; or
  - (b) a report of a person whose profession lends credibility to a statement made by the person.



- (4) A member of the independent review committee has complied with his or her duties under paragraph (1)(a) if the member has relied in good faith on
- (a) a report or certification represented as full and true to the independent review committee by the manager or an entity related to the manager; or
  - (b) a report of a person whose profession lends credibility to a statement made by the person.

*Commentary*

1. *The standard of care for IRC members under this section is consistent with the special relationship between the IRC and the investment fund.*

*The CSA consider the role of the members of the IRC to be similar to corporate directors, though with a much more limited mandate, and therefore we would expect any defences available to corporate directors to also be available to IRC members.*

2. *The CSA consider the best interests of the investment fund referred to in paragraph (1)(a) to generally be consistent with the interests of the securityholders in the investment fund as a whole.*
3. *It is not the intention of the CSA to create a duty of care on the part of the IRC to any other person under paragraph (1)(b).*

### **3.10 Ceasing to be a member**

- (1) An individual ceases to be a member of an independent review committee when
- (a) the investment fund terminates;
  - (b) the manager of the investment fund changes, unless the new manager is an affiliate of the former manager; or
  - (c) there is a change of control of the manager of the investment fund.
- (2) An individual ceases to be a member of an independent review committee if
- (a) the individual resigns;

- (b) the individual's term of office expires and the member is not reappointed;
  - (c) a majority of the other members of the independent review committee vote to remove the individual; or
  - (d) a majority of the securityholders of the investment fund vote to remove the individual at a special meeting called for that purpose by the manager.
- (3) An individual ceases to be a member of the independent review committee if the individual is
  - (a) no longer independent within the meaning of section 1.4 and the cause of the member's non-independence is not temporary for which the member can recuse himself or herself;
  - (b) of unsound mind and has been so found by a court in Canada or elsewhere;
  - (c) bankrupt;
  - (d) prohibited from acting as a director or officer of any issuer in Canada;
  - (e) subject to any penalties or sanctions made by a court relating to provincial and territorial securities legislation; or
  - (f) a party to a settlement agreement with a provincial or territorial securities regulatory authority.
- (4) If an individual ceases to be a member of the independent review committee due to a circumstance described in subsection (2), the manager must, as soon as practicable, notify the securities regulatory authority or regulator of the date and the reason the individual ceased to be a member.
- (5) The notification referred to in subsection (4) is satisfied if it is made to the investment fund's principal regulator.
- (6) The notice of a meeting of securityholders of an investment fund called to consider the removal of a member under paragraph (2)(d) must comply with the notice requirements set out in section 5.4 of National Instrument 81-102 *Mutual Funds*.

- (7) For any member of the independent review committee who receives notice or otherwise learns of a meeting of securityholders called to consider the removal of the member under paragraph (2)(d),
  - (a) the member may submit to the manager a written statement giving reasons for opposing the removal; and
  - (b) the manager must, as soon as practicable, send a copy of the statement referred to in paragraph (a) to every securityholder entitled to receive notice of the meeting and to the member unless the statement is included in or attached to the notice documents required by subsection (6).

*Commentary*

- 1. *The CSA do not anticipate that the securityholder vote contemplated in paragraph 3.10(2)(d) will be routine. When a manager calls a meeting of securityholders to consider the removal of a member, subsection (7) requires that the member will have an opportunity to respond to the manager's notice.*
- 2. *In the circumstances described in paragraphs 3.10(1)(b) and (c), all members of the IRC will cease to be members. This does not preclude the new manager from reappointing the former members of the IRC under subsection 3.3(5).*
- 3. *Paragraph 3.10(3)(a) is meant to exclude a situation where a member may face, or be perceived to face, a conflict of interest with respect to a specific conflict of interest matter the IRC is considering.*

**3.11 Authority**

- (1) An independent review committee has authority to
  - (a) request information it determines useful or necessary from the manager and its officers to carry out its duties;
  - (b) engage independent counsel and other advisors it determines useful or necessary to carry out its duties;
  - (c) set reasonable compensation and proper expenses for any independent counsel and other advisors engaged by the independent review committee; and

- (d) delegate to a subcommittee of at least three members of the independent review committee any of its functions, except the removal of a member under paragraph 3.10(2)(c).
- (2) If the independent review committee delegates to a subcommittee under paragraph (1)(d) any of its functions, the subcommittee must report on its activities to the independent review committee at least annually.
- (3) Despite any other provision in this Instrument, an independent review committee may communicate directly with the securities regulatory authority or regulator with respect to any matter.

#### *Commentary*

1. *The CSA recognize that utilizing the manager's staff and industry experts may be important to help the members of the IRC deal with matters that are beyond the level of their expertise, or help them understand different practices among investment funds.*

*While this Instrument does not require legal counsel or other advisers for the IRC to be independent of the manager or the investment fund, there may be instances when the members of the IRC believe they need access to counsel or advisers who are free from conflicting loyalties. Paragraph (1)(b) gives the IRC the discretion and authority to hire independent legal counsel and other advisers. The CSA expect that the IRC will use independent advisors selectively and only to assist, not replace, IRC decision-making. The CSA do not anticipate that IRCs will routinely use external counsel and other advisers.*

2. *Paragraph (1)(d) is intended to allow an IRC of more than three members to delegate any of its functions, except the removal of an IRC member, to a subcommittee of at least three members. The CSA expect in such instances that the written charter of the IRC will include a defined mandate and reporting requirements for any subcommittee.*

*The CSA do not consider delegation by the IRC of a function to a subcommittee to absolve the IRC from its responsibility for the function.*

3. *Subsection (3) specifies that the IRC may inform the securities regulatory authority or regulator of any concerns or issues that it may not otherwise be required to report. For example, the IRC may be concerned if very few matters have been referred by the manager for review, or it may have found, or have reasonable grounds to suspect, a breach of securities legislation has occurred.*

*However, the IRC has no obligation to report matters other than those prescribed by this Instrument or elsewhere in securities legislation.*

4. *The CSA do not consider that this section or this Instrument prevents the manager from communicating with the securities regulatory authorities with respect to any matter.*

### **3.12 Decisions**

- (1) A decision by the independent review committee on a conflict of interest matter or any other matter that securities legislation requires the independent review committee to review requires the agreement of a majority of the independent review committee's members.
- (2) If, for any reason, an independent review committee has two members, a decision by the independent review committee must be unanimous.
- (3) An independent review committee with one member may not make a decision.

#### *Commentary*

1. *This section requires a decision of the members of the IRC to represent the majority. Should the IRC find itself with two members, subsection (2) permits the IRC to continue to make decisions on conflict of interest matters provided the remaining two members agree.*

### **3.13 Fees and expenses to be paid by the investment fund**

The investment fund must pay from the assets of its fund all reasonable costs and expenses reasonably incurred in the compliance of this Instrument.

#### *Commentary*

1. *A manager is expected to allocate the costs associated with the IRC on an equitable and reasonable basis amongst the investment funds for which the IRC acts.*

*This Instrument does not prohibit a manager from reimbursing the investment fund for any of the costs associated with compliance with this Instrument. It is expected that the prospectus will disclose whether or not the manager will reimburse the investment fund.*

2. *The CSA do not expect costs that the manager or investment fund would ordinarily incur in the operation of the investment fund without the presence of the IRC (for example, rent) to be charged to the investment fund under this section. Among the costs the CSA expect will be charged to the investment fund under this section are the following:*
  - *the compensation and expenses payable to the members of the IRC and to any independent counsel and other advisers employed by the IRC;*
  - *the costs of the orientation and continuing education of the members of the IRC; and*
  - *the costs and expenses associated with a special meeting of securityholders called by the manager to remove a member or members of the IRC.*

### **3.14 Indemnification and insurance**

- (1) In this section, "member" means:
  - (a) a member of the independent review committee;
  - (b) a former member of the independent review committee; and
  - (c) the heirs, executors, administrators or other legal representatives of the estate of an individual in (a) or (b).
- (2) An investment fund and manager may indemnify a member against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgment, reasonably incurred by the person in respect of any civil, criminal, administrative, investigative or other proceeding in which the member is involved because of being or having been a member.
- (3) An investment fund and manager may advance moneys to a member for the costs, charges and expenses of a proceeding referred to in subsection (2). The member must repay the moneys if the member does not fulfill the conditions of subsection (4).
- (4) An investment fund and manager may not indemnify a member under subsection (2) unless
  - (a) the member acted honestly and in good faith, with a view to the best interests of the investment fund; and

- (b) in the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, the member had reasonable grounds for believing that the individual's conduct was lawful.
- (5) Despite subsection (2), a member referred to in that subsection is entitled to an indemnity from the investment fund in respect of all costs, charges and expenses reasonably incurred by the member in connection with the defence of any civil, criminal, administrative, investigative or other proceeding to which the member is subject because of the member's association with the investment fund as described in subsection (2), if the member seeking indemnity
  - (a) was not judged by the court or other competent authority to have committed any fault or omitted to do anything that ought to have been done; and
  - (b) fulfills the conditions set out in subsection (4).
- (6) An investment fund and manager may purchase and maintain insurance for the benefit of any member referred to in subsection (2) against any liability incurred by the member in his or her capacity as a member.

#### *Commentary*

1. *This Instrument requires that members of an IRC be accountable for their actions. At the same time, this section does not prevent an investment fund or a manager from limiting a member's financial exposure through insurance and indemnification.*
2. *This section permits an investment fund and the manager to indemnify and purchase insurance coverage for the members of the IRC on terms comparable to those applicable to directors of corporations. The broad goals underlying the indemnity provisions are to allow for reimbursement for reasonable good faith behaviour, thereby discouraging the hindsight application of perfection to the IRC's actions.*

*Under this section, the investment fund is required to indemnify an IRC member who has been sued and has successfully defended the action, subject to certain conditions. If the IRC member does not defend the action successfully, the investment fund and manager may indemnify the member in certain circumstances. The intention of indemnity is to encourage responsible behaviour yet still permit enough leeway to attract strong candidates.*

*The two conditions which must be satisfied in either instance under this section for an IRC member to be indemnified are:*

- *the IRC member must have acted in a manner consistent with his or her fiduciary duty with respect to the action or matter for which the IRC member is seeking the indemnification; and*
- *the IRC member must have had reasonable grounds for believing that his or her conduct was lawful.*

*The CSA expect any such coverage to be on reasonable commercial terms.*

3. *It is open to members of the IRC to negotiate contractual indemnities with the manager and the investment fund provided the protection is permissible under this section.*

### **3.15 Orientation and continuing education**

- (1) The manager and independent review committee must provide orientation consisting of educational or informational programs that enable a new independent review committee member to understand
  - (a) the role of the independent review committee and its members collectively; and
  - (b) the role of the individual member.
- (2) The manager may provide a member of the independent review committee with educational or informational programs, as the manager considers useful or necessary, that enable the member to understand the nature and operation of the manager's and investment fund's businesses.
- (3) The independent review committee may reasonably supplement the educational and informational programs provided to its members under this section.

#### *Commentary*

1. *The CSA expect members of the IRC to regularly participate in educational or informational programs that may be useful to the members in understanding and fulfilling their duties.*

*Section 3.15 sets out only the minimum educational programs that a manager and IRC are expected to provide for members of the*



*IRC. Educational activities could include presentations, seminars or discussion groups conducted by:*

- *personnel of the investment fund or manager,*
- *outside experts,*
- *industry groups,*
- *representatives of the investment fund's various service providers, and*
- *educational organizations and institutions.*

2. *The CSA expect a discussion of a member's role referred to in paragraph (1)(b) to include a reference to the commitment of time and energy that is expected from the member.*

#### **Part 4 Functions of independent review committee**

##### **4.1 Review of matters referred by manager**

- (1) The independent review committee must review and provide its decision under section 5.2 or under section 5.3 to the manager on a conflict of interest matter that the manager refers to the independent review committee for review.
- (2) The independent review committee must perform any other function required by securities legislation.
- (3) The independent review committee has the authority to choose whether to deliberate and decide on a matter referred to in subsection (1) and (2) in the absence of the manager, any representative of the manager and any entity related to the manager.
- (4) Despite subsection (3), an independent review committee must hold at least one meeting annually at which the manager, any representative of the manager or any entity related to the manager are not in attendance.
- (5) The independent review committee has no power, authority or responsibility for the operation of the investment fund or the manager except as provided in this section.

##### *Commentary*

1. *The Instrument requires the IRC only to consider matters referred to it by the manager that involve or may be perceived to involve a*

*conflict of interest for the manager between its own interests and its duty to manage an investment fund.*

*Securities legislation also requires the IRC to consider other matters. For example, a change in a mutual fund's auditor and certain reorganizations and transfers of assets between related mutual funds under Part 5 of NI 81-102 require the review and prior approval of the IRC for the manager to proceed.*

2. *The manager and the IRC may agree that the IRC will perform functions in addition to those prescribed by this Instrument and elsewhere in securities legislation. This Instrument does not preclude those arrangements, nor does this Instrument regulate those arrangements.*
3. *Subsection (3) permits the IRC to decide who, other than IRC members, may attend any IRC meeting other than the meeting referred to in subsection (4). Subsection (3) also does not preclude the IRC from receiving oral or written submissions from the manager or from holding meetings with representatives of the manager or an entity related to the manager or any other person not independent under this Instrument. The CSA believe utilizing the manager's staff and industry experts may be important to help the members of the IRC understand matters that are beyond their specific expertise, or help them understand different practices among investment funds.*
4. *The requirement that the IRC hold at least one meeting without anyone else present (including management of the investment fund) is intended to give the members of the IRC an opportunity to speak freely about any sensitive issues, including any concerns about the manager.*

*The CSA are of the view that subsection (4) is satisfied if the IRC holds a portion of any meeting annually without the presence of the manager, any representative of the manager or any entity related to the manager.*

## **4.2 Regular assessments**

- (1) At least annually, the independent review committee must review and assess the adequacy and effectiveness of
  - (a) the manager's written policies and procedures required under section 2.2;

- (b) any standing instruction it has provided to the manager under section 5.4;
  - (c) the manager's and the investment fund's compliance with any conditions imposed by the independent review committee in a recommendation or approval it has provided to the manager; and
  - (d) any subcommittee to which the independent review committee has delegated, under paragraph 3.11(1)(d), any of its functions.
- (2) At least annually, the independent review committee must review and assess
- (a) the independence of its members; and
  - (b) the compensation of its members.
- (3) At least annually, the independent review committee must review and assess its effectiveness as a committee, as well as the effectiveness and contribution of each of its members.
- (4) The review by the independent review committee required under subsection (3) must include a consideration of
- (a) the independent review committee's written charter referred to in section 3.6;
  - (b) the competencies and knowledge each member is expected to bring to the independent review committee;
  - (c) the level of complexity of the issues reasonably expected to be raised by members in connection with the matters under review by the independent review committee; and
  - (d) the ability of each member to contribute the necessary time required to serve effectively on the independent review committee.

#### *Commentary*

1. *Section 4.2 sets out the minimum assessments the independent review committee must perform. Subject to these requirements, the IRC may establish a process for (and determine the frequency of) additional assessments as it sees fit.*
2. *The annual self-assessment by the IRC should improve performance by strengthening each member's understanding of his or her role*

and fostering better communication and greater cohesiveness among members.

3. When evaluating individual performance, it is expected that the IRC consider factors such as the member's attendance and participation in meetings, continuing education activities and industry knowledge. The manager may also provide IRC members with feedback which the IRC may consider.

It is expected the self-assessment should focus on both substantive and procedural aspects of the IRC's operations. When evaluating the IRC's structure and effectiveness, the IRC should consider factors such as the following:

- the frequency of meetings;
  - the substance of meeting agendas;
  - the policies and procedures that the manager has established to refer matters to the IRC;
  - the usefulness of the materials provided to the members of the IRC;
  - the collective experience and background of the members of the IRC;
  - the number of funds the IRC oversees; and
  - the amount and form of compensation the members receive from an individual investment fund and in aggregate from the fund family.
4. The CSA expect the members of an IRC to respond appropriately to address any weaknesses found in a self-assessment. For example, it may be necessary to improve the IRC members' continuing education, recommend ways to improve the quality and sufficiency of the information provided to them, or recommend to the manager decreasing the number of investment funds under the IRC's oversight.

In rare circumstances, the IRC may consider removing a member of the IRC as contemplated under paragraph 3.10(2)(c) as a result of the self-assessment.

### **4.3 Reporting to the manager**

The independent review committee must as soon as practicable deliver to the

manager a written report of the results of an assessment under subsection 4.2(1) and (2) that includes

- (a) a description of each instance of a breach of any of the manager's policies or procedures of which the independent review committee is aware, or that it has reason to believe has occurred;
- (b) a description of each instance of a breach of a condition imposed by the independent review committee in a recommendation or approval it has provided to the manager, of which the independent review committee is aware, or that it has reason to believe has occurred; and
- (c) recommendations for any changes the independent review committee considers should be made to the manager's policies and procedures.

#### **4.4 Reporting to securityholders**

- (1) An independent review committee must prepare, for each financial year of the investment fund and no later than the date the investment fund files its annual financial statements, a report to securityholders of the investment fund that describes the independent review committee and its activities for the financial year and includes
  - (a) the name of each member of the independent review committee at the date of the report, with
    - (i) the member's length of service on the independent review committee;
    - (ii) the name of any other fund family on whose independent review committee the member serves; and
    - (iii) if applicable, a description of any relationship that may cause a reasonable person to question the member's independence and the basis upon which the independent review committee determined that the member is independent;
  - (b) the percentage of securities of each class or series of voting or equity securities beneficially owned, directly or indirectly, in aggregate, by all the members of the independent review committee of the investment fund
    - (i) in the investment fund if the aggregate level of ownership exceeds 10 percent;

- (ii) in the manager; or
  - (iii) in any person or company that provides services to the investment fund or the manager;
- (c) the identity of the Chair of the independent review committee;
- (d) any changes in the composition or membership of the independent review committee during the period;
- (e) the aggregate compensation paid to the independent review committee and any indemnities paid to members of the independent review committee by the investment fund during the period;
- (f) a description of the process and criteria used by the independent review committee to determine the appropriate level of compensation of its members and any instance when, in setting the compensation and expenses of its members, the independent review committee did not follow the recommendation of the manager, including
  - (i) a summary of the manager's recommendation; and
  - (ii) the independent review committee's reasons for not following the recommendation;
- (g) if known, a description of each instance when the manager acted in a conflict of interest matter referred to the independent review committee for which the independent review committee did not give a positive recommendation, including
  - (i) a summary of the recommendation; and
  - (ii) if known, the manager's reasons for proceeding without following the recommendation of the independent review committee and the result of proceeding;
- (h) if known, a description of each instance when the manager acted in a conflict of interest matter but did not meet a condition imposed by the independent review committee in its recommendation or approval, including
  - (i) the nature of the condition;
  - (ii) if known, the manager's reasons for not meeting the condition; and

- (iii) whether the independent review committee is of the view that the manager has taken, or proposes to take, appropriate action to deal with the matter; and
  - (i) a brief summary of any recommendations and approvals the manager relied upon during the period.
- (2) The report required under subsection (1) must as soon as practicable
- (a) be sent by the investment fund, without charge, to a securityholder of the investment fund, upon the securityholder's request;
  - (b) be made available and prominently displayed by the manager on the investment fund's, investment fund family's or manager's website, if it has a website;
  - (c) be filed by the investment fund with the securities regulatory authority or regulator; and
  - (d) be delivered by the independent review committee to the manager.

#### *Commentary*

1. *The report to be filed with the securities regulatory authorities should be filed on the SEDAR group profile number of the investment fund as a continuous disclosure document. The CSA expect that the investment fund will pay any reasonable costs associated with the filing of the report.*
2. *It is expected the report will be displayed in an easily visible location on the home page of the website of the investment fund, the investment fund family or the manager, as applicable. The CSA expect the report to remain on the website at least until the posting of the next report.*
3. *The disclosure required in subparagraph (1)(a)(iii) is expected to be provided only in instances where a member could reasonably be perceived to not be 'independent' under this Instrument.*

#### **4.5 Reporting to securities regulatory authorities**

- (1) If the independent review committee is aware of an instance where the manager acted in a conflict of interest matter under subsection 5.2(1) but did not comply with a condition or conditions imposed by securities legislation or the independent review committee in its approval, the

independent review committee must, as soon as practicable, notify in writing the securities regulatory authority or regulator.

- (2) The notification referred to in subsection (1) is satisfied if it is made to the investment fund's principal regulator.

#### *Commentary*

1. *Subsection (1) captures a breach of a condition imposed for an otherwise prohibited or restricted transaction described in subsection 5.2(1), for which the manager has acted under Part 6 of this Instrument or under Part 4 of NI 81-102. This includes a breach of a condition imposed by the IRC as part of its approval (including a standing instruction), or, for example, any conditions imposed for inter-fund trading under section 6.1 of this Instrument or section 4.3 of NI 81-102, for transactions in securities of related issuers under section 6.2 of this Instrument, and for purchases of securities underwritten by related underwriters under section 4.1 of NI 81-102.*

*The CSA consider that a breach of a condition imposed by securities legislation (including this Instrument) or by the IRC in a transaction described in subsection 5.2(1) will result in the transaction having been made in contravention of securities legislation. In such instances, the securities regulatory authorities may consider taking various action, including requiring the manager to unwind the transaction and pay any costs associated with doing so.*

2. *The CSA expect that the IRC will include in its notification the steps the manager proposes to take, or has taken, to remedy the breach, if known.*
3. *Notification under this section is not intended to be a mechanism to resolve disputes between an IRC and a manager, or to raise inconsequential matters with the securities regulatory authorities.*
4. *The CSA do not view this section or this Instrument as preventing the manager from communicating with the securities regulatory authorities with respect to any matter.*

#### **4.6 Independent review committee to maintain records**

An independent review committee must maintain records, including

- (a) a copy of its current written charter;
- (b) minutes of its meetings;



- (c) copies of any materials and written reports provided to it;
- (d) copies of materials and written reports prepared by it; and
- (e) the decisions it makes.

*Commentary*

1. *Section 4.6 sets out the minimum requirements regarding the record keeping by an IRC. The CSA expect IRCs to keep records in accordance with existing best practices.*
2. *The IRC is expected under paragraph (b) to keep minutes only of any material discussions it has at meetings with the manager or internally on matters subject to its review.*

*The CSA do not view this section or this Instrument as preventing the IRC and manager from sharing record keeping and maintaining joint records of IRC and manager meetings.*

3. *The CSA expect the IRC to keep records of any actions it takes in respect of a matter referred to it, in particular any transaction otherwise prohibited or restricted by securities legislation, as described in subsection 5.2(1), for which the manager has sought the approval of the IRC.*

## **Part 5 Conflict of interest matters**

### **5.1 Manager to refer conflict of interest matters to independent review committee**

- (1) Subject to section 5.4, when a conflict of interest matter arises, and before taking any action in the matter, the manager must
  - (a) determine what action it proposes to take in respect of the matter, having regard to
    - (i) its duties under securities legislation; and
    - (ii) its written policies and procedures on the matter; and
  - (b) refer the matter, along with its proposed action, to the independent review committee for its review and decision.
- (2) If a manager must hold a meeting of securityholders to obtain securityholder approval before taking an action in a conflict of interest

matter, the manager must include a summary of the independent review committee's decision under subsection (1) in the notice of the meeting.

#### *Commentary*

1. *Section 5.1 recognizes that a manager may not be able to objectively determine whether it is acting in the best interests of the investment fund when it has a conflict of interest. This section requires managers to refer all conflict of interest matters – not just those subject to prohibitions or restrictions under securities legislation - to the IRC so that an independent perspective can be brought to bear on the manager's proposed action.*

*A decision tree for different types of conflict of interest matters is set out in Appendix A to the Commentary.*

*While the CSA expect the IRC to bring a high degree of rigour and skeptical objectivity to its review of conflict of interest matters, the CSA do not consider it the role of the IRC to second-guess the investment or business decisions of a manager or an entity related to the manager.*

2. *Section 5.1 sets out how the manager must proceed when faced with a conflict of interest matter.*

*Referring proposed actions involving conflict of interest matters to the IRC for its review is not considered by the CSA to detract from the manager's obligations to the investment fund under securities legislation to make decisions in the best interests of the fund. Subparagraph (a)(i) is intended to reinforce this obligation.*

3. *In referring a matter to the IRC, a manager is expected to inform the IRC whether its proposed action follows its written policies and procedures on the matter under section 2.2.*

*If an unanticipated conflict of interest matter arises for which the manager does not have an existing written policy and procedure, the CSA expect the manager to bring the matter and its proposed action to the IRC for its review and input at the time the matter is referred to the IRC.*

4. *There may be matters that are subject to a securityholder vote that also involve a "conflict of interest matter" under this Instrument. For example, increases in the charges of the manager to the mutual fund will be a conflict of interest matter as well as a matter subject to a securityholder vote under Part 5 of National Instrument 81-102 Mutual Funds. For these matters, subsection (2) requires a manager*

*to refer the matter first to the IRC before seeking the approval of securityholders, and to include a summary of the IRC's decision in the written notice to securityholders.*

## **5.2 Matters requiring independent review committee approval**

- (1) A manager may not proceed with a proposed action under section 5.1 without the approval of the independent review committee if the action is
  - (a) an inter-fund trade as described in subsection 6.1(2) of this Instrument or a transaction as described in subsection 4.2(1) of National Instrument 81-102 *Mutual Funds*;
  - (b) a transaction in securities of an issuer as described in subsection 6.2(1) of this Instrument; or
  - (c) an investment in a class of securities of an issuer underwritten by an entity related to the manager as described in subsection 4.1(1) of National Instrument 81-102 *Mutual Funds*.
- (2) An independent review committee must not approve an action unless it has determined, after reasonable inquiry, that the action
  - (a) is proposed by the manager free from any influence by an entity related to the manager and without taking into account any consideration relevant to an entity related to the manager;
  - (b) represents the business judgment of the manager uninfluenced by considerations other than the best interests of the investment fund;
  - (c) is in compliance with the manager's written policies and procedures relating to the action; and
  - (d) achieves a fair and reasonable result for the investment fund.

### *Commentary*

1. *For the transactions described in subsection (1), provided the manager receives the IRC's approval under this section, and satisfies the additional conditions imposed under the applicable sections of Part 6 of this Instrument or Part 4 of NI 81-102, the manager will be permitted to proceed with the action without obtaining regulatory exemptive relief.*

*The IRC may give its approval for certain actions or categories of actions in the form of a standing instruction as described in section 5.4. If no standing instruction is in effect, the manager is required to*

*seek the IRC's approval prior to proceeding with any action set out in subsection (1). An IRC may consider as guidance any conditions in prior exemptive relief orders, waivers or approvals obtained from the securities regulatory authorities when contemplating the appropriate terms and conditions in its approval.*

- 2. If the IRC does not approve a proposed action described in subsection (1), the manager is not permitted to proceed without obtaining exemptive relief from the securities regulatory authorities. The CSA consider it in the best interests of the investment fund, and ultimately investors, for the IRC to be able to stop any proposed action which does not meet the test in subsection (2).*
- 3. The CSA would usually expect that, before the IRC approves a proposed action described in subsection (1), it will have requested from the manager or others a report or certification to assist in its determination that the test in subsection (2) has been met.*
- 4. The CSA expect that the manager will discuss with the IRC any instance where the IRC does not approve a proposed action, so that an alternative action satisfactory to both the manager and the IRC can be found, if possible.*
- 5. The CSA consider that the ability of the manager to seek the removal of a member or members of the IRC under paragraph 3.10(2)(d) sufficiently addresses any concern that a manager may have about an IRC's ongoing refusal to approve matters.*

### **5.3 Matters subject to independent review committee recommendation**

- (1) Before a manager may proceed with a proposed action under section 5.1 other than those set out in subsection 5.2(1),
  - (a) the independent review committee must provide a recommendation to the manager as to whether, in the committee's opinion after reasonable inquiry, the proposed action achieves a fair and reasonable result for the investment fund; and
  - (b) the manager must consider the recommendation of the independent review committee.
- (2) If the manager decides to proceed with an action in a conflict of interest matter that, in the opinion of the independent review committee after reasonable inquiry, does not achieve a fair and reasonable result for the investment fund under paragraph (1)(a), the manager must notify in writing the independent review committee before proceeding with the proposed action.

- (3) Upon receiving the notification described in subsection (2), the independent review committee may require the manager to notify securityholders of the investment fund of the manager's decision.
- (4) A notification to securityholders under subsection (3) must
  - (a) sufficiently describe the proposed action of the manager, the recommendation of the independent review committee and the manager's reasons for proceeding;
  - (b) state the date of the proposed implementation of the action; and
  - (c) be sent by the manager to each securityholder of the investment fund at least thirty days before the effective date of the proposed action.
- (5) The investment fund must, as soon as practicable, file the notification referred to in subsection (4) with the securities regulatory authority or regulator upon the notice being sent to securityholders.

#### *Commentary*

1. *This section captures all conflict of interest matters a manager encounters other than those listed in subsection 5.2(1). This includes conflict of interest matters prohibited or restricted by securities legislation not specified in subsection 5.2(1), and a manager's business and commercial decisions made on behalf of the investment fund that may be motivated, or be perceived to be motivated, by the manager's own interests rather than the best interests of the investment fund. Examples include:*

- *increasing charges to the investment fund for costs incurred by the manager in operating the fund;*
- *correcting material errors made by the manager in administering the investment fund;*
- *negotiating soft dollar arrangements with dealers with whom the manager places portfolio transactions for the investment fund; and*
- *choosing to bring services in-house over using third-party service providers.*

*The CSA expect that, in seeking guidance in identifying conflict of interest matters caught by this Instrument, among the factors the manager will look to for guidance to identify conflict of interest matters will be industry best practices. However, the CSA also*

*acknowledge that each manager will need to consider the nature of its investment fund operations in determining a conflict of interest matter.*

2. *The CSA expect the IRC's recommendation to state a positive or negative response as to whether they view the proposed action as achieving a fair and reasonable result for the investment fund.*
3. *For a proposed action in a conflict of interest matter under this section that is prohibited or restricted by securities legislation (but not specified in subsection 5.2(1)), a manager will still need to seek exemptive relief from the securities regulatory authorities.*
4. *Subsection (2) recognizes that, in exceptional circumstances, the manager may decide to proceed with a proposed course of action despite a negative recommendation from the IRC. In such instances, subsection (2) requires the manager to notify the IRC before proceeding with the action. If the IRC determines that the proposed action is sufficiently important to warrant notice to securityholders in the investment fund, the IRC has the authority to require the manager to give such notification before proceeding with the action.*

*The CSA anticipate that the situation of a manager proceeding with a conflict of interest matter, despite a negative recommendation by the IRC, will occur infrequently.*

5. *The notification referred to in subsection (5) should be filed on the SEDAR group profile number of the investment fund as a continuous disclosure document.*

#### **5.4 Standing instructions by the independent review committee**

- (1) Despite section 5.1, the manager is not required to refer a conflict of interest matter nor its proposed action to the independent review committee if the manager complies with the terms of a standing instruction that is in effect.
- (2) For any action for which the independent review committee has provided a standing instruction, at the time of the independent review committee's regular assessment described in subsection 4.2(1),
  - (a) the manager must provide a written report to the independent review committee describing each instance that it acted in reliance on a standing instruction; and
  - (b) the independent review committee must

- (i) review and assess the adequacy and effectiveness of the manager's written policies and procedures on the matter or on that type of matter with respect to all actions permitted by each standing instruction;
  - (ii) review and assess the manager's and investment fund's compliance with any conditions imposed by it in each standing instruction;
  - (iii) reaffirm or amend each standing instruction;
  - (iv) establish new standing instructions, if necessary; and
  - (v) advise the manager in writing of all changes to the standing instructions.
- (3) A manager may continue to rely on a standing instruction under subsection (1) until such time as the independent review committee notifies the manager that the standing instruction has been amended or is no longer in effect.

#### *Commentary*

1. *Section 5.4 recognizes that there are certain actions or categories of actions of the manager for which it may be appropriate for the IRC to choose to provide a standing instruction. For example, this may include a manager's ongoing voting of proxies on securities held by the investment fund when the manager has a business relationship with the issuer of the securities, or, a manager's decision to engage in inter-fund trading.*
2. *The CSA expect that, before providing or continuing a standing instruction to the manager for an action or category of actions, the IRC will have:*
  - *reviewed the manager's written policies and procedures with respect to the action or category of actions;*
  - *requested from the manager or other persons a report or certification to assist in deciding whether to give its approval or recommendation for the action or category of actions under subsection 5.2(1) or 5.3(1), as the case may be;*

- *considered whether a standing instruction for the particular action or category of actions is appropriate for the investment fund; and*
- *established very clear terms and conditions surrounding the standing instruction for the action or category of actions.*

*An IRC may consider including in any standing instruction any terms or conditions in prior exemptive relief orders, waivers or approvals obtained from the securities regulatory authorities.*

3. *As part of the IRC's review under subparagraph (2)(b)(ii), the IRC is expected to be mindful of its reporting obligation under section 4.5 of this Instrument, which includes notifying the securities regulatory authorities of any instance where the manager, in proceeding with an action, did not meet a condition imposed by the IRC in its approval (this includes a standing instruction).*
4. *This section is intended to improve the flexibility and timeliness of the manager's decisions concerning a proposed course of action in a conflict of interest matter.*

## **Part 6 Exempted transactions**

### **6.1 Inter-fund trades**

- (1) In this section
  - (a) "current market price of the security" means,
    - (i) if the security is an exchange-traded security or a foreign exchange-traded security,
      - (A) the closing sale price on the day of the transaction as reported on the exchange upon which the security is listed or the quotation trade reporting system upon which the security is quoted, or
      - (B) if there are no reported transactions for the day of the transaction, the average of the highest current bid and lowest current ask for the security as displayed on the exchange upon which the security is listed or the quotation trade reporting system upon which the security is quoted, or
      - (C) if the closing sale price on the day of the transaction is outside of the closing bid and closing ask, the



average of the highest current bid and lowest current ask for the security as displayed on the exchange upon which the security is listed or the quotation trade reporting system upon which the security is quoted; or

- (ii) for all other securities, the average of the highest current bid and lowest current ask determined on the basis of reasonable inquiry; and

(b) “market integrity requirements” means

- (i) if the security is an exchange-traded security, the purchase or sale

- (A) is printed on a marketplace that executes trades of the security; and

- (B) complies with the market conduct and display requirements of the marketplace, its regulation services provider and securities regulatory authorities; or

- (ii) if the security is a foreign exchange-traded security, the purchase or sale complies with the requirements that govern transparency and trading of foreign exchange-traded securities on the foreign exchange or foreign quotation and trade reporting system; or

- (iii) for all other securities, the purchase or sale is through a dealer, if the purchase or sale is required to be reported by a registered dealer under applicable securities legislation.

(2) The portfolio manager of an investment fund may purchase a security of any issuer from, or sell a security of any issuer to, another investment fund managed by the same manager or an affiliate of the manager, if, at the time of the transaction

- (a) the investment fund is purchasing from, or selling to, another investment fund to which this Instrument applies;

- (b) the independent review committee has approved the transaction under subsection 5.2(2);

- (c) the bid and ask price of the security is readily available;

- (d) the investment fund receives no consideration and the only cost for the trade is the nominal cost incurred by the investment fund to print or otherwise display the trade;
- (e) the transaction is executed at the current market price of the security;
- (f) the transaction is subject to market integrity requirements; and
- (g) the investment fund keeps written records, including
  - (i) a record of each purchase and sale of securities;
  - (ii) the parties to the trade; and
  - (iii) the terms of the purchase or sale

for five years after the end of the fiscal year in which the trade occurred, the most recent two years in a reasonably accessible place.

- (3) The provisions of National Instrument 21-101 *Marketplace Operation*, and Part 6 and Part 8 of National Instrument 23-101 *Trading Rules*, do not apply to a portfolio manager or portfolio adviser of an investment fund, or an investment fund, with respect to a purchase or sale of a security referred to in subsection (2) if the purchase or sale is made in accordance with that subsection.
- (4) The inter-fund self-dealing investment prohibitions do not apply to a portfolio manager or portfolio adviser of an investment fund, or an investment fund, with respect to a purchase or sale of a security referred to in subsection (2) if the purchase or sale is made in accordance with that subsection.
- (5) The dealer registration requirement does not apply to a portfolio manager of an investment fund, with respect to a purchase or sale of a security referred to in subsection (2) if the purchase or sale is made in accordance with that subsection.
- (6) In subsection (5), “dealer registration requirement” has the meaning ascribed to that term in National Instrument 14-101 *Definitions*.

#### *Commentary*

- 1. *The term “inter-fund self-dealing investment prohibitions” is defined in section 1.5 of this Instrument. It is intended to capture the prohibitions in the securities legislation and certain regulations of each securities regulatory authority regarding inter-fund trades.*

2. *This section is intended to exempt investment funds from the prohibitions in the securities legislation and certain regulations that preclude inter-fund trades. It is not intended to apply to securities issued by an investment fund that are purchased by another fund within the same fund family.*

*The CSA are of the view that this section applies to inter-fund trades between fund families of the same manager provided the purchase or sale is made in accordance with subsection (2).*

3. *This section is also intended to provide a portfolio manager with a dealer registration exemption, where necessary, for inter-fund trades made in accordance with this section, but will not apply to any other activities of the portfolio manager. The exemption is based on compliance with this Instrument and the limitation of its application to prospectus-qualified investment funds. The CSA note that the Registration Reform project may re-examine this exemption.*
4. *This section sets out the minimum conditions for inter-fund trades to proceed without regulatory exemptive relief. An IRC may consider including in any approval any terms or conditions in prior exemptive relief orders, waivers or approvals obtained from the securities regulatory authorities.*
5. *This section does not specify the policies and procedures that a manager must have to effect inter-fund trades. However, the CSA expect the manager's policies to include factors or criteria for*
  - *allocating securities purchased for or sold by two or more investment funds managed by the manager; and*
  - *ensuring that the terms of purchase or sale will be no less beneficial to the investment fund than those generally available to other market participants in arm's-length transactions.*
6. *The CSA expect that the IRC may give its approval in the form of a standing instruction under section 5.4, to give the manager greater flexibility to take advantage of perceived market opportunity.*
7. *Paragraph (2)(c) requires that the market quotations for the transactions be transparent. The CSA expect that if the price information is publicly available from a marketplace, newspaper or through a data vendor, for example, this will be the price. If the price is not publicly available, the CSA expect the investment fund to obtain at least one quote from an independent, arm's-length purchaser or seller, immediately before the purchase or sale.*

8. *The CSA consider the requirement in paragraph (2)(f) to be a way to facilitate price discovery and integrity. The CSA believe this is essential to well-functioning and efficient capital markets. Subparagraph (1)(b)(iii) is intended to capture, for corporate debt securities, the requirement, if applicable, to report the trade to CanPx, and for illiquid securities, the requirement, if applicable, to report the trade to the Canadian Unlisted Board (CUB).*
9. *Paragraph (2)(g) sets out the minimum expectations regarding the records an investment fund must keep of its inter-fund trades made in reliance on this section. The records should be detailed, and sufficient to establish a proper audit trail of the transactions.*

## **6.2 Transactions in securities of related issuers**

- (1) An investment fund may make or hold an investment in the security of an issuer related to it, its manager, or an entity related to the manager, if
  - (a) at the time that the investment is made,
    - (i) the independent review committee has approved the investment under subsection 5.2(2); and
    - (ii) the purchase is made on an exchange on which the securities of the issuer are listed and traded; and
  - (b) no later than the time the investment fund files its annual financial statements, the manager of the investment fund files with the securities regulatory authority or regulator the particulars of the investment.
- (2) The mutual fund conflict of interest investment restrictions do not apply to a mutual fund with respect to an investment referred to in subsection (1) if the investment is made in accordance with that subsection.
- (3) In subsection (2), “mutual fund conflict of interest investment restrictions” has the meaning ascribed to that term in National Instrument 81-102 *Mutual Funds*.

### *Commentary*

*1. This section is intended to relieve investment funds in Quebec, and mutual funds elsewhere in Canada, from the prohibitions in the securities legislation of each securities regulatory authority that preclude investments in securities of related issuers.*

*2. This section sets out the minimum conditions for purchases to proceed*

*without regulatory exemptive relief. An IRC may consider including in any approval any terms or conditions in prior exemptive relief orders, waivers or approvals obtained from the securities regulatory authorities.*

*The CSA expect that the IRC may give its approval in the form of a standing instruction as described in section 5.4 to allow the manager greater flexibility in its decisions.*

*3. This section contemplates that the manager will comply with the applicable reporting requirements under securities legislation for each purchase. The filing referred to in paragraph (1)(b) should be filed on the SEDAR group profile number of the investment fund, as a continuous disclosure document.*

*4. If an IRC gives its approval for the investment fund to purchase securities of an issuer described in this section, and then subsequently withdraws its approval for additional purchases, the CSA will not consider the continued holding of the securities to be subject to subsection 1.2(b) of the Instrument. However, we will expect the manager to consider whether continuing to hold those securities is a conflict of interest matter that subsection 1.2(a) of the Instrument would require the manager to refer to the IRC.*

## **Part 7 Exemptions**

### **7.1 Exemptions**

- (1) The securities regulatory authority or regulator may grant an exemption from 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.

### **7.2 Existing exemptions, waivers or approvals**

Any exemption, waiver or approval under a provision of securities legislation that was effective before this Instrument came into force and that deals with the matters that this Instrument regulates, will expire one year after this Instrument comes into force.

#### *Commentary*

1. *The CSA have, in a number of jurisdictions, granted exemptions and waivers from the conflict of interest and self-dealing provisions in securities legislation to permit the manager and/or the investment fund to make investments not otherwise permitted by securities legislation. Some of those exemptions and waivers*

*contained "sunset" provisions that provided for the expiry of the exemption or waiver upon the coming into force of legislation or a CSA policy or rule that effectively provides for fund governance.*

*For greater certainty, the CSA note that the coming into force of section 7.2 of this Instrument will effectively cause all exemptions and waivers that deal with the matters regulated by this Instrument - not just those exemptions and waivers that deal with the matters under subsection 5.2(1) - to expire one year after its coming into force whether or not they contained a "sunset" provision.*

## **Part 8 Effective date**

### **8.1 Effective date**

This Instrument comes into force on November 1, 2006.

### **8.2 Transition**

- (1) Despite section 8.1, this Instrument does not apply to an investment fund until the earlier of
  - (a) the date on which the manager provides to the securities regulatory authority or regulator the notification referred to in subsection (4); and
  - (b) the date one year after this Instrument comes into force.
- (2) Despite subsection (1), six months from the date this Instrument comes into force the manager must appoint the first members of the independent review committee under section 3.2 in compliance with this Instrument.
- (3) Despite section 4.4, the independent review committee's first report to securityholders must be completed by the 120<sup>th</sup> day after the end of the first financial year of the investment fund to which this Instrument applies.
- (4) A manager of an investment fund must notify the securities regulatory authority or regulator in writing if it intends to comply with this Instrument prior to the expiration of the transition period under subsection (1).
- (5) The notification referred to in subsection (4) is satisfied if the notification is made to the investment fund's principal regulator.

## Commentary

1. *Section 8.2 is intended to address transitional concerns.*

*The CSA expect that all investment funds will be compliant with this Instrument following the expiry of the transition period under subsection 8.2(1), twelve months after the Instrument is in force. For an investment fund established after the expiry of the transition period, it is expected that the investment fund will be compliant with this Instrument before any purchase order for securities of the investment fund is accepted.*

2. *Subsection 8.2(2) allows a manager an extra six months from the date this Instrument is in force to appoint the initial members of the IRC.*

*While a six month transition period exists for the appointment of IRC members, the CSA strongly encourage a timely appointment of the IRC by the manager so that within the twelve month transitional period there is sufficient time for the IRC to adopt its charter, to review the manager's policies and procedures, and to review (subject to manager referral) any existing conflict of interest matters.*

*The transition period is also intended to give the manager sufficient time to refer existing and new conflict of interest matters to the IRC for its review and determination.*

3. *The CSA anticipate a manager or investment fund may wish to rely on the Instrument before the expiry of the transition period so that it may proceed with IRC approval for an otherwise prohibited or restricted transaction in securities legislation described in subsection 5.2(1). This may not occur unless there is complete compliance with the Instrument. Subsection (4) is intended to assist the CSA in knowing which managers of investment funds are proceeding in this manner before the expiry of the transition period.*
4. *For investment funds established before the expiry of the transition period, the CSA expect the manager to establish policies and procedures on any conflict of interest matters (if they do not already have them), and to refer to the IRC these policies and procedures and any decisions related to such matters prior to the end of the transition period.*
5. *The CSA do not consider a manager's organization of an investment fund (such as the initial setting of fees or the initial choice of service providers) to be subject to IRC review, unless the manager's decisions give rise to a conflict of interest concerning*

*the manager's obligations to existing investment funds within the manager's fund family. However, the CSA expect the manager will establish policies and procedures for any conflict of interest matters arising from the investment fund's organization or otherwise, and refer to the IRC these policies and procedures and any decisions related to such matters.*

*It is anticipated that the manager will wish to engage the IRC early in the establishment of the investment fund to ensure the IRC is adequately informed of potential new conflicts of interest.*

- 6. An investment fund, whether established before or after the date this Instrument comes into force, has a total transition period of up to twelve months from the date the Instrument comes into force to comply with the Instrument. Only if the manager of an investment fund intends to comply with the Instrument in its entirety before the expiry of the transition period is the notice in subsection (4) required.*
- 7. It is expected that investment funds will incorporate any new disclosure obligations arising out of this Instrument as part of their annual prospectus renewal or continuous disclosure filing following the expiry of the transition period.*
- 8. The CSA do not consider the expenses incurred by existing investment funds in establishing an IRC under this Instrument to be caught by section 5.1 of NI 81-102. We do not view section 5.1 as intending to capture the costs associated with compliance by an investment fund with new regulatory requirements.*



## APPENDIX A – CONFLICT OF INTEREST OR SELF-DEALING PROVISIONS

JURISDICTION	SECURITIES LEGISLATION REFERENCE
Alberta	Part 15 – Insider Trading and Self-Dealing of the <i>Securities Act</i> (Alberta)
British Columbia	Part 15 – Self-Dealing of the <i>Securities Act</i> (British Columbia)
Manitoba	Part XI – Insider Trading of the <i>Securities Act</i> (Manitoba)
Newfoundland and Labrador	Part XX – Insider Trading and Self-Dealing of the <i>Securities Act</i> (Newfoundland and Labrador)
New Brunswick	Part 10 – Insider Trading and Self-Dealing of the <i>Securities Act</i> (New Brunswick)
Northwest Territories	Part 11 – Insider Reporting and Early Warning of the <i>Securities Act</i> (Northwest Territories)
Nova Scotia	Sections 112 – 128 of the <i>Securities Act</i> (Nova Scotia)
Ontario	Part XXI – Insider Trading and Self-Dealing of the <i>Securities Act</i> (Ontario)
Quebec	Section 236 of the <i>Securities Regulation</i> (Quebec)
Saskatchewan	Part XVII – Insider Trading and Self-Dealing – Mutual Funds of the <i>Securities Act</i> (Saskatchewan)
Alberta, British Columbia, Manitoba, Newfoundland and Labrador, New Brunswick, Northwest Territories, Nova Scotia, Nunavut, Ontario, Prince Edward Island, Quebec, Saskatchewan and Yukon	Part 4 of National Instrument 81-102 <i>Mutual Funds</i> and section 13.5 of National Instrument 31-103 – Registration Requirements and Exemptions

## APPENDIX B – INTER-FUND SELF-DEALING CONFLICT OF INTEREST PROVISIONS

<b>JURISDICTION</b>	<b>LEGISLATION REFERENCE</b>
Alberta	Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
British Columbia	Section 127(1)(b) of the <i>Securities Act</i> (British Columbia) Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
Manitoba	Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
New Brunswick	Section 144(1)(b) of the <i>Securities Act</i> (New Brunswick) Section 11.7(6) of Local Rule 31-501 <i>Registration Requirements</i> Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
Newfoundland and Labrador	Section 119(2)(b) of the <i>Securities Act</i> (Newfoundland and Labrador)  Section 103(6) of Reg. 805/96 Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
Northwest Territories	Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
Nova Scotia	Section 126(2)(b) of the <i>Securities Act</i> (Nova Scotia) Section 32(6) of the General Securities Rules Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
Nunavut	Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
Ontario	Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>

Prince Edward Island	Section 38.1(6) of Securities Act Regulations Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
Quebec	Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
Saskatchewan	Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>
Yukon	Section 13.5(2)(b) of National Instrument 31-103 <i>Registration Requirements and Exemptions</i>

# APPENDIX A to COMMENTARY – DECISION TREE

